JANUARY 2017

State of the consumer products industry: emerging turbulence stirs up uncertainty

At A Glance

1 The struggle to sustain growth

- Companies face weak demand and increasingly fickle consumers.
- The industry's top line has stagnated, with revenue peaking back in 2013.
- To weather these storms, companies launched aggressive operational efficiency programs and stepped up M&A activity.

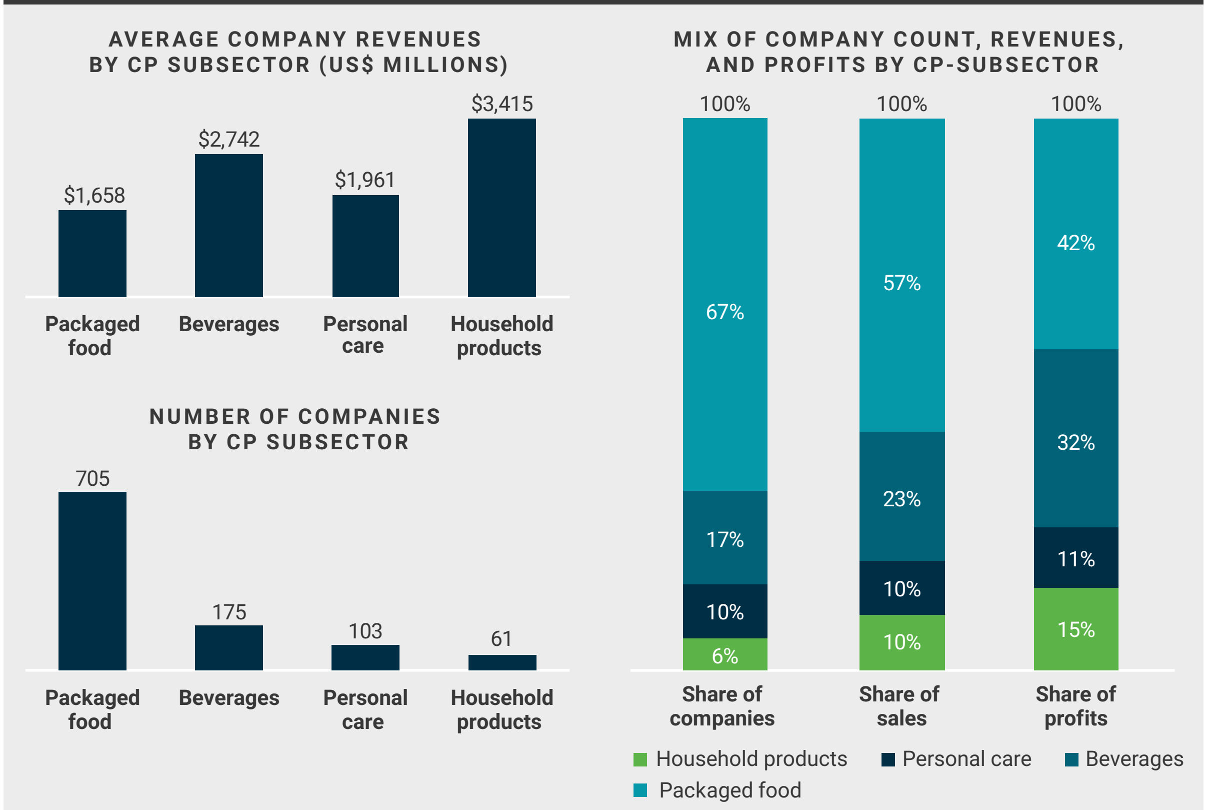
2 Even more turbulence on the horizon

- Digital transformation and a power shift to consumers are challenging the traditional business model.
- To win in this environment, companies will need to drive efficient growth
- They can reconfigure their business models from marketing to distribution to supply chain efficiencies.

Stagnating top lines and a focus on cost reduction—there's no doubt that the global consumer products industry faces an uncertain future. And that uncertainty will only intensify as powerful forces—including stepped-up mergers, acquisitions, and divestures—continue reshaping the industry landscape.

With the launch of our new, consumer products series, we seek to arm savvy executives with insights and a guide for successfully navigating this complex terrain. To launch the consumer products (CP) series, we collected data on 1,044 public consumer products companies around the globe with annual revenues greater than US$100 million. We examined data from the past eight years, with a special focus on the past 12 months. We assessed key aspects of the industry's performance and ways the industry's structure is changing. We've set the stage for taking a closer look at the powerful forces shaping the opportunities and challenges the industry faces, including consumers' shifting expectations and demands, technology advances, and supply trends. In future articles, we will explore those topics, present specific issues for executives to consider and explore, and offer our thoughts on how companies can position themselves for success.

FIGURE 1: CP SUBSECTORS VARY IN SHARES OF SALES AND PROFITS



Source: S&P Capital IQ, AlixPartners analysis
Note: CP – Consumer Products

For the scope of this study, the global CP industry (figure 1) comprises all publicly traded food, beverage, personal care, and household products companies with annual revenues greater than US$100 million. The industry overall recorded US$2.1 trillion in sales worldwide in the 12 months ended June 2016. It also registered an earnings-before-interest-and-taxes (EBIT) margin of 12.2% during that same time frame—the highest in the past eight years. The top 10 players in terms of revenue accounted for roughly 25% of total industry sales and claimed about 33% of profits. But despite those impressive numbers, all is not well because top line for the industry has stagnated in the past three years. The next section considers possible explanations.

THE STRUGGLE TO SUSTAIN GROWTH

CP companies have long used a stable business model built on a few simple pillars.

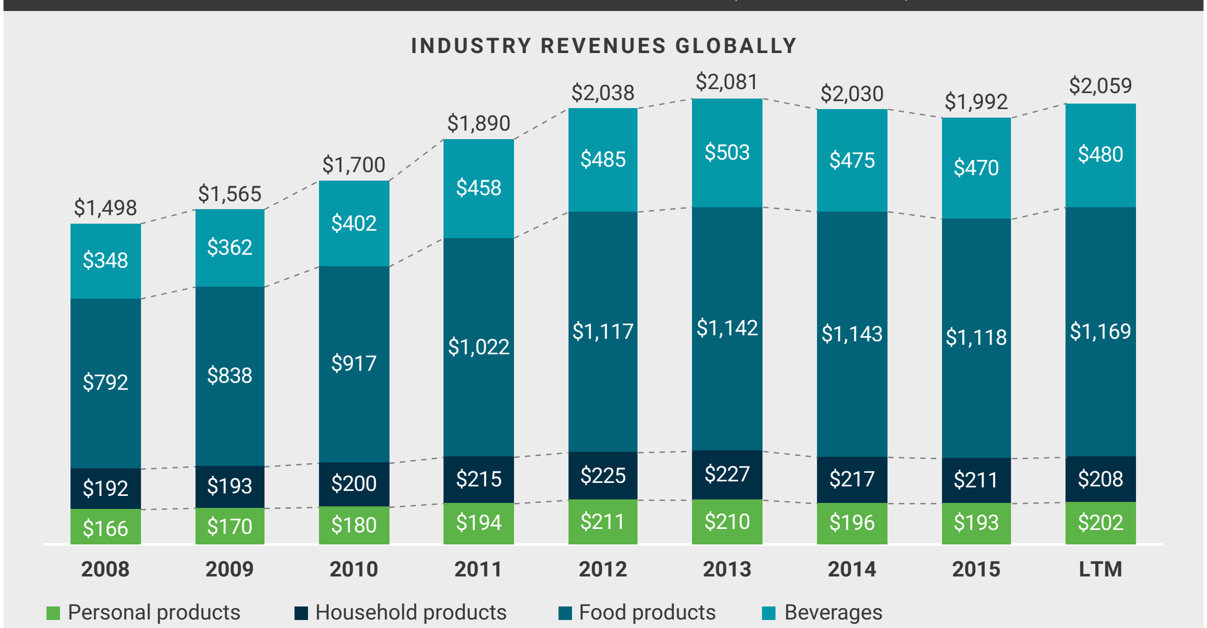
- Capitalize on growing demand for consumer products from an expanding middle class around the world.
- Build iconic brands for mass markets through TV, print, and radio marketing and by commanding the shelf space where consumers buy their products.
- Innovate to keep up with consumers' ever-changing preferences, expectations, and needs.
- Generate efficiency in operations and the supply chain by building global scale.

Industry players drew on that traditional business model to ride a wave of global growth from 2008 to 2013. During that time, they focused their efforts on opportunities to drive growth in emerging markets, as central banks loosened monetary policy to stimulate growth. For instance, the Chinese economy was in full swing. In turn, China as a consumer nation as well as an investor has fueled increased demand for consumer products in other resource-rich emerging markets like Russia, Brazil, and parts of Africa. India's favorable macroeconomic environment, characterized by an expanding middle class, further drove demand in the global CP industry.

But more recently, CP companies have faced weak demand growth in North America and Europe. Demand has also been cooling in emerging markets because China's growth has slowed and because a decline in commodity prices has adversely affected economies in Brazil and Russia. Central banks around the world have further loosened monetary policy, including setting negative interest rates in some places, but such moves have had limited success in jump-starting global growth.

Meanwhile, demand for CP companies' products has fragmented across geographic, socioeconomic, demographic, and benefits lines. Simultaneously, consumers have grown increasingly fickle by having become empowered by social media, online search,

FIGURE 2: THE CP INDUSTRY'S TOP LINE HAS STAGNATED (US$ BILLIONS)



Source: S&P Capital IQ, AlixPartners analysis

and other tools that let them compare companies and products and communicate their experiences and opinions to others. The historical model of one-way mass-market communication is giving way to two-way dialogue and relationship building at a more granular level. Corporate social responsibility (CSR) has gone mainstream, and consumers are demanding more-transparent, more-responsible businesses.

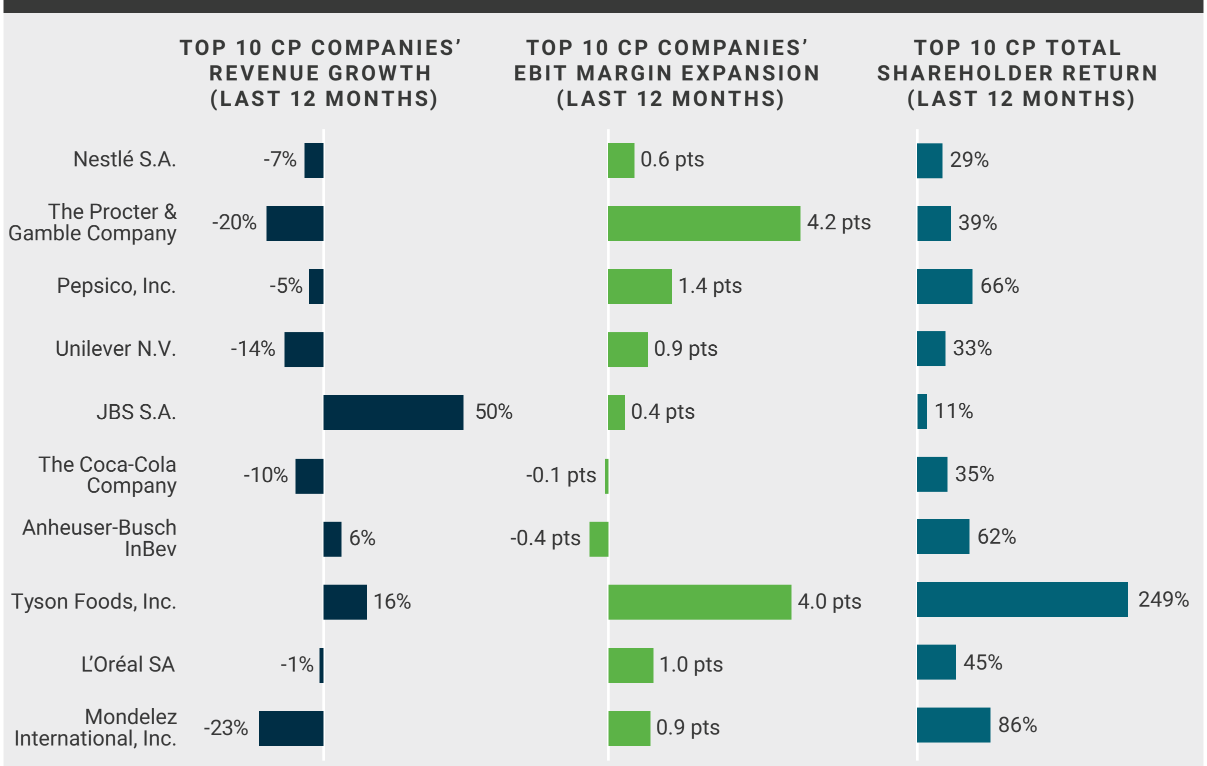
Because of all of those forces, CP companies, especially larger ones, have had difficulty in growing their top lines during the past four years (figure 2). In fact, revenue peaked in 2013. So, in a bid to boost their performance, companies have shed marginally performing businesses and embarked on programs aimed at supercharging efficiency. Global CP giant Procter & Gamble alone announced two US$10-billion cost-reduction programs in the past few years. Other companies have turned to mergers and acquisitions (M&A) to achieve efficiency in operations and selling, general, and administrative expenses. Even the top 10 players in the industry have had difficulty in growing revenues since 2012, and the struggle has been reflected in a dampening of total shareholder returns (figure 3, figure 4).

A STEADY WAVE OF M&A ACTIVITY

In a bid to build global scale and drive efficiency, CP companies have stepped up their M&A activity. The total value of announced deals involving CP companies reached a peak of US$300 billion in 2015, a 103% increase over 2014 (figure 5). But the number of such deals has dropped steadily since 2011, perhaps caused by rising valuations.

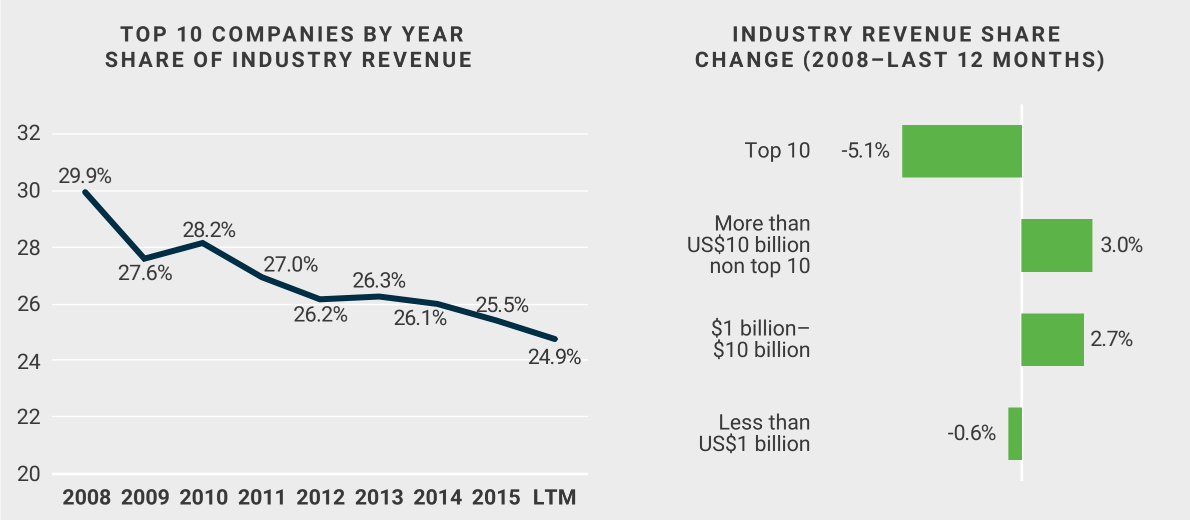
In 2015, the largest announced M&A deal was the megadeal of Anheuser-Busch InBev SA/NV's proposal to acquire SABMiller plc, a transaction ultimately valued at US$111 billion. Heinz's acquisition of Kraft, valued at US$55 billion, to create Kraft Heinz, was the other megadeal struck in 2015. Additional recent strategic acquisitions include Snyder's- Lance's purchase of Diamond Foods for US$1.3 billion, Monster Beverage Corporation's acquisition of American Fruits & Flavors for US$690 million, Dr Pepper Snapple group's acquisition of Bai Brands for $1.7 billion and PepsiCo's purchase of KeVita for $200 million.

FIGURE 3: THE TOP 10'S REVENUE PERFORMANCE LAGS EBIT EXPANSION, DAMPENING SHAREHOLDER RETURNS



Source: S&P Capital IQ, AlixPartners analysis

FIGURE 4: THE TOP 10'S MARKET SHARE HAS DECLINED SINCE 2008



Source: S&P Capital IQ, AlixPartners analysis

Characterized by both megadeals and an active middle-market sector, the M&A landscape for the CP industry is unique in that it has strong strategic as well as financial buyers—and both are flush with cash. The resulting combination maintains strong valuation multiples. Larger and more-profitable companies are expected to continue demanding valuation multiples of more than 10x earnings before interest, taxes, depreciation, and amortization. We anticipate that long-term M&A trends will remain positive in this industry, as companies seek to strengthen their brands and their geographic presences.

EVEN MORE TURBULENCE ON THE HORIZON

The next few years could prove even more turbulent for the CP industry, as ongoing disruptions in consumer demand and expectations, digital transformation, and other forces continue challenging the core pillars that define the industry's traditional business model. To win in the new environment, companies will have to drive not just growth but also efficiency. In the past few years, industry players' focus on enhancing their operational efficiency has drawn their attention away from making the investments in product and marketing innovation needed to fund future revenue growth. To free up resources they can channel toward meeting that need, companies will have to attain next-generation efficiency gains.

To fulfill all of those imperatives, companies will have to reconfigure their business models in innovative ways such as by deploying direct-to-consumer distribution and making savvier use of digital channels in their marketing and product distribution strategies. And they'll have to make their supply chains more efficient than ever while also—and even more important—becoming nimble enough to satisfy consumers more swiftly and effectively than ever.

MOVING FROM SURVIVING TO THRIVING

In light of the many challenges they face, forward-thinking CP executives should take time now to consider—and answer—questions like:

- What do we have to do now to position the company for success in the future?
- Do we have to fundamentally change our business model to harness digital transformation?
- How do we take advantage of digital technologies for efficiency and growth?
- What is the role of brands in the new environment?
- How can we best connect with an increasingly fragmented marketplace?
- How do we advance corporate social responsibility goals while enhancing returns for shareholders?
- How can we continue to generate efficiencies while also managing complexities?
- How will mergers, acquisitions, and divestures in our industry affect the product categories we compete in?
- How do we best allocate resources?

In the coming weeks and months, we will continue this discussion by delving into key developments affecting the CP industry and its leaders. We'll also explore ideas about ways companies can thrive —not merely survive—in the new landscape. Here's a preview of the themes we'll be examining in our series.

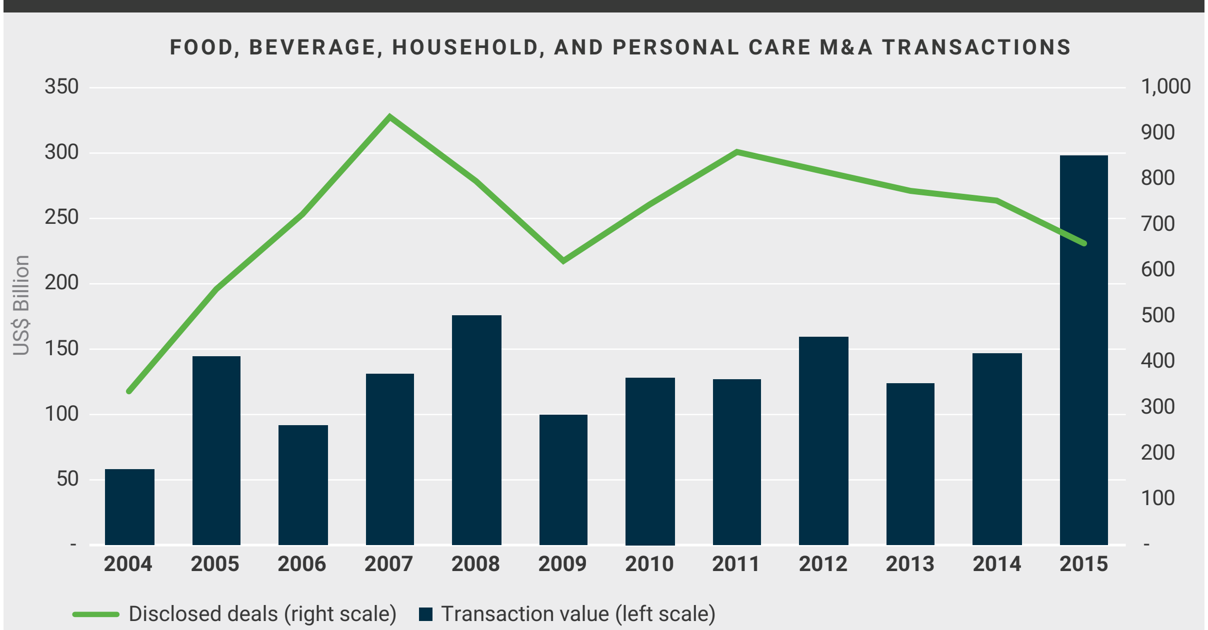
Digital transformation: The continued progress in digital technologies is reshaping CP companies' business models and is now becoming a disruptive force. E-commerce as a channel will mature and play a significant role at CP companies, not just their retail partners. CP companies will experiment with innovative business models, including direct distribution. They'll continue using social media and shifting more of their media spending to digital channels. But they should also push further, making digital part of their DNA. Achieving the full promise of digital technologies will require embedding them in every part of the organization. And winners will embrace the change, whereas others will be swept aside by the tidal wave.

Sluggish and fragmenting consumer demand: Many CP companies have been and will continue to be hampered by a sluggish macroeconomic environment and an increasingly fragmented marketplace. Faced with competing priorities, CP executives could be forced to make choices about how and where to allocate resources. They'll have to answer questions and make informed decisions about where they can scale back and where they should continue to invest despite near-term challenges. Fragmentation means less leverage and more complexity, and those that can overcome fragmentation will win.

Shifting power to consumers: The rise of digital technologies and the fragmentation of consumer demand are expected to shift power away from CP companies and retailers and toward consumers. Companies and their channel partners are evolving—and will continue evolving—from a category- and supply-centric view to a consumer-demand and benefit-driven view. Winners will successfully harness the power of data and analytics to better understand consumer demand and to strengthen their relationships with consumers.

Mainstreaming of corporate social responsibility: CSR has evolved from a fringe movement to become a vital part of CP companies' strategies and marketplace success. Consumers are demanding that CP companies act more responsibly when it comes to economic, social, and environmental issues. Indeed, proactively accepting CSR responsibility and facing both the issue and opportunities within its strategy will be key elements of a company's success.

FIGURE 5: THE CP INDUSTRY IS SEEING BRISK M&A ACTIVITY



Source: S&P Capital IQ, AlixPartners analysis

Transformational supply chains: In the past few decades, CP companies have focused on building global supply chains to drive efficiency through technology, process, and scale. Commodity deflation has caused an additional tailwind recently, but global supply chains have come under increasing pressure with the rise in commodity-price volatility and shifts in consumer preferences. Consumers are demanding more-transparent, sustainable supply chains and greater access to locally sourced products. Simultaneously, the fragmentation of consumer demand is necessitating nimbler supply chains. Winners will build next-generation supply models; others will continue to lose share to nimbler, smaller companies.

Next-generation efficiency: Major CP companies have embarked on significant cost reduction efforts in the past few years. However, the hunt for efficiency is not over. In the coming years, CP leaders will seek to achieve next-generation efficiency gains so they can fund future revenue growth. The recent wave of major consolidation within subsectors will continue as companies seek to further drive efficiency. And digital transformation will serve as an additional avenue for achieving the new efficiencies. **A**

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