



Market polarization: The implications for FMCG companies



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Content

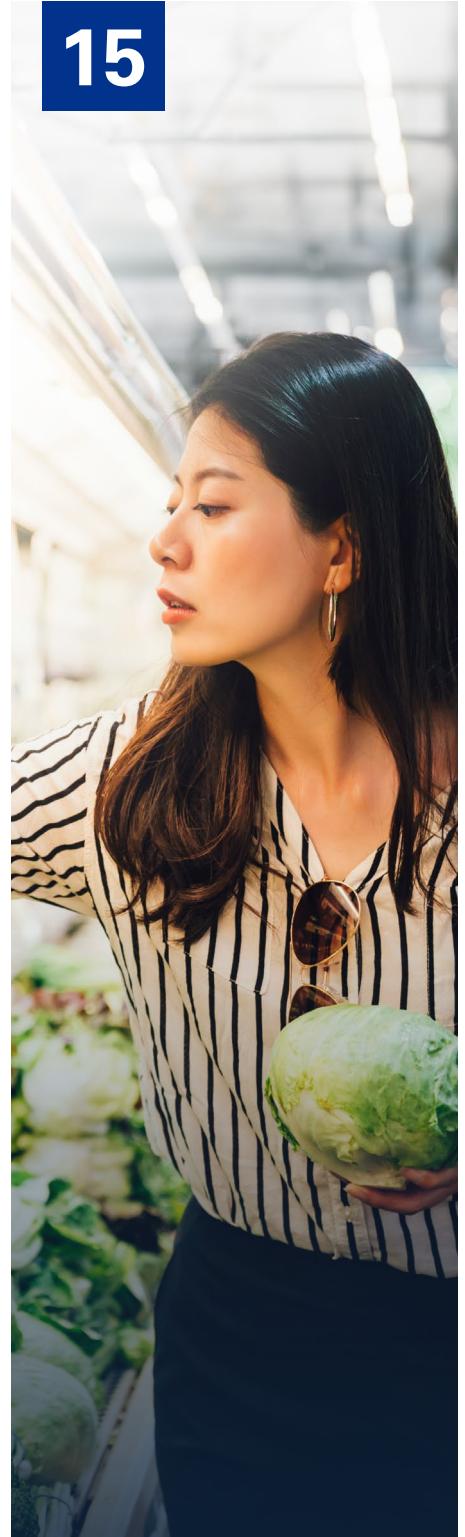
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Foreword

Fast Moving Consumer Goods (FMCG) markets have been through a category polarization process for years, increasing the distance between premium and value extremes. Several factors are driving this trend — better pricing transparency, changes in buying patterns, increased access to product information and so on. But perhaps the most influential factor has been the increasing wealth inequality being experienced in many consumer markets around the world.

Many of these factors — wealth inequality in particular — have been exacerbated by the recent pandemic and subsequent inflationary pressures. History suggests this has often been the case: similar trends emerged after the 2008 financial crisis, for example.

Yet regardless of the reasons, the implications of this market polarization for consumer goods companies are real. And we expect to see significant increased levels of divestment and acquisition activity within the industry over the next few years as a result.

In this report, we explore how leading consumer goods companies are reevaluating their portfolios. We identify the sectors and subsectors most likely to see heightened divestment and acquisition activity. And we share some of key metrics that investors and capital markets want to see as proof that producers are adapting their own portfolios to navigate this increasing market polarization trend.

On behalf of KPMG's global network of Consumer and Retail professionals, we encourage you to contact your local KPMG member firm to learn more about the topics raised in this report and to discuss your own unique portfolio strategy for a polarized market environment.

Javier Rodriguez Gonzalez

Partner, Strategy Group
KPMG Spain

The disappearance of the middle class

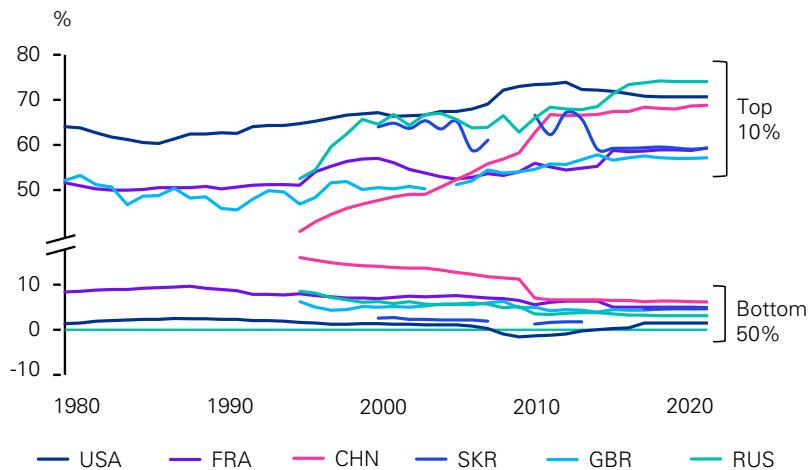


Globalization may have lifted tens of millions out of poverty. Yet it has done little to slow the rising inequality between the top 10 percent of earners and the bottom 50 percent. The figures show that inequality in wealth and purchasing power keeps growing globally.

Even before the global pandemic, inequality was rising sharply in some markets. Since the mid-1990s — when comparable data started being collected — the gap between the low- and high-income classes has widened, with wealth becoming increasingly concentrated within already rich households.

The Gini Index — a popular standard used by statisticians and policy professionals to measure inequality in income and wealth — tells a similar story. It shows growing inequality in nearly every major economy over the past decade, with the largest increases in inequality being experienced in China, India and the US.

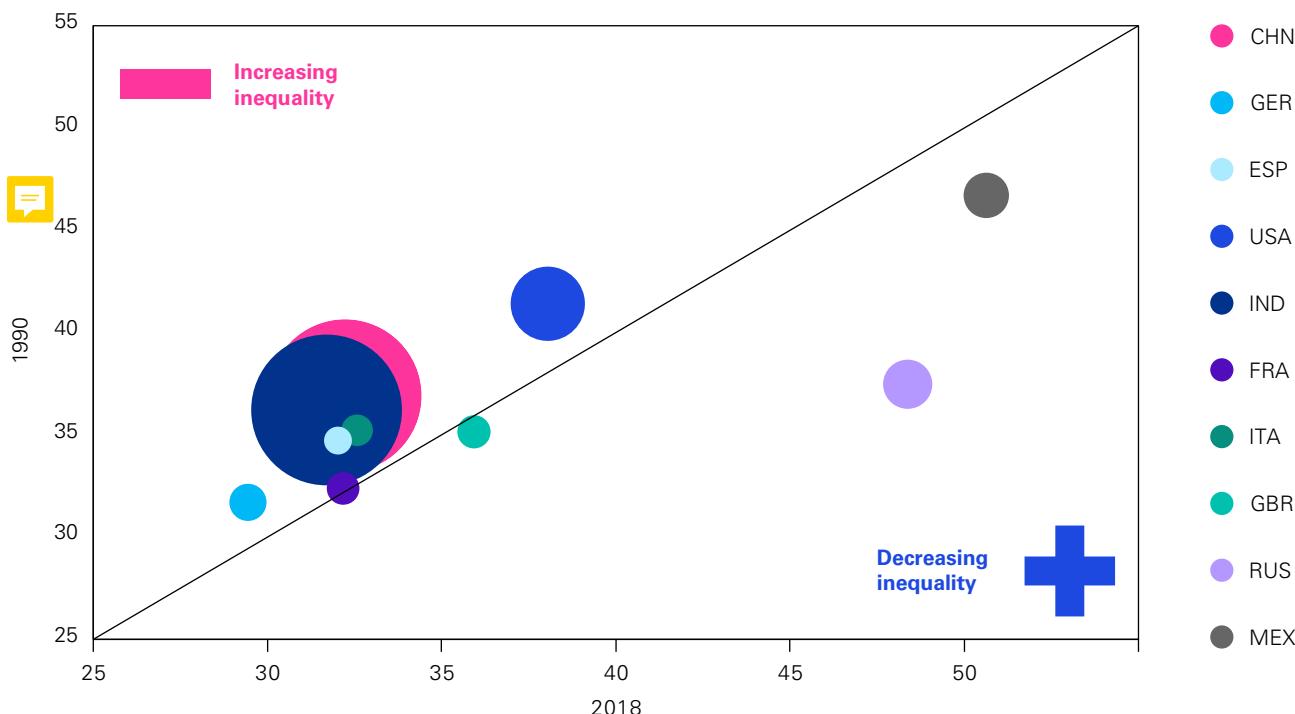
Share of net personal wealth by household 1980-2021



Source: World inequality database, Euromonitor, Our world in data; All sources last accessed on 27.01.2023; KPMG analysis

Unfortunately, previous experiences show how inequality tends to spike in times of crisis. During the Global Financial Crisis of 2008, sharp job losses and high inflation rates led consumers to seek out lower prices, fueling the growth of what's known as the 'mass market'. More recently, the COVID-19 pandemic created an even deeper shock to inequality levels. The post-pandemic period has only made matters worse.

Gini index 1990 vs. 2018



The polarization of the mass market

As the gap in income equality widens, markets are witnessing the emergence of new customer segments with significantly different purchasing behaviors that gravitate around two polarized segments: 'Premium' and 'Value'.

Premium purchasing behaviour

Consumer preferences

- **Increased customization and enhanced experience** of their purchase process (e.g., Nespresso stores)
- **Greater sustainability** of purchased products
- **Health & Wellness** products for new lifestyle needs
- **Wellbeing** across physical, mental and financial dimensions

Purchasing behavior

- Will look more at **quality** than prices and **will not necessarily down-trade** or drop products. Rather they might just reduce consumption of pricier products
- Will agree to pay a **premium for sustainable products**, especially fresh food and personal care/health
- Will do **purpose-driven purchases**, choosing products that are aligned with their values and can provide them with **health and wellness benefits**

Relationship establishment with this profile

- Companies need to offer a **customized experience** of the shopping process to enable a durable relationship
- Companies need to effectively communicate brand **innovation & sustainable responsibility** in order to get their **trust**

Value purchasing behavior

Consumer preferences

- Great **value offered for the money**
- Products that **do not strain budget** for shopping basket, especially for food and beverage
- **Less impulse buys**, specially in luxury-perceived categories
- Certain **lifestyle and health products**, which the consumer is still willing to pay a premium for

Purchasing behavior

- Will check prices more often as they are more **price-sensitive and possibly down-trade or drop products**, if perceived out of budget ("Budgeteering")
- Will wait for **promotions**, especially for home-care
- Will **lower their total value basket**, which can affect categories that are usually considered as impulse purchases
- Will **shop more at discounters & opt for private labels**

Relationship establishment with this profile

- Companies need to **offer perceived value for the money to counter risk of consumer dropping or down-trading the product** (convenience, sustainability, health & premiumization)
- Manufacture **credible balance** of emotionalization and responsibility to build a strong brand relation

What happens to the Mass Market approach?

The polarization of consumers seems to be making the mass market approach to retail increasingly unsustainable as the middle class hollows out and consumers start to gravitate around premium or value products.



We are seeing the distance between Premium and Value segments widen in terms of growth and market valuation," notes Javier Rodríguez González, Partner in the Strategy Group at KPMG in Spain. "But the reality is that few FMCG companies focus solely on one or the other. The leading players usually offer a range of Premium products that deliver strong margins and growth rates, alongside Value products that drive volume and scale."

Javier Rodríguez González,
Partner in the Strategy Group at KPMG in Spain

	Business model	Operating model	M&A Drivers
	<ul style="list-style-type: none">— Premium channels with tailored propositions— Premium-price positioning	<ul style="list-style-type: none">— Diversified niche-product portfolio— Competition product attributes	<ul style="list-style-type: none">— Sales & marketing management— Flexibility and ability to react to market changes
	<ul style="list-style-type: none">— Traditional mass and indirect channels— Value for price positioning	<ul style="list-style-type: none">— Monolithic brand structures— Competition on price & promotional strategies	<ul style="list-style-type: none">— Cost & utilization management— Cash and capital discipline

The main challenge lies in the fact that these different segments have significantly different business and operating models. Premium brands usually require sophisticated distribution channels and complex marketing strategies; Value products are mainly driven by cost discipline and economies of scale.

While the mass market approach may not be dead, it is becoming increasingly clear that market polarization will have a massive impact on the way consumers shape their purchasing behavior and retail companies shape their product and brand portfolios in the years to come.

How to grow in a polarized environment

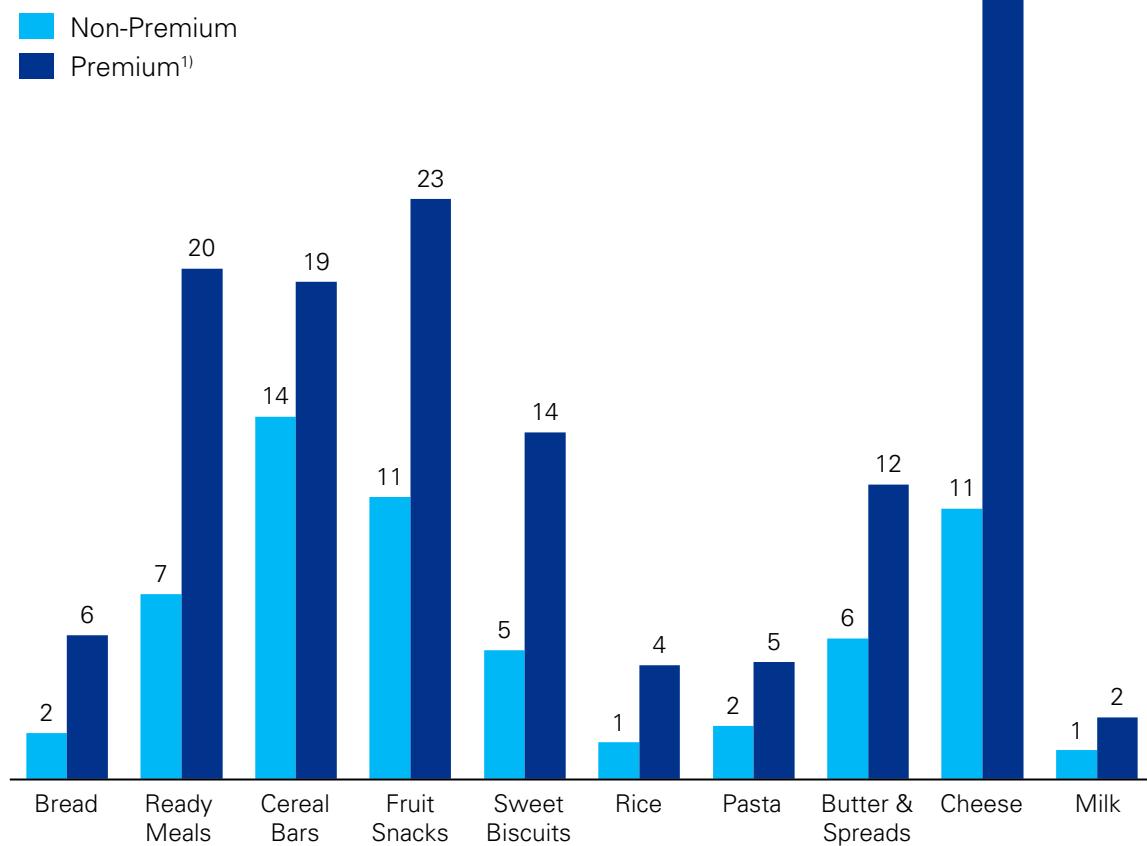


The trend towards 'premiumization' has been evolving for some time now. Since the mid-2010s, many consumer goods brands have been exploring how they could play around with concepts like quality, durability, cost, customization and purpose, in order to carve-out a distinctive niche in their respective markets. More recently, technological advances and increased access to data and analytics have allowed FMCG players to become increasingly sophisticated at predicting and catering to niche customer expectations.

A quick look at a 'basket' containing different food items clearly shows how Premium products deliver higher margins when compared to their Value equivalents. Products classified as 'organic', for example, tend to deliver higher growth rates than non-organic. Volumes may be lower, but the higher margins often make Premium products very attractive to consumer goods companies.

At the same time, the Value segment often enjoys a much larger addressable market. Higher volumes — when supported by excellent pricing practices and efficient economies of scale — can deliver significant growth for Value products. In other words, while the Value segment may deliver slower growth rates at lower margins when compared against Premium, the overall size of its market is much larger.

Premium¹⁾ vs Non-Premium Value to Volume Factor



Source: Euromonitor Analysis

Notes: 1) "Organic" is considered as premium in this analysis



Finding the right balance

This dichotomy has led many consumer goods leaders to strive to create product portfolios that contain some combination of both Premium and Value segments. The Premium segment represents an opportunity to penetrate fast-growing markets with higher levels of profitability, and Value products are key to increasing the existing customer base and enabling economies of scale.

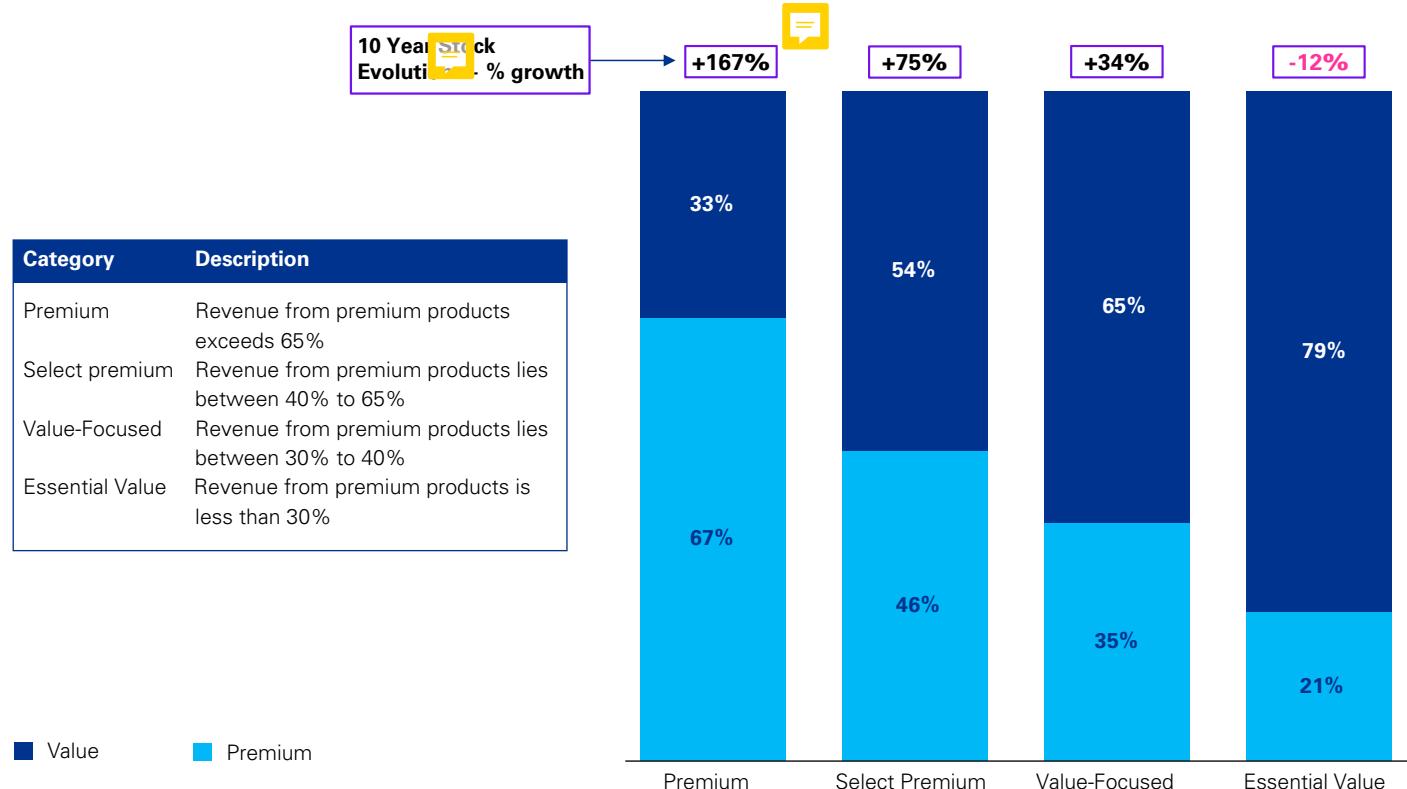
To test our hypothesis, we conducted a comprehensive analysis of a diverse group of companies. We segmented

them based on their revenue contributions from Premium and Value products, leading to distinct categories such as Premium, Select Premium, Value-Focused and Essential Value. We then examined the stock price growth of these companies over the past decade.

What we found was a clear correlation between product categorization and long-term stock performance. Companies categorized as Premium delivered maximum stock price while Essential Value's stock price contracted (refer illustration).

...deriving into two clusters of FMCG players, those with high premium offering, and those closer to the Value segment

Revenue share: premium vs. value, based on RSP in USD (%)



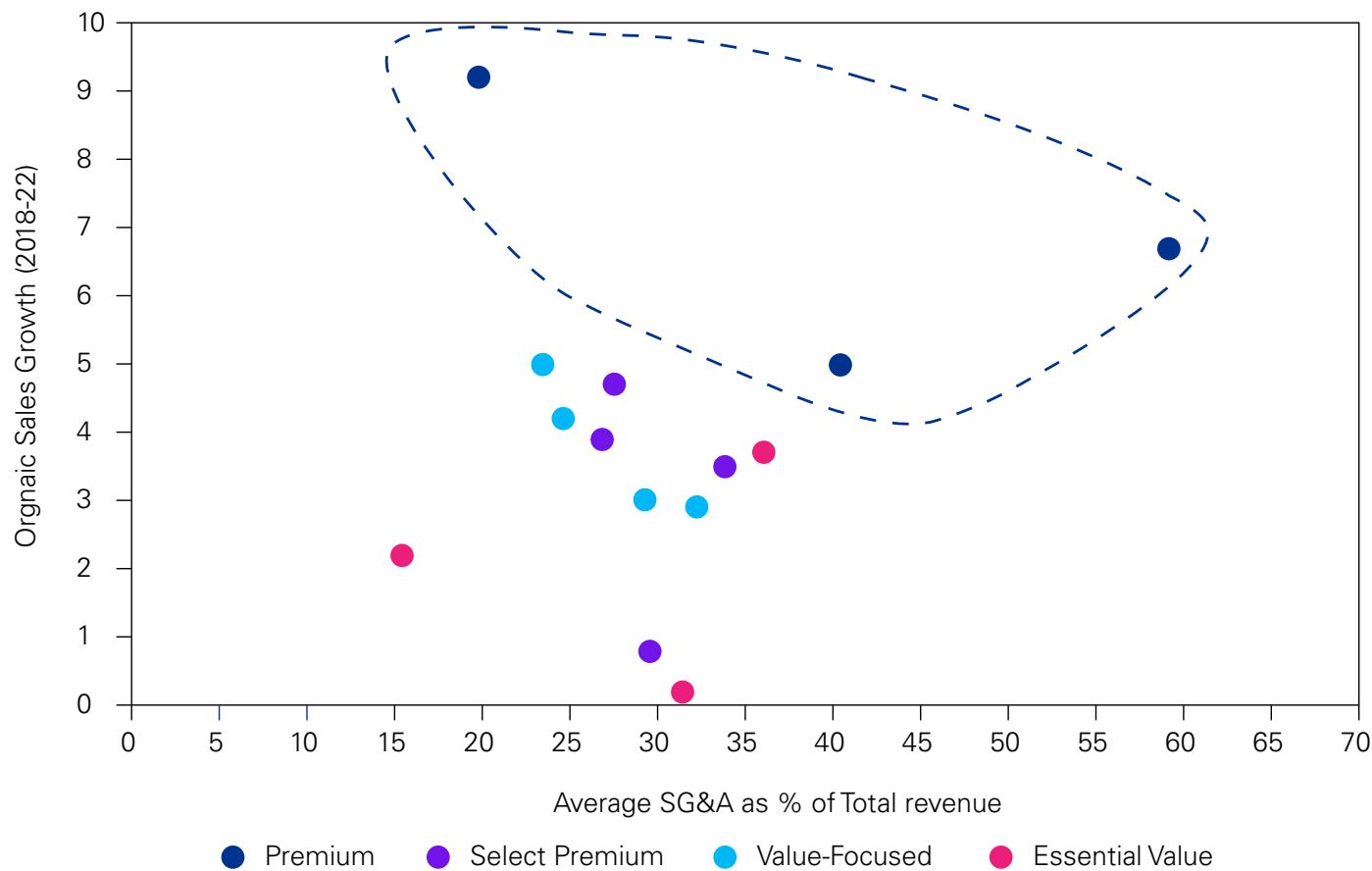
Source: Euromonitor database, last accessed on (Update Pending); Refinitiv accessed in Jul 2023, Annual reports of respective companies; KPMG analysis;

Note: Analysis has been performed on The Estée Lauder Companies Inc., Nestlé S.A., L'Oréal, Beiersdorf AG, Procter & Gamble Company (P&G), Henkel AG & Co. KGaA, Reckitt Benckiser plc, Colgate-Palmolive Company, Unilever, Danone S.A., Mondelez International, Inc., PepsiCo, Inc., The Kraft Heinz Company, Associated British Foods plc

Not surprisingly, our research shows the majority of the leading FMCG companies offer some mix of Premium and Value products in their portfolios. However, the approach is not uniform, with some companies trending towards a higher proportion of Premium products over the Value ones, while others are more geared towards Value products with a small share of Premium SKUs.

Analysis of the selected players shows higher growth rate for those with higher share of Premium portfolio...

Organic sales growth vs. SG&A ratio on sales (average 2018-22)



Source: Annual reports of respective companies; KPMG analysis

Note: Analysis has been performed on The Estée Lauder Companies Inc., Nestlé S.A., L'Oréal, Beiersdorf AG, Procter & Gamble Company (P&G), Henkel AG & Co. KGaA, Reckitt Benckiser plc, Colgate-Palmolive Company, Unilever, Danone S.A., Mondelez International, Inc., PepsiCo, Inc., The Kraft Heinz Company, Associated British Foods plc

Four clusters of players:

Category	Description
Premium	Revenue from premium products exceeds 65%
Select Premium	Revenue from premium products lies between 40% to 65%
Value-Focused	Revenue from premium products lies between 30% to 40%
Essential Value	Revenue from premium products is less than 30%

The SG&A ratio is mainly driven by the selling expenses in the industry.

As consumer purchasing power increases and decision drivers evolve, producers tend to develop their own premium product portfolio.

Premium products require more sophisticated distribution channels and complex marketing strategies, which derives into higher SG&A costs.

The analysis shows how premium players outperform competitors in terms of annual sales growth.

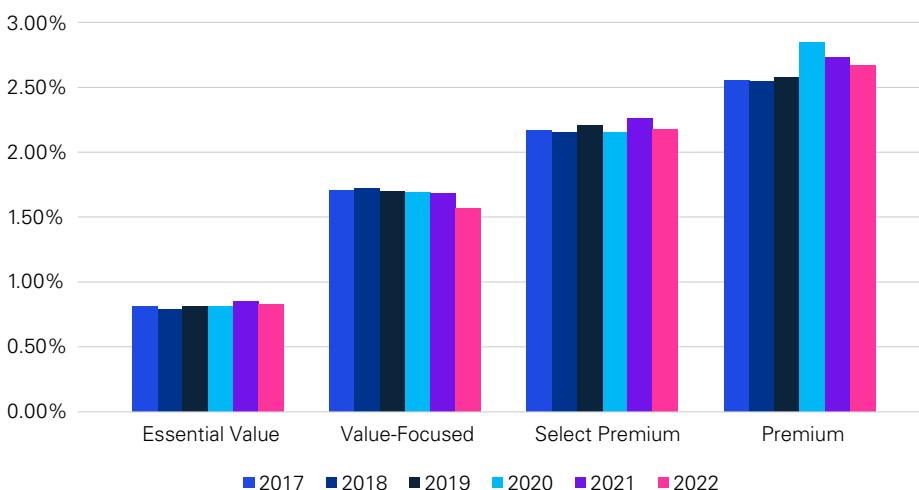
 Positive correlation between selling expenditures and organic sales growth."



...being this also related to the investment amount on specific functions like R&D

Premium players tend to spend more on R&D to ensure the high customization and distinct product characteristics

R&D Expenses as a % of revenue



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Premium	Revenue from premium products exceeds 65%
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Increased R&D spending is often related to the intention either to renew the existing product portfolio or to penetrate new market segments, such as premium



The analysis shows a clear relation between premium players and higher R&D expenses
Higher investment in R&D towards "premiumization" is usually related to faster growth rates

Insights:

Given the shrinking mass market, there may be an opportunity to increase revenues and margins by investing in growing segments and divesting those SKUs that are less profitable.

...as investors look for higher growth rates and margin levels, which in turn are favored by premium segment

Capital Market Expectations

- Companies that managed to achieve...

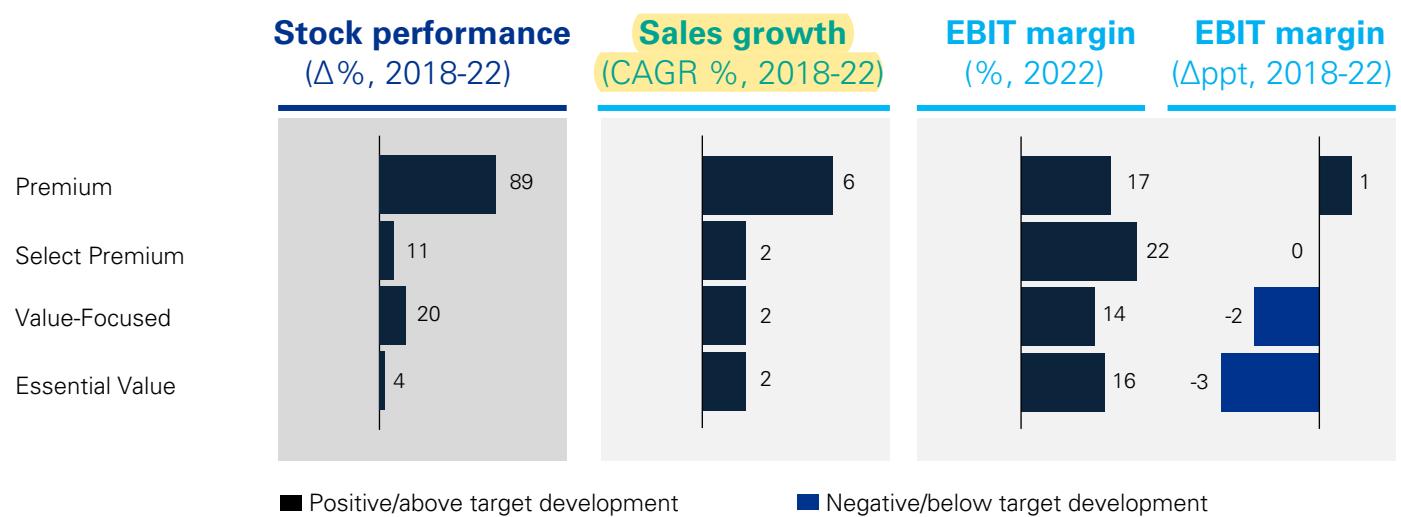
- sustainable sales growth of >3% p.a.

EBIT margin levels of >18%

...have been well perceived by investors and increased their market capitalization.

The best performing companies are in the premium segment and exceed expectations.

Financial performance top FMCG manufacturers (2018-2022)



Category	Description
Premium	Revenue from premium products exceeds 65%
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Players with higher shares of Premium products have performed better in the capital markets...

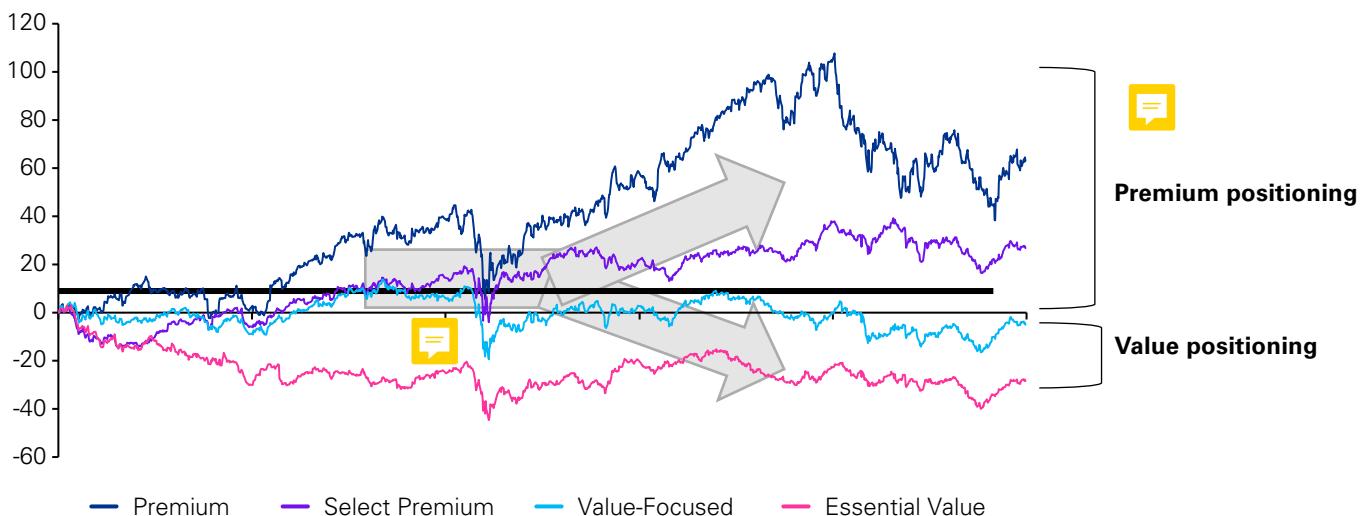
Premium

The analysis shows how, from 2016 to 2022, FMCG players with higher share of premium products among their portfolio saw an average increase of 35% on their share prices

Value

At the same time, those players with higher share of Value products among their portfolios have seen a much slower share price increase (or even decrease in some cases), with an average growth rate of 10 percent

Share Price evolution of Top 15 FMCG manufacturers (Index:2018)



Category	Description
Premium	Revenue from premium products exceeds 65%
Select Premium	Revenue from premium products lies between 40% to 65%
Value-Focused	Revenue from premium products lies between 30% to 40%
Essential Value	Revenue from premium products is less than 30%

Source: Capital IQ database, last accessed on 27.01.2023; KPMG analysis

Note: Analysis has been performed on The Estée Lauder Companies Inc., Nestlé S.A., L'Oréal, Beiersdorf AG, Procter & Gamble Company (P&G), Henkel AG & Co. KGaA, Reckitt Benckiser plc, Colgate-Palmolive Company, Unilever, Danone S.A., Mondelez International, Inc., PepsiCo, Inc., The Kraft Heinz Company, Associated British Foods plc

Divestments, acquisitions, and portfolio management



In this environment, FMCG players will likely try to reevaluate and actively manage their product portfolios to ensure the right mix of Premium and Value to drive growth and deliver investors' expected returns. We can expect the years to come to bring increased activity in the deal space, with many companies divesting their non-strategic and underperforming assets while looking to acquire attractive brands in promising, fast-growing segments.

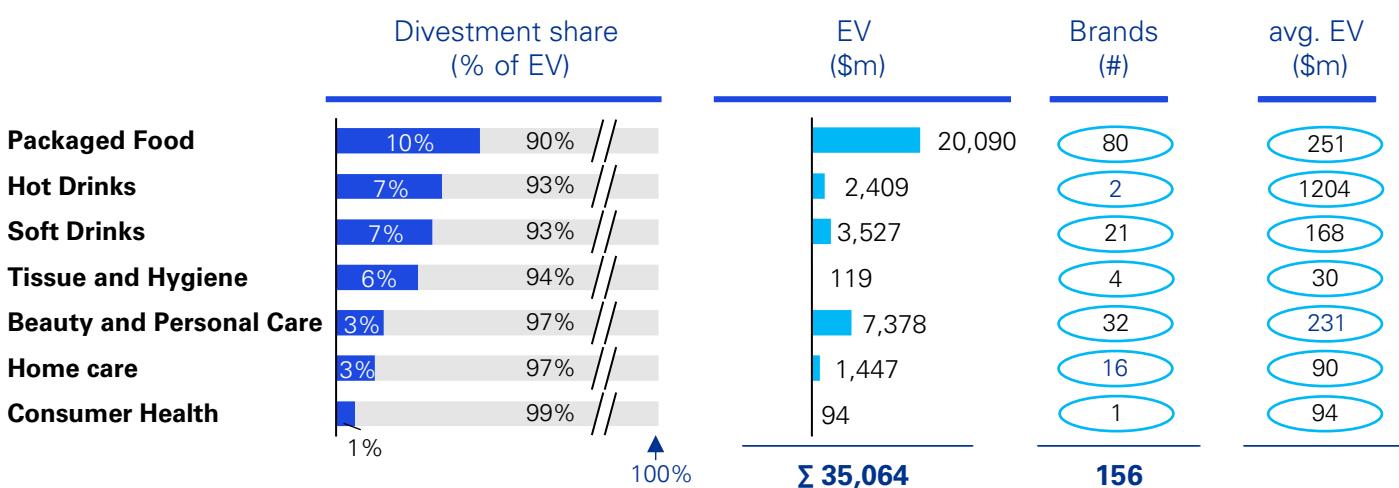
Where are the opportunities?

We took a look at where the greatest divestment activity might happen in the FMCG sector. For this, we compared the attractiveness of the underlying category and the

performance of individual brands within that category. Then, using publicly available market data and running a score-based analysis, we calculated how many brands might be up for divestment, and what quantity of enterprise value they might represent.

Our analysis indicates that the greatest volume and quantum of divestments will likely occur within the Packaged Food sector where 10 percent of brands seem ripe for divestment — representing some 80 different brands with a total enterprise value of more than US\$20 billion. In total, our analysis suggests that around US\$35 billion in enterprise value will likely come into the M&A market in the near future.

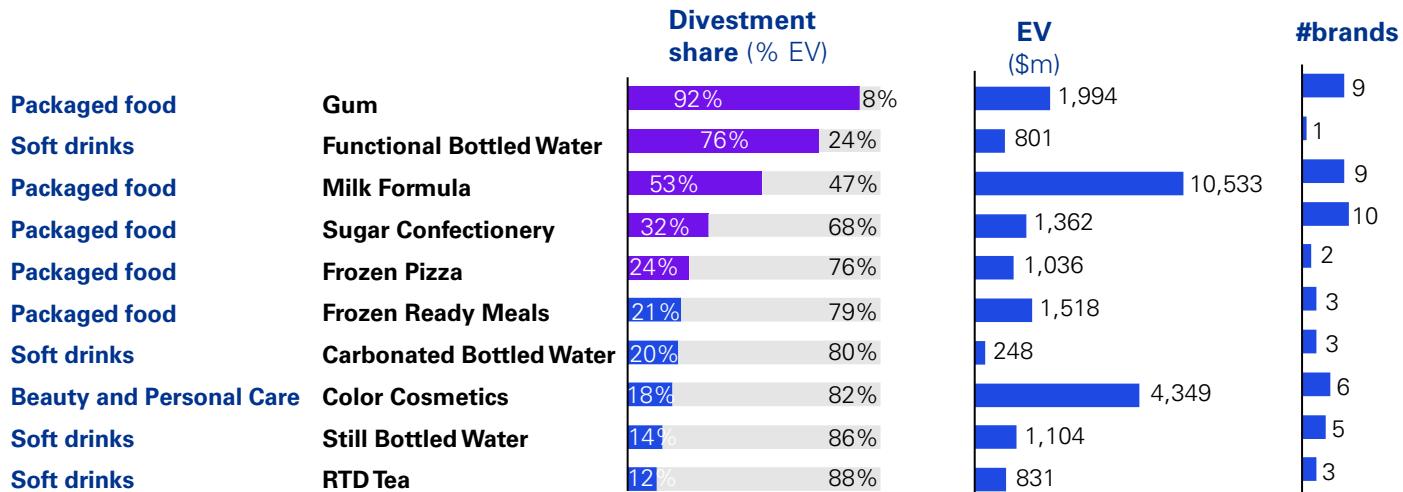
Results divestment analysis — Overview by category



Source: Euromonitor database, last accessed May 2023; KPMG analysis

Value to be found

Much of what is likely to come to market has a distinct 'Value' characteristic to it. Top subcategories for divestment include packaged gum, bottled water, milk formula, sweets and frozen pizza. The least likely brands to come to market are those in categories where quality plays a key role — few FMCG companies are planning to divest of their Beauty and Personal Care brands, for example.





“FMCG companies will be looking to offload or transform some of their underperforming brands as they reshape their portfolio for a polarized marketplace”, adds Joshua Martin, Global Deal Advisory Lead for Consumer and Retail. “Market leaders will be using that capital to invest in Premium brands in more promising, fast-growing subcategories. I do believe that we’re going to see a lot of deal activity in the Consumer and Retail sector over the coming months.”

Next steps: Maximizing investor value in a polarized world

Our team of consumer and retail professionals has worked on both buy and sell sides of the table. We've helped FMCG companies reshape their product portfolios through divestitures and acquisitions, and we've helped investors make savvy deals that create new value and unlock growth opportunities. Based on our experience, here's our advice for both sides of the table.



Consumer Goods companies

The coming years will probably see a flurry of dealmaking activity in the FMCG world as companies look to adjust their portfolios as a way to move into higher-growth markets by divesting underperforming brands and acquiring some premium niche players. Our experience working with leading FMCG companies on maximizing shareholder value suggests they should follow a structured, four-phased approach:

- 1. Shape the portfolio:** Based on the overall group's strategy, thoroughly analyze your current business and brand portfolio across regions in terms of each business's stand-alone attractiveness, fit to group's strategy and synergy possibilities. Identify potential adjustments, analyze their feasibility, quantify their impact and prioritize for a final decision.
- 2. Dress the assets:** For assets being divested, take time to prepare them for market sounding. The objective should be to divest at maximum deal value, thereby obtaining the required financial leeway for growth investments. Assets must therefore be standalone operable to ensure deal security and attract financial investors, as well as designed to have an optimized, lean and — especially during the due-diligence process — defendable organizational cost position. In addition, the transformation journey must be underpinned by a robust, implementable roadmap on how to grow sales and improve margins for maximum deal value.
- 3. Set the sail for growth:** Organic growth will probably not be sufficient to offset lost revenues amid divestments. Instead, you'll need to actively search for promising add-on acquisitions. However, the target landscape is now more fragmented than ever, amid numerous local and premium niche players emerging over the last 10 years. Therefore, it will be increasingly important to excel in target identification and prioritization to choose the right ones.
- 4. Integrate smart and capture value:** With an increasing number of smaller acquisitions, having a deal playbook with enough flexibility will be key to ensuring value is captured. This can be especially important in the integration phase where value deterioration is often experienced. New brands need enough space to develop and flourish, without compromising the synergies achieved by being part of the professional and scalable operating platform that the group provides.



Private Equity funds

At the same time, we expect to see non-core disposal activity create exciting opportunities for private equity funds, especially those with experience driving value from complex carve-outs and low-growth businesses. Going forward, we see two major success factors for private equity firms actively seeking to engage in the FMCG sector:

- 1. Apply advanced analytics:** Preparing for a deal once rumors of an asset sale are spreading in the market often proves to be too late. Anticipate developments early on and ensure you're in contact with the M&A departments of major consumer goods players to place yourself in a leading and advantageous position before the deal process starts. In this context, a forward-looking, data-driven analytical approach to predicting activity on the corporate sell-side is becoming more prominent.
- 2. Have a vision:** Gain a deep understanding of underlying trends governing an asset's specific market segment. Develop a clear roadmap to transform the business over the investment cycle and provide the 'right' resources in terms of funding and professional operational support to help the business achieve mutually defined objectives.



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