

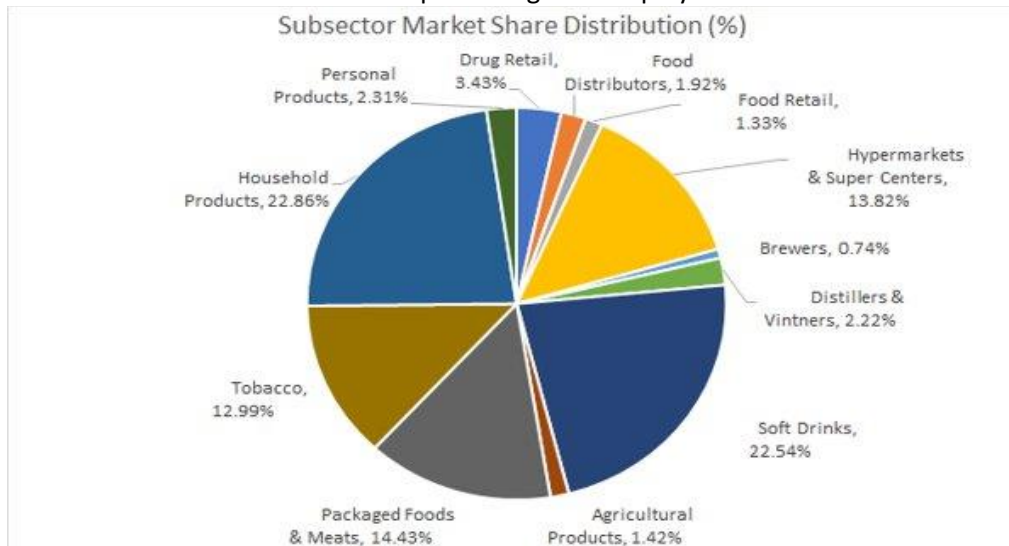
# Consumer Staples Sector Update and Analysis Spring 2019

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### Sector Synopsis

The consumer staples sector includes companies whose products are essential to consumers. These are products such as toilet paper or milk, which we purchase regardless of economic or financial hardship. The sector is comprised of three main subsectors: Household & Personal Products (25.17%), Food & Staples Retailing (20.49%), and Food, Beverage, and Tobacco (54.34%). The specific industries within the subsectors and their market share percentage are displayed below.



### Key Characteristics

Since the consumer staples sector consists of inelastic goods, it is widely viewed as a "safety net". Its low correlation to the overall market prevents its companies from being hit as hard during economic downturns. Companies within the sector have consistent revenues regardless of business cycles, which is the main reason for their low stock price volatility. Consumer staples companies have also consistently paid high dividends across the years. The dividend yield is currently at 3.12%, compared to the S&P 500 of only 2.07%. This allows for investors to gain consistent and safe returns.

### Performance

As of February 20, The S&P 500 has increased by 1.92%, compared to the consumer staples sector decrease of 1.88%. Among the sub-sectors in this sector, Tobacco contributed much to the decrease in the sector with a 1-Year return of -20.32%, mainly due to the new enforcement action and announcement of the Youth Tobacco Prevention Plan by the FDA. Household products led the sector with a 13.3% 1-Year return which beat the S&P 500 by 12.64%.

### SWOT Analysis

**Strength:** The consumer staples sector is very defensive. This is due to its low correlation to the market and low volatility. The consistent dividend payout also ensures the consistent gains and safe returns for the investors.

**Weakness:** The growth in the consumer staples sector is fairly slow as compared to other sectors.

**Opportunity:** An economic downturn is an opportunity for the sector as it would not be impacted as much as other sectors. This makes consumer staples beat the overall market during recessions.

**Threat:** As competition rises in this sector, companies will have to cut costs and push down prices to drive out competition. This will cause a negative impact on the companies as profits decrease. A growing economy is also a threat to this sector because it has a slower growth. As other sectors grow rapidly, consumer staples will lag behind.

## **Key Drivers**

### **Overall Economy**

The economy's performance can lead to various results for consumer staples companies, depending on which types of products they sell. Consumers spend more on high-end products when the economy is flourishing, so companies which sell cheap products are less likely to see as much growth. However, a company that sells a more luxurious staple is likely to receive less income during a recession in comparison to companies which offer more affordable products.

### **Product Differentiation**

The consumer staples sector is highly competitive due to the similar products that competitors have to offer. One way to gain a competitive advantage is to create a new market trend through product differentiation, offering consumers something different from its competitors. For example, with the emerging healthy lifestyle trend, companies in the foods subsector focus more on organic and natural products.

### **Competition**

The highly competitive market drives the sector as a whole. The more competitive the market is, the lower the revenue stream of the company. Rivals in the consumer staples sector offer similar products with similar price. Therefore, if prices were pushed down by one's rivals, the price-sensitive buyers will switch to them instead, driving down one's earnings. Another way to push away competition is by reducing costs which will then maximize the profits of a company.

### **Mergers & Acquisition**

Mergers and acquisitions play an important role in a company's growth within the consumer staples sector. Due to their defensive nature, the opportunities for consumer staples companies to grow are fairly low. However, one can enter new markets through acquisitions and reduce competition. Some could also reduce costs through merging with competitors due to economies of scale.

## **Recommendations**

### **Estee Lauder Companies Inc (EL) - HOLD**

- Consistently beats EPS expectations
- Strong growth in Asia-Pacific Markets which are the emerging markets for beauty products
- Beauty industry does well in recessions due to the Lipstick Effect (Theory in which consumers still spend on small indulgences during recessions to forget about their financial problems).
- Increasing demand from young people which has further expanded its target market

### **Constellation Brands (STZ) - HOLD**

- Bought 38% of Canopy Growth, CBD is an emerging market
- Decreasing wine and spirits portfolio by 40% to increase margins
- New CEO March 1st a reason for optimism
- Recent dip in stock price consistent with its competitors

### **Kraft Heinz Company (KHC) - SELL**

- Under SEC investigation for its accounting practices
- Decreased dividend payout by 36%, suggesting they have less disposable income
- Focused on cutting costs instead of capturing healthy food product market share