S&P Global
Ratings

# Industry Top Trends 2022

## Consumer Products

### Companies Navigate Inflationary Pressures, Changing Consumer Demand

*This report does not constitute a rating action*

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## What's changed?

**Supply chain disruption.** Despite congestion at ports and terminals easing, issuers will likely maintain higher inventory leading to elevated working capital needs.

**Inflation.** Pressures gradually abate from the second half as supply and demand near historical levels and the labor shortage eases. Companies look for offsetting cost efficiencies, selective price increases, and product rationalization and launches at premium prices to limit the impact on margins.

**Sustainability.** Companies are actively establishing sustainability strategies and action plans, making significant investments in their supply chains and scaling up production of sustainable products, new technology, and business practices.

## What are the key assumptions for 2022?

**Financial policies will continue to be balanced.** There is some evidence of increased share buybacks, while some companies express caution due to weaker margins from higher inflation. Acquisitions and disposals are likely to gather pace.

**Sustained resilience.** Companies have learned to cope with disruptions across their supply chains and distribution channels. Greater digitization has improved the resilience of companies' operating models and ability to cope with uncertainties.

**Regional variations in recovery pace.** Countries with lower vaccination rates and limited access to booster shots won't likely return to prepandemic performance until 2023. Companies will continue to be affected by related disruptions in many markets.

## What are the key risks around the baseline?

**Higher and more persistent inflation.** We expect many components to ease in the second half. However, we're watching closely for signals that suggest inflation, including for agricultural commodities, will become more entrenched.

**COVID-19 variants.** Stricter restrictions or lockdowns following a case rise upon spread of the omicron variant could temper sales of discretionary goods and food service.

**Consumer spending fatigue.** Higher prices, pandemic-related fatigue, and slowing economic growth could begin to affect consumer sentiment and shopping behavior.

# Ratings trends and outlook

## Global Consumer Products

Chart 1

### Ratings distribution by region

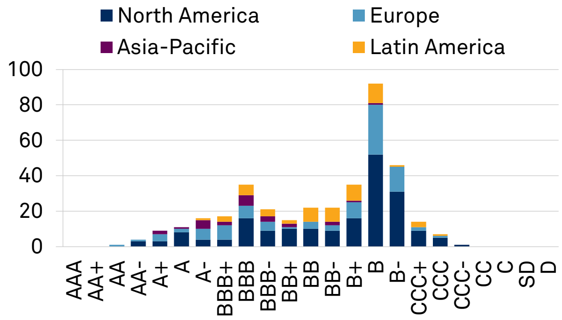



Chart 2

### Ratings distribution by subsector

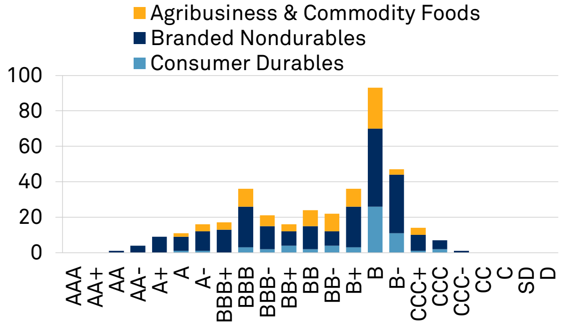



Chart 3

### Ratings outlooks by region

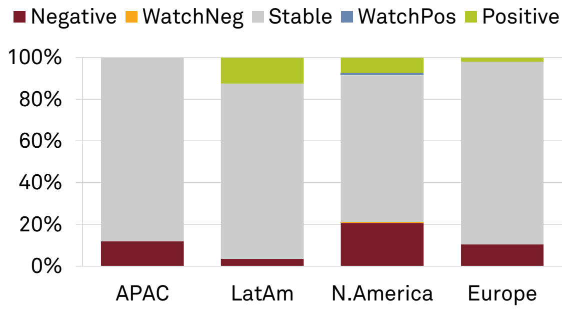



Chart 4

### Ratings outlooks by subsector

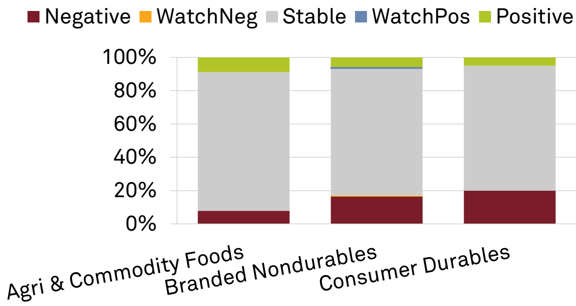



Chart 5

### Ratings outlooks net bias by region

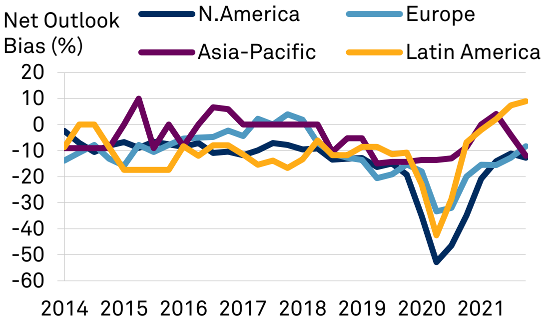



Chart 6

### Ratings net outlook bias by subsector

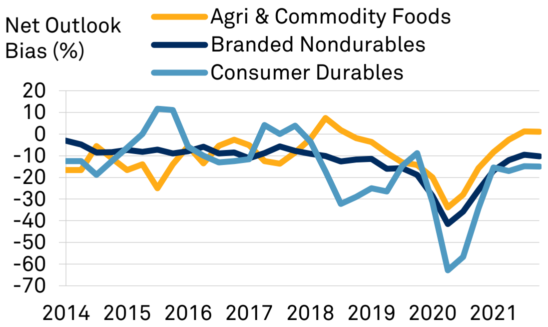



Chart 7

### Ratings outlooks

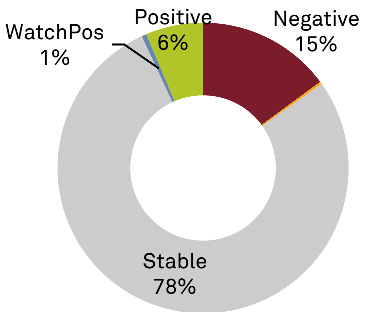
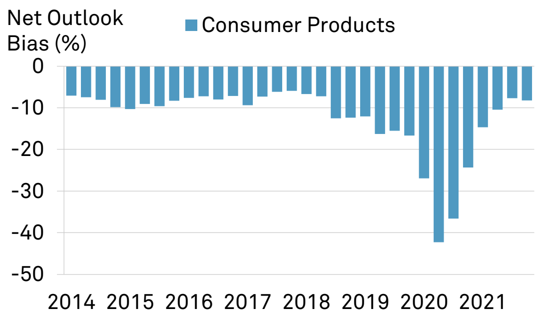



Chart 8

### Ratings net outlook bias




Source: S&P Global Ratings. Ratings data measured at quarter end.

# Consumer Products

## Ratings trends and outlook

Over recent months, rating actions across the consumer products companies have been mainly positive. This reflects these companies' higher-than-anticipated resilience to tough operating conditions during the pandemic. Close to 80% of ratings in the sector have stable outlooks. Higher operating and financial resilience and strong consumer demand dramatically decreased the negative bias. We have negative outlooks on only 15% of the issuers we rate compared to 36% a year ago. More negative outlooks in North America reflect the greater proportion of discretionary products manufacturers rather than higher pressure in the region.

Consumer goods companies face higher wages, price rises, shortages of raw materials, and increased costs for freight, packaging, logistics, and energy. While we expect some squeeze on margins, most market leaders and large companies will benefit from more demand and offset higher input costs from a combination of internal cost-saving measures and selective price rises. A diverse supplier base, bigger order capacity, and superior supply chains and logistics will enable larger companies to gain more competitive advantage based on better product range and availability. Accordingly, credit prospects are relatively stable for investment-grade companies given their strong positions within their categories, product diversification, good cash flow characteristics, and willingness to moderate shareholder returns in times of stress.

Still, 'B' remains the largest rating category, accounting for the highest number of issuers in the sector. This includes many highly leveraged companies with weak business risk profiles, which typically have less bargaining power with suppliers and services such as freight. While some regional players holding niche product leadership positions or those with efficient local supply chains and low overhead will be less affected, many smaller companies remain vulnerable to significant volatility in operating performance, strong competition, and tough execution amid persistent cost inflation.

## Main assumptions about 2022 and beyond

### 1. Consumption trends will gradually wane in some discretionary categories

During the pandemic, there has been a structural shift to at-home consumption because of social distancing mandates. For at least the next few years, employers and employees will likely strike a balance between working in the office and at home. Consumers have demonstrated an interest in at-home cooking. Consumer staples will use innovation, marketing, and value propositions to retain some of the share they gained. We expect variable demand patterns in discretionary categories such as apparel as pent-up demand subsides, and consumers pay higher prices for staples.

### 2. Product portfolios scrutinized for strategic fit, sustainability, and growth

This has intensified. The pandemic prompted consumer goods companies to examine and reshape their product and brand portfolios more. Evolving consumption patterns and sustainability considerations will drive portfolio transformation through investment, bolt-on acquisitions, and disposals.

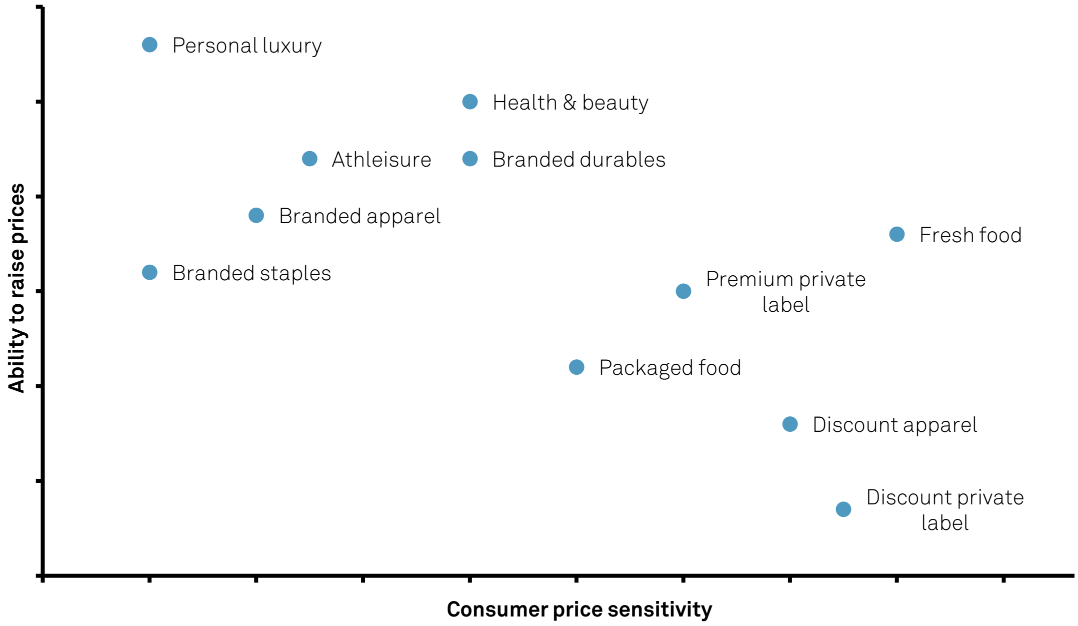
### 3. Credit quality will sustain, including a high share of 'B' category ratings

Sound operating performance and balanced financial policies, supported by economic recovery, consumption, and favorable financing conditions have led to largely positive rating actions in recent months. However, many highly leveraged and smaller companies are still highly sensitive to the ongoing impact of the pandemic. Supply chain and logistical challenges and persistent inflation, which we expect will continue through the first half, will result in margin pressure, slower deleveraging, and less rating headroom.

Inflationary pressures that began in 2021 due to supply chain constraints and labor shortages, especially in North America and Europe, are likely to continue well into 2022. To date, the ratings impact of inflation has been limited. However, we expect pressure to increase before it abates, possibly leading to more rating actions in the coming months. In our view, branded consumer products companies have a moderate to high ability to pass costs on to consumers (see chart 9). However, the wide array of competing brands and products often mean consumer prices increase, typically after a lag and only after consideration of several alternatives. These include implementing cost efficiencies elsewhere in the value chain, promoting less, and modifying, rationalizing, or reconfiguring the product. Furthermore, many consumer goods companies have invested significantly in information technology systems to gather and analyze customer data. They have good visibility on what their consumers are buying and their reaction to price modifications. We expect many companies will make small and periodic price adjustments, carefully monitoring consumers' response at each increment, rather than one-off large increases.

Chart 9

### Pricing Flexibility And Impact Vary By Segment




Source: S&P Global Ratings.

## Subsector assumptions in 2022

- **Household products.** Price increases that offset inflation is a major theme for these companies, with Procter and Gamble citing a $2.3 billion inflationary hit for its fiscal 2022. Companies whose products used daily will continue to benefit, but it's possible consumers will pay for brands at higher prices with perceived superior benefits or trade down. Another key challenge is meeting still elevated demand with supply chain constraints, although lower than at the onset of the pandemic.
- **Packaged foods.** At-home food consumption remains robust as consumers work and eat at home. We estimate sector revenues, on average, will increase in the mid- to high-single-digit percentages in 2022 due to high-single-digit price increases and modest volume gains. We forecast EBITDA margins to contract due to higher input, labor, and transportation costs. In addition, we believe companies will continue to reinvest in their businesses to increase the top line long term. We believe sector growth will outpace the prepandemic rate because we expect the hybrid work model to remain. Brands continue to outperform private labels, and demand has not significantly dropped from recent price increases. However, we believe if inflationary pressures do not abate, consumers could trade down, hurting volumes for branded players and benefitting private labels. We expect portfolio reshaping to continue as companies divest noncore assets and seek acquisitions in faster expanding categories or for geographical expansion. We believe most acquisitions will likely be tuck-ins.
- **Agribusiness.** The profit outlook remains favorable, underpinned by our continued expectations for elevated commodity prices in 2022, including beef, chicken, corn, oilseeds, dairy, and sugar, which remains in short supply because of Brazil's drought-stricken harvest last year. A combination of strong global demand, robust feed demand to rebuild tight livestock supplies (particularly Chinese pork and U.S. poultry), lower ending grain and oilseed stocks after significant year-end purchasing activity in 2021, and the risk of smaller than anticipated harvests out of South America depending on rainfall totals should keep supplies from building. Moreover, elevated oil and gasoline prices, renewable fuel production mandates in countries such as the U.S. and India, and ongoing strong Chinese import volumes continue to support elevated corn, soybean oil, and other oilseed prices. Still, margins are likely to moderate for many issuers in 2022 because of a difficult comparison to last year's records, particularly beef packers. We expect a normalization in beef cutout margins by at least 500 basis points year over year as tighter cattle availability should increase input costs. For Chinese hog producers, margins have been tight following the rapid price correction during 2021 with massive herd rebuild effort over the past two years, but we expect price and profit recovery in the latter part of 2022 when hog inventory is digested by the market. Supply chain constraints for agricultural inputs including fertilizer in certain regions such as Belarus, and higher labor costs should also modestly pressure margins in 2022. Improved balance sheets after two years of strong operating performance may lead to modest releveraging either to fund increased shareholders remuneration or more likely for acquisitions in high-growth areas such as value-added ingredients, specialty feed, and renewable fuels. Risks include increased trade restrictions, a delayed rebound in food service demand due to the COVID-19 omicron variant, and increased regulatory scrutiny. U.S. meat processors' record-high margins raise anticompetitive concerns.
- **Food service.** We expect to start the year with a pause in the recovery—which for large players reached 90% or more of 2019 sales—because of the omicron variant. Credit metrics are likely to weaken somewhat due to supply chain and labor trends. We assume large distributors will continue to pass through most inflation. Near-term sales downside will be limited because of delivery and carry-out services, and for certain issuers, geographic diversity including in areas with less stringent virus prevention measures. Assuming infection rates subside, the sales recovery should resume by or before mid-year. However, a sustained increase in food prices could pose a risk to volumes and profits if it becomes too expensive for many people to dine away from home.

We expect large players will focus on bolt-on M&A, especially given Sysco's aggressive organic growth plans, and both U.S. Foods' and Performance Food Group's recent sizable acquisitions.

- **Apparel manufacturers.** The industry continues to benefit from strong demand as consumers return to some social activity. Travel and out-of-home activity are still below prepandemic levels and leaving consumers with more cash to purchase discretionary consumer products. Gross margins are relatively high for most branded apparel players because of lean inventories across the industry and higher direct-to-consumer sales contribute to pricing power and less promotional activity. Additionally, many apparel companies are holding on to extra cash as an insurance policy, learned from the early days of the pandemic. If positive trends continue, we believe issuers may use excess cash to fund M&A or shareholder return activity. These factors are leading to strong credit metrics for most apparel companies we rate in the 'BB' category and investment-grade issuers. However, we believe these trends will gradually reverse as consumers' pent-up demand wanes. As promotional activity returns credit metrics will likely weaken. Jeans, athletic performance apparel, athleisure, sneakers, and performance footwear are categories with high demand while dresswear and formal footwear still lag.
- **Beauty.** Recovery remains slow and uneven after a year. Issuers have upped their website and virtual capabilities through online advisers and live streaming product instructions. The shift to direct-to-consumer is also increasing consumers' basket size and benefiting companies with good e-commerce channel concentration. Self-care via enhanced skin care is a trend we expect to stay and fuel growth for companies with a strong presence. The skin-care category is not correlated to COVID-19 restrictions, more stable than color cosmetics, and offers higher gross margins due to higher prices. Color cosmetics show signs of recovery and growth but is very regional and hindered by mask-wearing. After a sharp drop in 2020, demand for fragrances has seen a strong recovery as consumers view them as a form of self care and indulgence. Hair care has been affected by the pandemic and the closure of salons at times, but we believe it will become another avenue of self care as consumers look for ways to continue to make themselves feel good. We believe demand for clean ingredients and brands with positive environmental and social campaigns will continue to be strong.
- **Luxury.** The prospects continue to be dampened by the pandemic with a severe decline in 2020, an estimated value reduction of 22%-25% (about €215 billion from €280 billion in 2019), and a much more significant decline in operating profits. But operating and recovery prospects remain mixed with the large, rated luxury companies (LVMH, Kering, Richemont) outperforming our original base case mainly on better-than-expected performance in U.S. and China. In the first nine months of 2021, LVMH posted strong organic revenue growth of 40% year on year and an 11% increase compared with the same period in 2019. As consumers become more mobile and global travel spending returns, luxury spending should follow. However, we expect the recovery to be slower than most other consumer discretionary segments, and especially slow surrounding international travel (a key driver of luxury spending in Europe). The COVID-19 pandemic boosted digital sales that were relatively low in luxury. Online sales are increasing quickly and account for more than 20% of the total industry, up from about 10% in 2019. We note that recovery in China has remained strong, which is significant as Chinese customers represent about 25%-30% of luxury goods buyers. While there is limited impact so far, Beijing's priority shift from economic growth to social inequality and common prosperity and job cuts in the high-earning e-commerce, property, and education sectors could dampen purchasing power of the upper-middle class. This could in turn slow the premiumization trend and demand for luxury products.
- **Durables.** We expect revenues to increase in the low- to mid-single-digit percentage range in 2022, largely driven by price increases. We forecast EBITDA to decline modestly due to higher costs, depending on the subsector. Consumers continue to spend on home related items and outdoor and sporting goods. However, while revenues have continued

to increase, high input, transportation, and labor costs are hurting profitability. Companies that rely on imports or outsourcing, especially from Asia, have faced unprecedented freight costs they have not fully offset. Many companies have raised prices or added freight surcharges, but we do not anticipate these coming through until the first half of 2022 with additional increases likely through the remainder of the year if costs do not abate. For office-related companies such as Steelcase, we believe a recovery in demand will be slow due to coronavirus variants delaying a full return to the office and continuing hybrid models. Given the discretionary nature of durables, we believe continued extraordinary inflation could hurt demand if consumers' purchasing power continues to diminish.

– **Beverages-alcoholic.** Having performed better than expected, the sector is positioned to continue to expand faster than the broader consumer products industry. We expect 4%-6% net sales growth on average in 2022 for our rated universe. The primary driver is the continued premiumization, particularly in spirits. Above industry average growth in emerging markets is also expected to resume, which should benefit global brewers. In addition, the on-premises channel should continue to reopen, albeit with uncertainty in the coming months due to the omicron variant. Nonetheless, the growth is not sectorwide. Certain segments face secular pressure, notably nonpremium domestic beers in mature markets, while the still fast-expanding hard seltzer category has started slowing in key markets such as the U.S. Therefore, we expect certain companies to reinvest more heavily in advertising, promotion, and innovation in 2022, which may pressure margins. Supply chain constraints and input cost inflation remain an additional cost hurdle, albeit not as severe for the high-margin leaders with premium portfolios and proven track records of cost efficiencies. Financial policy remains the key ratings risk for the sector. Companies either are still deleveraging back to targets after heighted M&A activity or are balancing shareholder returns with ongoing growth investments, primarily M&A. The sector's high free cash flow conversion of EBITDA and highly variable cost structure historically has enabled companies to restore credit measures quickly if they get stretched such that downgrade risk is modest. After several positive rating actions in 2021as companies navigated the pandemic better than expected, only one issuer continues to have a negative rating outlook in large part because of recent M&A.

– **Beverages-nonalcoholic.** We expect sales—including for carbonated soft-drinks, water, coffee, tea, juice, dairy, energy, and sports drinks—to increase by a mid-single-digit percentage in 2022 on inflation-driven price increases. We believe volumes will be roughly flat as elevated at-home consumption early in the year shifts by midyear, assuming new COVID-19 infections decline. We expect EBITDA margins to contract moderately due to the operational problems plaguing most companies, though nonalcoholic beverage markers should fare relatively well compared to other consumables manufacturers because of their high brand equity and minimal private label competition. It's likely portfolios shift toward higher growth subcategories such as energy and sports drinks and away from underperformers such as juice.

– **Tobacco.** Global players face an increasingly adverse general regulatory landscape, and the pace of regulation is set to intensify. All the large players are investing in diversifying their product portfolios into potentially new reduced-risk alternatives as a future source of growth. Only IQOS—Philip Morris International Inc.'s heated tobacco product—and some Swedish Match snus smokeless tobacco products have obtained authorization from the U.S. Food and Drug Administration to be marketed as modified-risk tobacco products, which could help them gain a competitive advantage over other new tobacco categories. Although the large, rated tobacco companies have not been materially affected by the pandemic, compared with other consumer sectors, we foresee reduced rating headroom because of increasing regulatory volatility, the ongoing decline in combustible cigarette volumes, elevated spending related to new products, potential acquisitions, and ongoing shareholder returns, which continue to consume most of their free cash flows.

## Credit metrics and financial policy

While most of the consumer goods companies we rate have stable rating outlooks, we expect some deterioration in credit metrics for the sector. This is due to the negative impact of the pandemic, higher inflation, tight labor markets, supply chain challenges, and continued albeit moderate M&A activity. If the supply-side and shipping disruptions continue, companies will pay less attention to working capital and trade terms as their main priority will be to secure supplies on time to prevent stock-outs. Faced with supply disruptions, companies are more focused on maintaining amicable relationships with their suppliers and avoiding unnecessary tensions regarding pricing. This will have a knock-on impact on working capital, which we expect will deteriorate over 2021 and into the second half of 2022. In 2020, by contrast, working capital benefitted from companies' efforts to carefully manage order flow, inventories, and payment terms.

Although cash generation could moderate in 2021 due to balancing of the working capital effects and higher inflation, it should continue to benefit from companies' efforts to lower operating costs. While we expect consumer goods companies to be largely cautious regarding large M&A activity, we continue to factor in portfolio transformation through investment, bolt-on acquisitions, and disposals. Companies will continue to invest in developing and strengthening digital capabilities, so we expect that capital expenditures will remain elevated. The strong operating resilience against various pandemic and cash pile headwinds from preemptive refinancing has led to many large investment-grade and high speculative-grade companies renewing this focus on shareholder returns. This includes sizable share buyback initiatives announced by large multinational companies such as Unilever, Diageo and Nestle and smaller, less diverse companies such as Crocs.

While companies in the 'B' rating category or lower have good liquidity, they remain vulnerable to significant volatility in operating performance, strong competition, and tough execution amid ongoing cost inflation. Many, still early in the process of recovery from pandemic-related shocks, will struggle to provide a customer experience that can compete with the reach, range, speed, and efficiency of larger players' well-developed global diversified supply chain capability. For these companies, supply chain and logistical challenges and persistent inflation, which we expect will continue through the first half of 2022, will result in margin pressure, slower deleveraging, and lower rating headroom.

## Key risks or opportunities around the baseline

### 1. Higher and more persistent inflation

In our base case, we expect many components of higher inflation to likely ease in the second half. However, we're watching closely for signals that suggest inflation will become entrenched because we believe this would threaten credit quality for many smaller consumer products companies with leveraged capital structures.

### 2. Increased digitization as the distribution channel shift gains pace

Branded consumer goods companies are investing in technology to accelerate growth in e-commerce and direct-to-consumer operations. Digitization, however, goes beyond that and is helping garner insights into consumer needs and contribute to efficiencies and innovation in products, supply chain, marketing, and distribution.

### 3. Tapering consumer spending

Higher prices, pandemic-related fatigue, and slowing economic growth could begin to drag consumer sentiment and shopping behavior especially as travel and leisure activities open.

# Related Research

- ESG Credit Indicator Report Card: Consumer Products, Dec. 17, 2021
- ESG Credit Indicator Report Card: Agribusiness, Commodity Foods, And Commodity Trading, Dec. 17, 2021
- European Retailers And Consumer Product Companies Will Show Resilience Against Rising Costs, Nov. 22, 2021
- A Food Industry Reset Can Cut At Least 10% Of Global Emissions, Nov. 17, 2021
- Tobacco Companies Need More Balance Sheet Flexibility As Persistent Regulatory Overhang Casts A Cloud, Oct. 5, 2021
- Some U.S. Consumer Products Companies Could Fail The Inflation Stress Test, Sept. 28, 2021

# Industry forecasts

## Global Consumer Products

Chart 10

### Revenue growth (local currency)

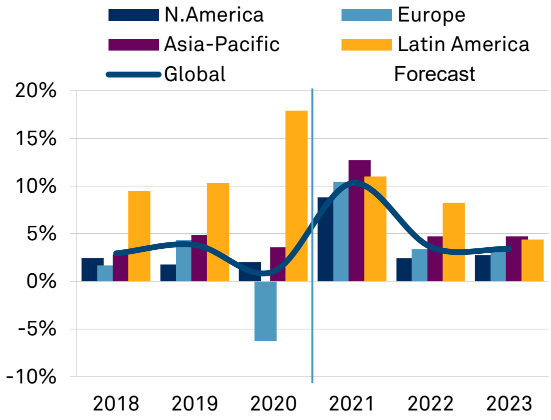



Chart 11

### EBITDA margin (adjusted)

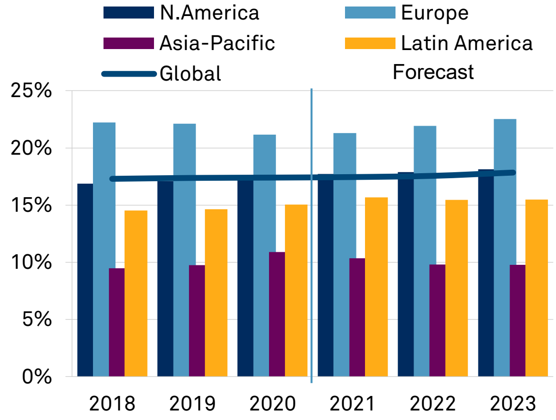



Chart 12

### Debt / EBITDA (median, adjusted)

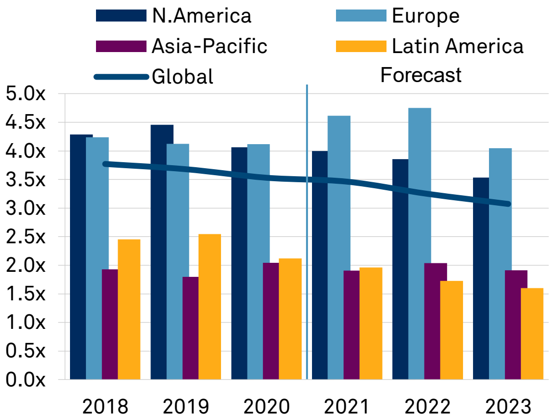
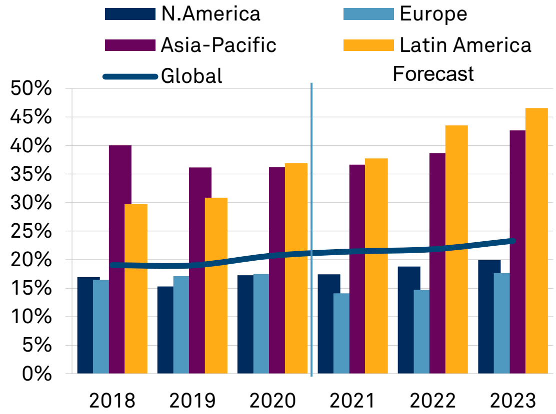



Chart 13

### FFO / Debt (median, adjusted)




Source: S&P Global Ratings. Revenue growth shows local currency growth weighted by prior-year common-currency revenue-share. All other figures are converted into U.S. Dollars using historic exchange rates. Forecasts are converted at the last financial year-end spot rate. FFO—Funds from operations.

# Cash, debt, and returns

## Global Consumer Products

Chart 14

### Cash flow and primary uses

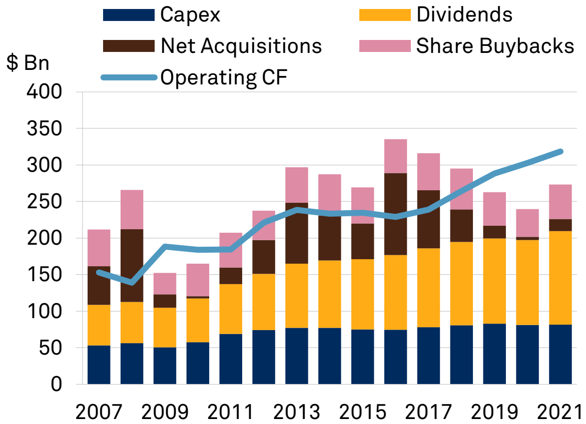



Chart 15

### Return on capital employed

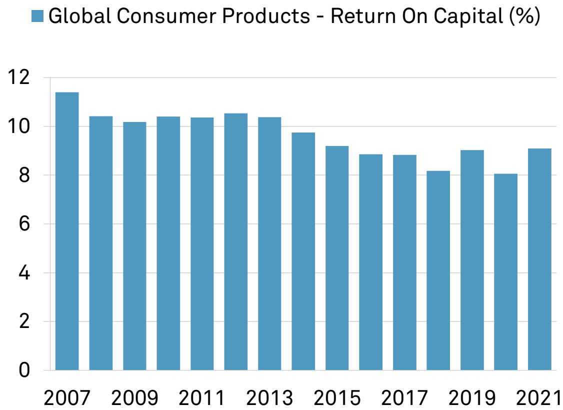



Chart 16

### Fixed versus variable rate exposure

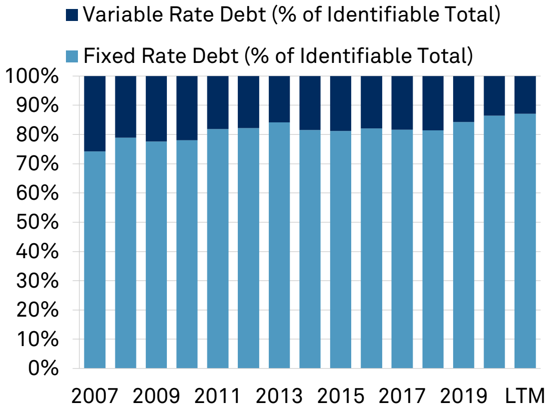



Chart 17

### Long term debt term structure

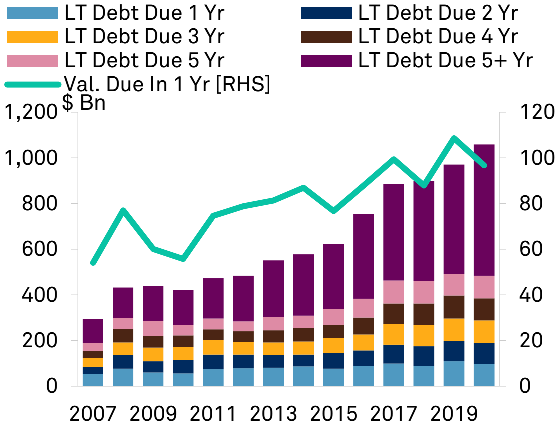



Chart 18

### Cash and equivalents / Total assets

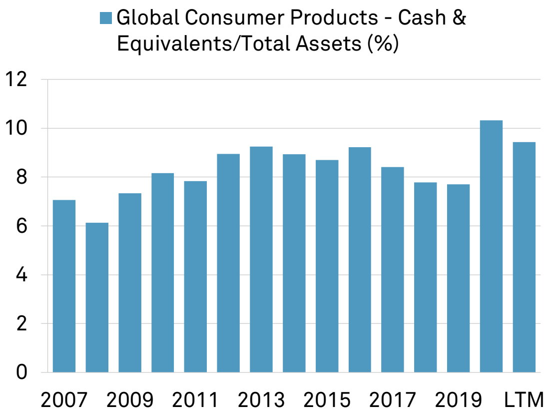
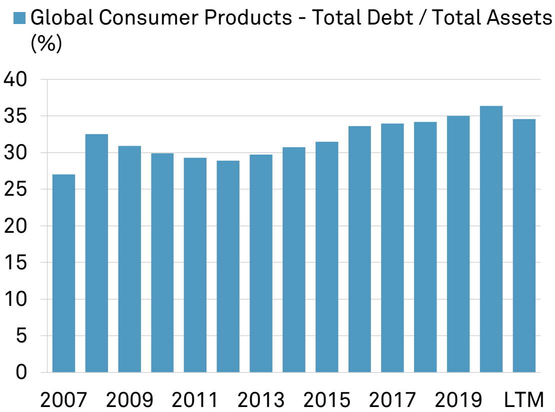



Chart 19

### Total debt / Total assets




Source: S&P Global Market Intelligence, S&P Global Ratings calculations. Most recent (2021) figures are using last twelve months (LTM) data.

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