COMMENTARY

4 DISTINCT COVID RESPONSE CHOICES

for Consumer Goods and Foodservice Companies

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As the pandemic spreads across the globe, the Consumer Goods sector has shown some resilience – while the S&P 1200 fell by c.16% in the 10 weeks ending 17 April, the S&P CPG Index fell only by c.8%. Looking at the Consumer Goods and Foodservice sector more closely though, we note that there is significant sub-sector variation. While Total Shareholder Returns have declined across the whole sector, Exhibit 1 highlights how some sub-sectors such as Household Products have benefitted from a seismic shift in demand in personal hygiene, whereas other sectors like Restaurants have suffered heavily from lockdown and social distancing measures.

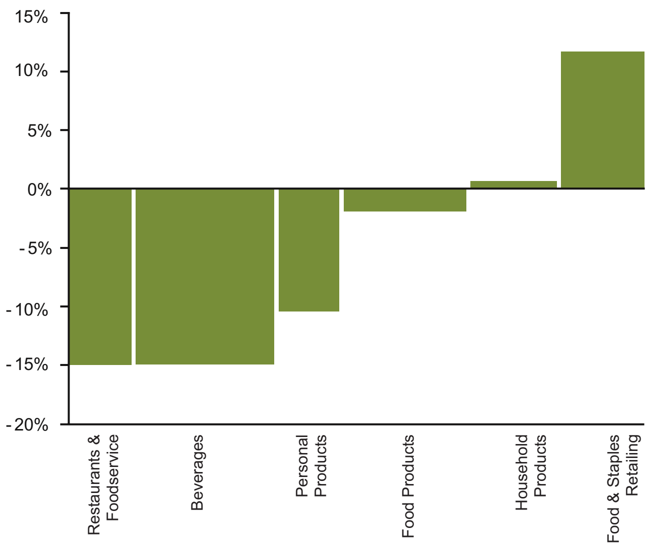
In fact, digging deeper within sub-sectors, there is significant variance between company performance and standing. In Exhibit 2, we observe that variation. For example, Food Products companies with more exposure to Foodservice (e.g., Lamb Weston) have contracted more than those with a mainly retail footprint such as General Mills.

Given the variation across companies, this article tries to move away from the temptation to paint all Consumer Goods companies with the same brush and offer a generic set of recommendations.

This article examines S&P 1200 companies in the Consumer Staples and Foodservice sectors in the US and Europe. It then shines a light on the importance of grounding the nature of the Board and Executive response in the specific strategic realities facing each company – creating a unique response framework.

Exhibit 1: Change in Consumer Goods & Foodservice Sub-sector Market Cap Since the Crisis

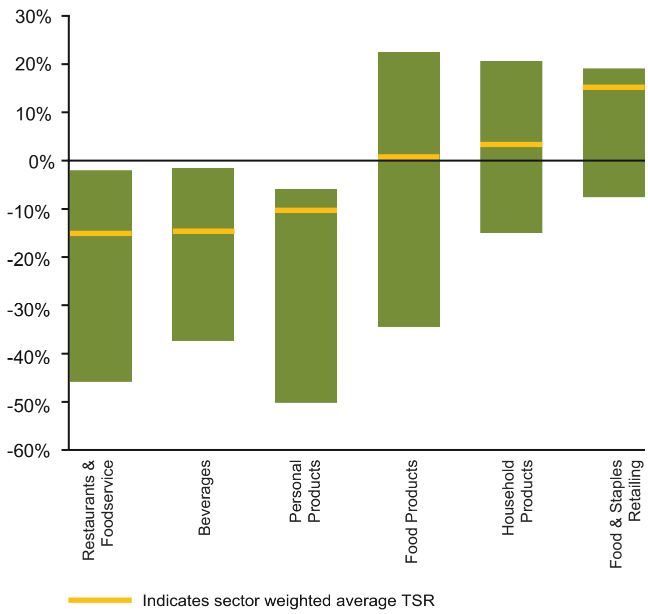
Total Shareholder Returns by Sub-sector; Width of the Bars Indicates Market Capitalisation



CPG sub-sector calculations use S&P 1200 companies in Consumer Staples and Restaurants

Exhibit 2: Distribution of Shareholder Returns by Company Within Each Sub-sector

Distribution of Shareholder Returns by Sub-sector



INTRODUCING THE COVID RESPONSE FRAMEWORK

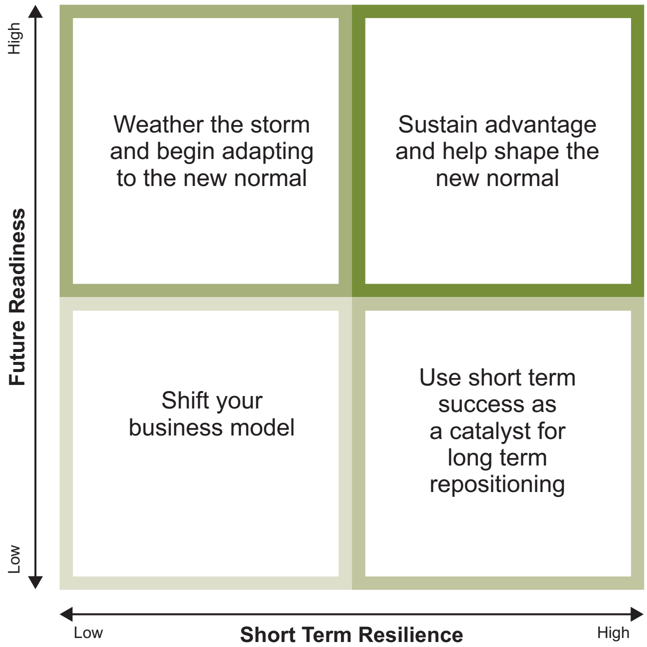
The Covid Response Framework will help you chart your unique way forward, firmly grounded in your distinct strategic reality. The Framework takes into account how well your company has been able to tide over the short term, and your readiness to take on the new normal. As Exhibit 3 highlights, the Covid Response Framework takes into account two parameters – Short Term Resilience of the company, and its Future Readiness.

1. **Short Term Resilience:** As lockdowns and social distancing norms drive consumers towards home occasions, and as consumers cut back on non-essentials such as cosmetics, companies with portfolios biased towards at-home consumption and towards necessities have been more resilient in the short term. Additionally, companies with 'unfavourable' portfolios who have weak liquidity ratios have been further negatively impacted in the short term. We score companies on Short Term Resilience based on three metrics i.e. Essentiality of Portfolio, Location of Product Consumption and Liquidity.

2. **Future Readiness:** A company's readiness for the future is dependent upon both the top team's caliber and the outlook of the sector the company plays in. Whilst value creation track record is a good proxy of top team capability, sector outlook is more difficult to predict. In 5 Lasting Changes CEOs Should Be Planning For, Now we highlight trends and behaviours that we believe are here to stay. Keeping those lasting behavioural changes in mind, we have adjusted each sector's pre-crisis outlook to attune it to the new normal. We score companies on Future Readiness based on two metrics i.e. their Historic Track Record (3 Year TSR, Growth and Spread) and their Future Sector Outlook.

Using the above approach, we mapped S&P 1200 CPG companies into four quadrants on the Framework – reflecting a distinct direction of travel and hence, strategic response.

Exhibit 3: Covid Response Framework



SHAPING YOUR STRATEGIC RESPONSE

This section highlights the nature of companies present in each quadrant, and why. It also highlights what your company's broad direction of travel and strategic response should be depending on your reality.

Sustain advantage and help shape the new normal: This quadrant includes strong packaged food and food ingredients companies and hygiene focused personal products companies who have thrived as consumers stockpile and draw-down in the lockdown phase. Their future readiness has been robust, but due to different reasons – in some cases like Clorox or Reckitt Benckiser (where over a third of the company revenue comes from hygiene products), Future Readiness is driven by post-COVID consumer trends shifting in favour of hygiene. Whereas for other companies like McCormick and Kerry Group, Future Readiness is driven by a strong top team track record of shareholder value creation (>20% over the last three years) along with a positioning in high growth categories such as ingredients. *If you are in this quadrant, you are probably already evaluating the best way to use your excess liquidity to generate shareholder returns – say, through opportunistic M&A. Being at the forefront of this crisis, you could envision the future and then invest* *resources behind making that a reality – investing in shaping consumer trends and behaviours. For example, predicting an uptick in online grocery ordering, Ocado has formed partnerships with several international grocery chains to upgrade their warehouses, enabling the growth of online grocery as demand accelerates.*

Use short term success as a catalyst for long term repositioning: This quadrant includes companies who are in structurally challenged sectors such as brick and mortar grocery retail but have made a windfall gain by being at the forefront of the pandemic. Grocery retailer Sainsbury's has seen shareholder returns decline by 4% over the last three years, but their sales soared by 22% on a YoY basis for the 12 weeks ending 21 Mar[1]. *If you are in this quadrant, you could use this opportunity to fix any systemic problems in your pre-crisis performance, positioning yourself strongly for the future. This could be by re-connecting with consumers who have returned to you due to the pandemic. This could be by rethinking your portfolio to better align it towards a focus on wellness and hygiene. This could also be by accelerating digital transformation of your business – supply chain, sales, marketing and operations. For example, Kraft Heinz has built a direct to consumer online platform that is currently focused on key workers but could be the first step in a broader digital transformation of sales.*

[1] HSBC Nielsen Market Share Report

Shift your business model: Companies in this quadrant have seen a structural shift in demand away from their sector (at least until we find a vaccine) e.g., full service restaurants; or those with a poor track record who are now facing sector demand collapse e.g., challenged cosmetics majors or challenged brewers. Some brewers, for instance, have seen a c.60% channel contraction and face alcohol restrictions in countries like South Africa, India and Mexico, putting additional pressure on companies who were already struggling in a low growth industry. *If you are in this quadrant, you may be thinking of a transformation due to two reasons – 1. the traditional business model hasn't generated the growth and returns historically, and 2. it now stands to be disrupted due to the new normal created by the pandemic. As you transform your business model, you could seek opportunities in the interim that are either organic (e.g., for brewers this could be dialling up D2C, brew at home) or inorganic (e.g., divest or seek partnerships to strengthen your position). As you undertake the above transformation, you would be closely managing liquidity – challenging cost and capital allocation strongly.*

Weather the storm and begin adapting to the new normal: Intrinsically strong companies with short term challenges such as channel closures or non-essential product mixes have landed in this quadrant. This quadrant includes strong cosmetics players such as Estee Lauder who have seen an estimated 80%

Exhibit 4: Distinct Strategic Responses

Sustain advantage and help shape the new normal	**Use short term success as a catalyst for long term repositioning**	**Shift your business model**	**Weather the storm and begin adapting to the new normal**
Nature of Companies Present: Packaged food companies with well-positioned portfolios, food ingredients companies, hygiene focused personal products companies	*Nature of Companies Present:* Grocery retailers, packaged food companies, personal and household product companies	*Nature of Companies Present:* Full service restaurants, challenged cosmetics majors, challenged brewers	*Nature of Companies Present:* Strong cosmetics players, limited service restaurants, strong beverage companies, catering service companies
Proposed Management Agenda: • Re-invest excess liquidity in shaping consumer trends • Undertake opportunistic M&A	*Proposed Management Agenda:* • Use opportunity to re-connect with consumers • Adjust portfolio towards wellness and hygiene • Accelerate digital transformation	*Proposed Management Agenda:* • Seek organic growth opportunities that are on-trend • Seek partnerships to strengthen position • Closely monitor liquidity	*Proposed Management Agenda:* • Re-position assets in the short term to generate returns • Hold your nerve – protect good costs and investments

channel closure, or value accretive limited service restaurants who have a limited online delivery presence such as Starbucks, Chipotle or McDonald's, or some of the stronger beverage companies like Coca Cola who have seen 40% channel closure somewhat offset by increased in home consumption. *If you are in this quadrant, you are probably focusing on skillfully managing the current crisis to emerge with minimum damage to your operations and your financial health. This could mean re-positioning some of your assets in the short term by re-allocating staff or manufacturing capacity e.g., spirits companies making hand sanitisers. The most important thing to remember if you're in this quadrant is to hold your nerve – protect 'good costs' and 'long term investments' – this crisis will eventually pass, and you want to retain your strong position when it does. Early learnings from China indicate that once the storm passes, demand for these categories is likely to grow again e.g., LVMH has seen a sharp rebound in China after 15% Q1 sales drop.*

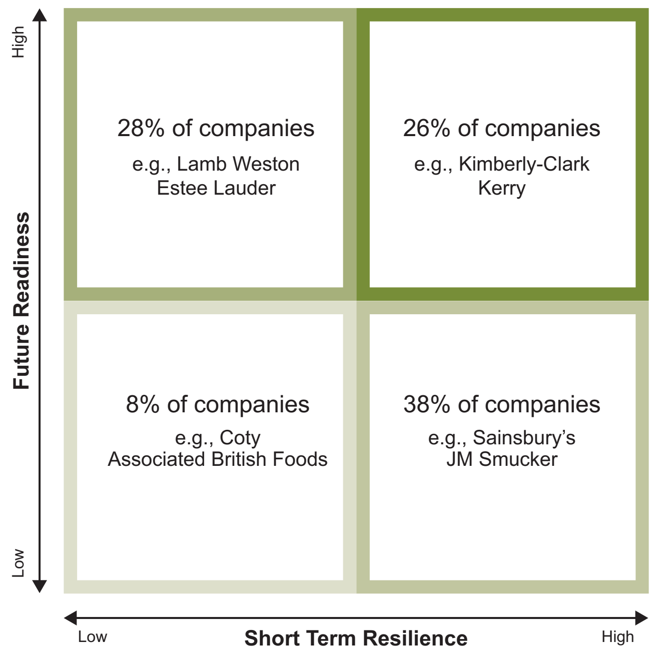
DRIVING PROGRESS: WHAT DOES THIS MEAN FOR ME AND MY EXECUTIVE TEAM?

Mapping the companies on the Covid Response Framework in Exhibit 5 reveals that only a quarter of the S&P Consumer Goods companies are sturdy in the present storm and are also ready to take on the future.

Our suggestion – as you internally shift from "crisis management" to "thinking time" – use the Covid Response Framework to have a debate on your starting point, to pressure-test your current plans and ideas, and to enhance and further develop your thinking on what you should be doing when. To begin with, work your way through the following types of questions:

1. Do I have alignment in my team regarding the implications of lasting changes in consumer behaviour on my business? If not, how can I get there?
2. Where do I fall in the 2x2 matrix, and why? Are the position and the short and long term factors understood, and is the perspective shared by my team or is there divergence?

Exhibit 5: Company Distribution Across the Covid Response Framework



3. Where is the rest of my industry and where are adjacent industries – and what dispersion of results and position is explain by portfolio vs. performance related issues?
4. What does this mean? What are the no regrets short term moves implied? What kind of strategic optionality can I create? What kinds of moves should I put on the list and what might the trigger points be?

We have used our Covid Response Framework to score CPG companies and categorise them using a combination of quantitative and qualitative factors. If you want to know where your company landed in comparison to your peers or want to brainstorm what this means for your company, please do make contact.

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ABOUT MARAKON

Marakon is a strategy and organizational advisory firm with the experience and track record of helping CEOs and their leadership teams deliver sustainable profitable growth. We get hired when our client's ambitions are high, the path to get there is not clear (or taking too long) and lasting capabilities are as important as immediate impact.

We help clients achieve their ambitions for sustainable profitable growth through:

- Stronger strategies and advantaged execution based on:
    a. A better understanding of what drives client economics and value
    b. Insight into changing industry dynamics and the context in which clients need to succeed
- A stronger management framework to generate better ideas and link decisions and actions to value
- A stronger organization with a more focused top management agenda and well-aligned resources
- A more confident and effective leadership team that's focused, decisive, and strategic

We have a joint team delivery approach where client ownership and engagement is paramount. Partners are highly engaged in the work product and supported by strong analytical and industry relevant capability. We work as advisers and catalysts in close, trust-based relationships with top management teams.