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# GREENWOOD REPORT

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## CAGNY 2010

The Consumer Analyst Group of New York (CAGNY) meets every February and invites executive management, typically the CEO and CFO, of twenty-eight consumer product companies to present their firm to buy-side and sell-side investment analysts. Attending our tenth annual meeting last week, we were encouraged by what we heard. The success story began eight to ten years ago when the tech bubble burst, the 9-11 attacks occurred, and the recession of 2001-2002 caused consumer demand to falter. The consumer product companies set in motion a strategy that is paying dividends today.

**2001:** Management told CAGNY attendees that they were cutting costs by focusing on their billion dollar brands. Other less important brands were sold, eliminated and/or consolidated to *build* their core brands.

**2002:** The following year, management reported that they were *extending* their core brands. This allowed them to target consumers of their discontinued brands while maximizing the efficiency of marketing dollars focused on core brands. Because there is a direct relationship between advertising spend and sales growth, and because price increases are difficult in periods of recession, management chose to pursue unit volume growth of the core brands to maintain revenue.

**2003 - 2006:** The economy continued to wane and expectations lacked certainty; management of many CAGNY firms moved even further to drive out costs and increase productivity. From 2003 to 2006, they announced strategies that included implementing SAP enterprise-management software to reduce costs and manage cash flow, improving supply chain logistics, reducing working capital, and reducing the number of SKUs. Management committed to reorganizing, reinventing, redesigning, revitalizing and reworking their entire organizations, *but warned that initially it would incur costs and require time*. Savings could be expected in three to five years.

Each year management reported on their progress of SAP implementation (a very expensive and sophisticated technology), where they were reducing plants, brands and SKUs and how their supply chain innovations were providing product delivery efficiencies. These were difficult times for consumer product companies because they lacked pricing power at a time when costs were increasing to implement the program. Nonetheless, management continued to forecast future cost savings that could be used for innovation.

**2007 - 2008:** Consumer product companies finally were able to take price increases and cover some of their strategy implementation costs. Then the credit crisis hit in September 2008 and the recession of 2009 occurred. Business struggled as demand shrank, sales were flat to down, and they had to provide special cash contributions to meet underfunded pension liabilities. At CAGNY 2009, in the midst of the recession, management comments were forward looking as they focused on emerging markets, touted green initiatives, reported inventory reductions and looked to mitigate private label competition for the consumer dollar with brand strengthening.

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**CAGNY 2010:** A pivotal year. Those companies that had progressed on their cost reduction strategies were reporting cost savings. Even though sales were flat or down due to the recession, profits were good and margins widened because the long awaited cost savings arrived and price increases continued to stick. The savings were substantial and improved cash flow. Managements reported an ability to fund pension liabilities, meet commodity cost inflation, maintain or raise dividends, continue share repurchase programs and fund increased marketing spend and innovation. The critical importance of enterprise management software to the overall success prompted one presenter to call SAP the “Rosetta stone.”

The increased marketing spend is allowing companies to explore alternative advertising channels, especially digital and/or social media, e.g. Face Book, Twitter, blogs, etc. Instead of being 10% of the media budget, digital is now around 30%. One company reported a low budget You Tube video that had gone “viral” with most viewers not realizing that it was a commercial. Because the digital media has more affinity to the Millennials or the Echo Boomers (children of the Baby Boomers), companies are using a portion of their increased ad spend to research how to reach this 78 million demographic group. Innovation in new packaging was also widespread and is expected to meet these changing demographics. Technology is enabling media marketers to measure increased utilization and research consumer insights. We can expect to see much more attention given to this demographic wave and alternative advertising channels.

**Going Forward:** Increased advertising and marketing spend is expected to be a win-win. Not only has the recession decreased media costs, but the increased cash flow is enabling even more spending at better prices. The direct result should be unit volume growth (increased sales). If companies can produce unit volume growth and keep their increased margin spread, profitability could be very good.

**Other Topics:** Innovations in product size, supply chain delivery, and alternative marketing channels will benefit those companies seeking to penetrate the expanding *Emerging Market middle class* (families with \$5,000+ annual income). “*Fewer, Bigger, Better*” brand offerings are seen as essential competitors to private label brands, providing a full range from “value” to “super premium” product offerings. Moreover, the margins on new products can be controlled to be accretive to overall profitability. *Sustainability* is no longer just green, but is an evolving concept that emphasizes the durability of three areas: Human (providing healthy foods), Talent (utilizing diversity in employees and skills) and Environmental (supporting the green initiatives).

**An Observation:** The investment community expressed disappointment with consumer product companies when sales were flat this earnings season, even though profits were good. Focused on the short-term, analysts tend to have a 6 to 12 month time horizon and are interested in the *fast money, mad money or hot money*. They have missed the success story. Corporations invest for the long-term and results require time. Only when the investor understands this relationship do they benefit from aligning their best interest with those of corporations. Greenwood & Associates believes long-term investment strategies align investors with the sustainable and dependable strategies of successful corporations.

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