Consumer Staples Sector

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Agenda

* Sector Overview
* Business Analysis
* Economic Analysis
* Financial Analysis
* Valuation analysis
* Recommendation
Sector Overview
Industry Overview

Size of the sector: $1.84 \text{T}

Industries Within Staples:

* Household & Personal Products
* Food, Beverage, and Tobacco
* Food & Staples Retailing

<table>
<thead>
<tr>
<th>Name</th>
<th>Weighted Return</th>
<th>Min</th>
<th>Max</th>
<th>Impact (bp)</th>
<th>Count</th>
<th>% Up</th>
<th>% Down</th>
<th>Weight</th>
</tr>
</thead>
<tbody>
<tr>
<td>1) All Securities</td>
<td>d</td>
<td>0.23%</td>
<td>-1.64%</td>
<td>1.99%</td>
<td>23.17</td>
<td>40</td>
<td>65.0%</td>
<td>35.0%</td>
</tr>
<tr>
<td>2) Food Beverage &amp; Tobacco</td>
<td>d</td>
<td>0.24%</td>
<td>-1.61%</td>
<td>1.99%</td>
<td>13.38</td>
<td>26</td>
<td>65.4%</td>
<td>34.6%</td>
</tr>
<tr>
<td>3) Household &amp; Personal Products</td>
<td>d</td>
<td>0.29%</td>
<td>-1.64%</td>
<td>1.28%</td>
<td>6.29</td>
<td>6</td>
<td>50.0%</td>
<td>50.0%</td>
</tr>
<tr>
<td>4) Food &amp; Staples Retailing</td>
<td>d</td>
<td>0.15%</td>
<td>-0.76%</td>
<td>0.75%</td>
<td>3.50</td>
<td>8</td>
<td>75.0%</td>
<td>25.0%</td>
</tr>
</tbody>
</table>
The Key Players

* Walmart (WMT)
* Proctor and Gamble (PG)
* Coca-Cola (KO)
* PepsiCo (PEP)
* Philip Morris (PM)
**Industry Overview cont.**

- Top 5 Companies = roughly 50% of total weight
- 40 Total Members
- All 3 sub-industries represented within top 5 companies

<table>
<thead>
<tr>
<th>Ticker</th>
<th>Name</th>
<th>Price</th>
<th>Market Cap</th>
</tr>
</thead>
<tbody>
<tr>
<td>WMT</td>
<td>Wal-Mart Stores Inc</td>
<td>76.205</td>
<td>246.81B</td>
</tr>
<tr>
<td>PG</td>
<td>Procter &amp; Gamble Co/The</td>
<td>86.450</td>
<td>232.25B</td>
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<tr>
<td>KO</td>
<td>Coca-Cola Co/The</td>
<td>40.600</td>
<td>178.77B</td>
</tr>
<tr>
<td>PEP</td>
<td>PepsiCo Inc</td>
<td>94.980</td>
<td>141.61B</td>
</tr>
<tr>
<td>PM</td>
<td>Philip Morris International Inc</td>
<td>88.230</td>
<td>137.53B</td>
</tr>
<tr>
<td>CVS</td>
<td>CVS Health Corp</td>
<td>84.920</td>
<td>98.26B</td>
</tr>
<tr>
<td>MO</td>
<td>Altria Group Inc</td>
<td>47.350</td>
<td>94.49B</td>
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<tr>
<td>CL</td>
<td>Colgate-Palmolive Co</td>
<td>65.850</td>
<td>60.25B</td>
</tr>
<tr>
<td>WAG</td>
<td>Walgreen Co</td>
<td>63.490</td>
<td>59.98B</td>
</tr>
<tr>
<td>MDLZ</td>
<td>Mondelez International Inc</td>
<td>35.070</td>
<td>58.55B</td>
</tr>
<tr>
<td>COST</td>
<td>Costco Wholesale Corp</td>
<td>130.420</td>
<td>57.31B</td>
</tr>
<tr>
<td>KMB</td>
<td>Kimberly-Clark Corp</td>
<td>113.110</td>
<td>42.20B</td>
</tr>
<tr>
<td>KRFT</td>
<td>Kraft Foods Group Inc</td>
<td>57.070</td>
<td>33.81B</td>
</tr>
<tr>
<td>RAI</td>
<td>Reynolds American Inc</td>
<td>61.670</td>
<td>32.97B</td>
</tr>
<tr>
<td>GIS</td>
<td>General Mills Inc</td>
<td>51.130</td>
<td>30.89B</td>
</tr>
<tr>
<td>ADM</td>
<td>Archer-Daniels-Midland Co</td>
<td>45.420</td>
<td>28.80B</td>
</tr>
<tr>
<td>EL</td>
<td>Estee Lauder Cos Inc/The</td>
<td>74.730</td>
<td>28.41B</td>
</tr>
<tr>
<td>KR</td>
<td>Kroger Co/The</td>
<td>54.540</td>
<td>26.80B</td>
</tr>
<tr>
<td>GMCR</td>
<td>Keurig Green Mountain Inc</td>
<td>146.100</td>
<td>23.27B</td>
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<tr>
<td>SYY</td>
<td>Sysco Corp</td>
<td>38.130</td>
<td>22.46B</td>
</tr>
<tr>
<td>K</td>
<td>Kellogg Co</td>
<td>62.690</td>
<td>22.36B</td>
</tr>
<tr>
<td>LO</td>
<td>Lorillard Inc</td>
<td>60.920</td>
<td>21.94B</td>
</tr>
</tbody>
</table>
Performance

* Year to Date
  - +5.29%, (10/20/14)

* Quarter to Date
  - +0.21%, (10/20/14)
Business Analysis
Demand and Life Cycle

* Demand for this sector remains constant throughout good and bad economic times
* Relatively predictable demand leads to ease of supply matching for producers
* Many suppliers offer high-end and low-end product offerings

* Consumer staples are non-cyclical (defensive) due to their strong demand in each season/ economic condition
* Steady dividends and low beta offer investors protection against riskier assets
Investor’s Assessment

* Number of quality assets to serve as insurance for investors
* The large sector offers diversification
* Consistent dividends and predictable earnings
* Consumers are unwilling or unable to cut these items out of their budget, regardless of financial situation
Market Timing

When to Buy Each Industry

1. Staples
2. Discretionary
3. Health Care
4. Financial
5. Telecom
6. Industrial
7. Technology
8. Energy
9. Material
10. Utility
11. Middle recovery
* Staples are consumer necessities throughout the US, supplied on a constant basis
* Revenue growth in emerging markets becoming key for mature companies
* Brand recognition important amongst foreign competition
## Porters Five Forces Model for Competition

<table>
<thead>
<tr>
<th></th>
<th>Level</th>
<th>Analysis</th>
</tr>
</thead>
<tbody>
<tr>
<td>Threat of New Entrants</td>
<td>Low</td>
<td>Extremely capital intensive to run an adequate operation</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Must achieve economies of scale to compete on price</td>
</tr>
<tr>
<td>Determinants of Supplier Power</td>
<td>Low</td>
<td>Many Suppliers in this space</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Abundance of materials gives low price negotiation</td>
</tr>
<tr>
<td>Determinants of Buyer Power</td>
<td>High</td>
<td>Highly price sensitive customers will buy based on cost</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Seek best value and have low brand loyalty</td>
</tr>
<tr>
<td>Threat of Substitutes</td>
<td>Moderate</td>
<td>Most products compete using same price &amp; quality, free-riders achieve sales</td>
</tr>
<tr>
<td></td>
<td></td>
<td>New product development sees growth then steady decline as competitors match product</td>
</tr>
<tr>
<td>Rivalry Amongst Existing Firms</td>
<td>High</td>
<td>The big players move to other industries and countries in lock-step with each other</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Compete using low price &amp; standardized product offerings</td>
</tr>
</tbody>
</table>
Industry Adjustments

* Tobacco Industry
  * Products now require warning labels
  * Experts expect drop in usage amongst teens
* Soft Drink Industry
  * Offering lower calorie products
  * Focusing in foreign markets
* Toiletries and Cleaning Products
  * Lower prices due to financial crisis
  * Substitute products took market share
Economic Analysis
CONS VS. S&P

Y = S&P 500 CONS STAPLES IDX
X = S&P 500 INDEX

Linear Beta

- Raw BETA: 0.559
- Adjusted BETA: 0.706
- ALPHA (Intercept): 0.997
- R^2 (Correlation^2): 0.404
- R (Correlation): 0.636
- Std Dev of Error: 5.795
- Std Error of ALPHA: 0.674
- Std Error of BETA: 0.077
- t-Test: 7.225
- Significance: 0.000
- Last T-Value: -0.016
- Last P-Value: 0.494
- Number of Points: 79
- Last Spread: 1507.22
- Last Ratio: 0.236
CONS VS. S&P

Regression Analysis

Y = S&P 500 CONS STAPLES IDX
X = S&P 500 INDEX

Linear Beta
Raw BETA 0.741
Adjusted BETA 0.827
ALPHA (Intercept) 0.021
R^2 (Correlation^2) 0.565
R (Correlation) 0.752
Std Dev of Error 0.932
Std Error of ALPHA 0.094
Std Error of BETA 0.065
t-Test 11.451
Significance 0.000
Last T-Value -1.619
Last P-Value 0.054
Number of Points 103
Last Spread 1426.72
Last Ratio 0.244
Driving Factors

* Business conditions in the consumer staples sector have remained relatively steady over recent quarter
  - Stable commodity pricing
  - Solid global economic backdrop

* Factors
  - Overall Economic
    - Consumer Price Index
    - Consumer Confidence
    - Unemployment
  - Commodity Price
  - Dollar Value
Financial Analysis
EPS of CONS VS. S&P

* EPS of CONS vs. S&P
  - Over last 25+ years
  - EPS lower, but much steadier
  - Not as susceptible to larger pullbacks
EPS of CONS VS. S&P
Profit Margin of CONS vs. S&P

- Over last 25+ years
- Margin lower, but much more consistent
- Trending up last few years
- Down recently vs. flat S&P
CONS VS. S&P

Revenue per Share of CONSvs. S&P

- Over last 25+ years
- RPS lower, but much more consistent
- Trending up last few years
- Again, no huge fluctuations
Valuation Analysis
### Absolute Basis

<table>
<thead>
<tr>
<th>Absolute Basis</th>
<th>High</th>
<th>Low</th>
<th>Median</th>
<th>Current</th>
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</thead>
<tbody>
<tr>
<td>P/E</td>
<td>20.71</td>
<td>11.4</td>
<td>17.31</td>
<td>18.84</td>
</tr>
<tr>
<td>P/B</td>
<td>5.36</td>
<td>2.75</td>
<td>2.98</td>
<td>4.62</td>
</tr>
<tr>
<td>P/S</td>
<td>1.58</td>
<td>0.69</td>
<td>1.06</td>
<td>1.22</td>
</tr>
<tr>
<td>P/EBITDA</td>
<td>10.73</td>
<td>6.06</td>
<td>9.10</td>
<td>10.57</td>
</tr>
</tbody>
</table>

- Sector is expensive relative to history
### Relative to S&P500

<table>
<thead>
<tr>
<th>Relative to S&amp;P500</th>
<th>High</th>
<th>Low</th>
<th>Median</th>
<th>Current</th>
</tr>
</thead>
<tbody>
<tr>
<td>P/E</td>
<td>1.26</td>
<td>0.61</td>
<td>1.07</td>
<td>1.05</td>
</tr>
<tr>
<td>P/B</td>
<td>1.95</td>
<td>1.33</td>
<td>1.66</td>
<td>1.70</td>
</tr>
<tr>
<td>P/S</td>
<td>1.06</td>
<td>0.69</td>
<td>0.80</td>
<td>0.71</td>
</tr>
<tr>
<td>P/EBITDA</td>
<td>1.65</td>
<td>1.13</td>
<td>1.32</td>
<td>1.16</td>
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</tbody>
</table>

- Sector is close to historical average relative to S&P 500
<table>
<thead>
<tr>
<th></th>
<th>1 Month</th>
<th>3 Month</th>
<th>YTD</th>
<th>Price per Earnings</th>
<th>Price to Sales</th>
<th>Dividend Yield</th>
</tr>
</thead>
<tbody>
<tr>
<td>Consumer Staples</td>
<td>0.61%</td>
<td>1.89%</td>
<td>6.50%</td>
<td>18.4</td>
<td>1.22</td>
<td>2.86%</td>
</tr>
<tr>
<td>Household &amp; Personal Products</td>
<td>0.21%</td>
<td>2.84%</td>
<td>1.37%</td>
<td>16.3</td>
<td>1.9</td>
<td>2.97%</td>
</tr>
<tr>
<td>Food Beverage &amp; Tobacco</td>
<td>0.51%</td>
<td>2.05%</td>
<td>9.26%</td>
<td>14.9</td>
<td>1.5</td>
<td>3.11%</td>
</tr>
<tr>
<td>Food &amp; Staples Retailing</td>
<td>1.22%</td>
<td>0.64%</td>
<td>5.21%</td>
<td>14.3</td>
<td>0.4</td>
<td>2.05%</td>
</tr>
</tbody>
</table>

Industry comparison

![Graph showing comparison of price per earnings, price to sales, and dividend yield for different industries.](graph.png)
Food, Beverage & Tobacco

The largest industry group in sector

Success comes from the fact that as a group they’ve earned exceptional returns on their equity across history.
Increase Holdings

* Food & Beverage Industry
  * Soft Drinks & Juices
  * Alcohol
* Child Care and Feminine Products
  * High birth rates internationally
  * Stronger focus on women in Brazil, China, & Russia
More volatile industries with uncertain future

Companies focused primarily in US exports

Stronger dollar makes exporting tough
Q&A

Thanks!