March 2021

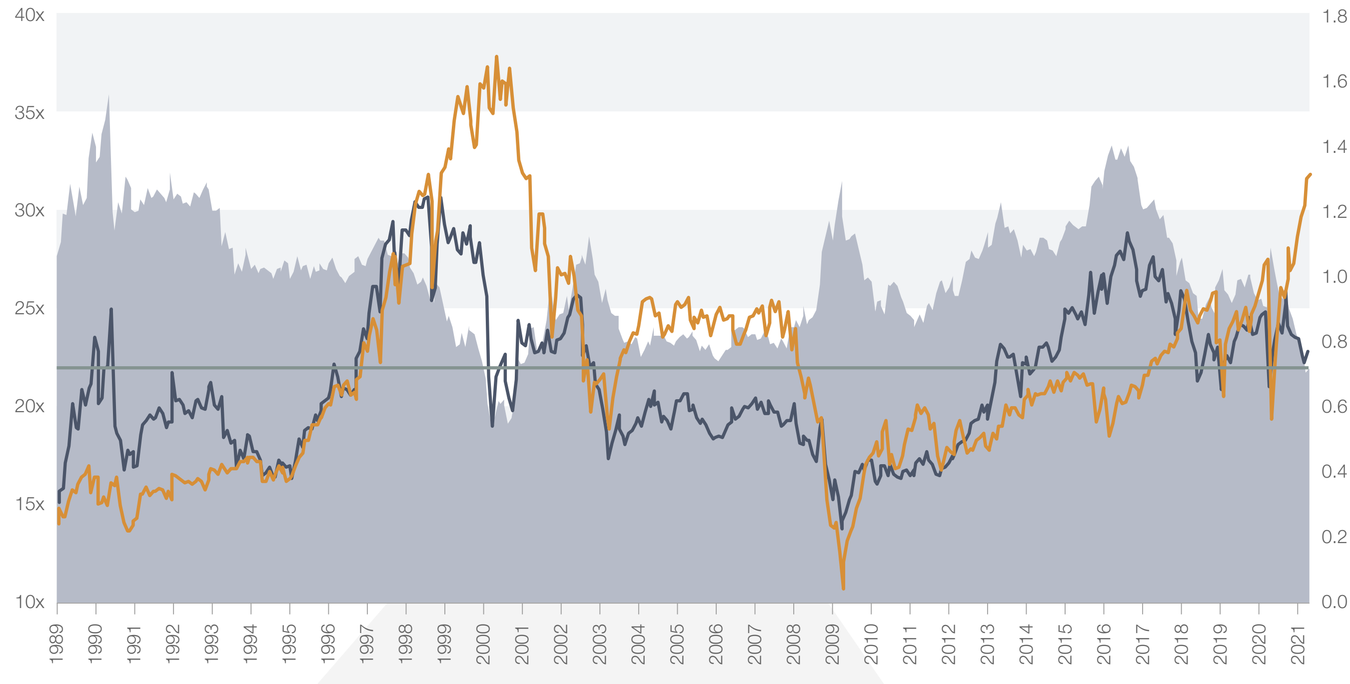
CONSUMER STAPLES: A VIEW ON RELATIVE VALUATIONS

The investment philosophy that lies at the core of our stock picking activity can be boiled down to "buying high quality companies at a fair price".

Historically, we have observed that few sectors have generated profits with an elevated return on capital employed with a greater consistency than consumer staples. Every day, all over the world, these companies sell a large number of small products to clients, leveraging their most valuable assets: their brands. The recognition of products like Coca-Cola, Nivea, or Colgate, to name a few, have been slowly built for decades into daily habits of generations of consumers worldwide. Thanks to their brands, massive scale and distribution, we believe good companies operating in this sector are likely to enjoy high return on capital employed, above-average margins, and good pricing power.

We have performed a study on a basket of 15 consumer staples businesses listed in the US[1] and compared their PE multiples (price to normalised earnings ratio, in dark blue below) against the market (S&P 500 CAPE ratio, in orange below) from January 1989 to March 2021. The grey area in the graph shows the relative valuation of staples versus the S&P 500 Index.

Staples PE vs S&P 500 CAPE (1989-2021)



Sources: Tikehau Capital internal research, Bloomberg, data as of 16/03/2021.

[1] We selected what we think are the 15 most representative consumer staples companies that are part of the S&P 500 Consumer Staples Index. These 15 companies are included into our investment universe: Colgate, Coca-Cola, PepsiCo, Kellogg's, General Mills, Campbell Soup, Clorox, Church & Dwight, McCormick, Kraft-Heinz, Mondelez, Procter & Gamble, Hershey, Kimberly Clark, Estée Lauder. We did not include in the above list any tobacco business, beer or spirit producer as well as any retailer, although these businesses are included in the S&P 500 Consumer Staples Index. As a reminder, tobacco companies are excluded from Tikehau International Cross Assets (InCA) and Tikehau Equity Selection (TES) investment universe as part of our internal ESG exclusion policy.

Since 1989, on average, the selected securities have traded more or less in line with the market[2]. Thanks to their defensive nature, consumer staples stocks tend to trade at more expensive valuations than the market during periods of uncertainty, as happened during the 1991, 2001 and 2009 recessions. On the contrary, in periods of general euphoria, consumer staples multiples tend not to surge as much as the market. This happened in the run-up to the 2000 tech bubble, in the period preceding the 2009 financial crisis, and, more recently, since the COVID vaccine news in November 2020.

As of March 16th 2021, the group of 15 consumer staples stocks depicted above trades at an average discount of 28% versus the market[3] (ratio: 0.72x). To put things into perspective, since 1989 the discount has never been larger except in 1999 before the peak of the tech bubble. Subsequently, it reverted to 1x by the end of the bear market that followed.

A hypothetical investor in 1999 investing with equal weights into this group of 15 businesses at a discount to the index similar to the present one would have been potentially rewarded with a return of +11.2%[4] by the end of the bear market in 2002. Over the same period, the S&P 500 lost 25.8% of its value[5].

We believe investors could be rewarded over the long term when buying high quality companies at a fair price. This is exactly what we have tried to do in recent months: as the relative discount of staples to the market widened, we increased the sector weighting in our equity portfolios. As of March 16th, the funds Tikehau International Cross Assets (InCA) and Tikehau Equity Selection (TES) had respectively 21.6% and 38.1% of their assets invested in consumer staples, compared to 6% and 14.1%, respectively, in April 2020.

		Apr-20	May-20	Jun-20	Jul-20	Aug-20	Sep-20	Oct-20	Nov-20	Dec-20	Jan-21	Feb-21	Mar-21
Staples weight	InCA	6,0%	6,5%	7,1%	8,9%	9,5%	9,8%	10,7%	14,6%	14,9%	14,7%	14,5%	21,6%
Staples weight	TES	14,1%	14,4%	16,8%	19,1%	17,8%	19,0%	19,2%	23,1%	25,2%	25,4%	32,7%	38,1%
Staples PE / S&P 500 CAPE		1,02x	0,99x	0,93x	0,93x	0,92x	0,90x	0,87x	0,82x	0,79x	0,75x	0,70x	0,72x

Sources: Tikehau Capital internal research, Bloomberg, data as of 16/03/2021.

[2] The monthly ratio between Staples PE and S&P 500 CAPE averaged 1.005x between January 1989 and March 2021.

[3] In statistical terms, the current discount lies in the 3rd percentile, meaning that since 1989 only less than 3% of the monthly observations in our dataset have shown a deeper discount.

[4] Performance of a hypothetical equal weighted portfolio from 20/12/1999 to 06/05/2002 without rebalancing. Of the 15 securities mentioned in note 1, a total of 13 were considered (Mondelez and Kraft-Heinz were not listed in 1999). These consumer staples stocks were trading on average at a multiple of 0.74x the market as of 20/12/1999, and of 1.03x as of 06/05/2002. The stated performance does not include trading fees and dividends received nor reinvested. This exercise is for informational purposes only.

[5] Performance of the S&P 500 from 20/12/1999 to 06/05/2002. It does not take into account trading fees and dividend received nor reinvested.

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