



Stock story: Nestlé

Innovation that enhances everyday brands is strengthening the Swiss giant's moat.

Vrimp, the vegan alternative to shrimp, is made from peas, seaweed and konjac root, a vegetable found in Asia. The vEGGie, a vegan egg, is a mixture of soy protein and omega-3 fatty acids. Wunda is a pea-based alternative milk. Offered too are the Vuna, a vegan tuna alternative, and vegan burgers, while an experiment is underway to make vegan chicken that comes with fake skin and bones. These products add to the plant-based dairy alternatives for chocolate, coffee, creamers, ice cream and malt beverages. Such are newest offerings of the Swiss-based Nestlé, the world's biggest food and drinks maker, as it responds to the latest twist in consumer demand.

The innovation drive extends to the staples that bring in so much of Nestlé's revenue, which reached 87.1 billion Swiss francs in fiscal 2021, a jump of 7.5% on an organic basis from 2020 and the fastest pace in 13 years.

Coffee (26% of fiscal 2021 sales) has benefited from the launch of Starbucks at Home, a tie-up with Starbucks and Nespresso, and innovation in Nescafé instant coffee. Bean selection is now approached in much the same way as wine makers grade grapes and there's an organic option. Providing high-quality flavour at scale isn't easy. In 2021 Nestlé scientists discovered two novel plant varieties of the coffee tree that produces Robusta beans. The result is a jump in yields by up to 50% and lower carbon emissions; as a result, people can enjoy a super-premium barista blend in their soluble coffee. Every second of every day, the world enjoys another 5,500 cups of Nescafé, including the premium Nescafé Gold.

Innovation in pet care (18% of sales) has become personalised (animalised?) with science aiding the production of healthy high-end labels. In many parts of the world, even where production volumes achieve economies of scale, Fido can receive a personalised blend of dog food and supplements delivered to

the home with his name stamped on the front. For house pets so inclined, there's a pet food line where insects and plant protein from fava beans and millet are mixed with meat. Pet carers are considered too. Improved online ordering means people can buy pet food in bulk without the need to lug it home.

KitKat was revitalised by a marketing campaign in Japan in 2014 that exploited how the Japanese pronunciation of KitKat (kitto katto) resembles the phrase 'you will win' (kitto katsu). Owing to that success, KitKat now has stand-alone stores across the globe. These 'KitKat bars' offer almost countless flavours including a vegan option (KitKat V) and let people devise their own recipes – 'create your break'.

Such is the revamp of a company with a history stretching to 1866 since Mark Schneider became CEO in 2017. Key drivers of success under Schneider include a switch into healthier products such as plant-based foods and vitamins and supplements, and a focus on novel products with faster times to market for the latest offerings. Schneider has also reshaped the company's portfolio of assets by conducting some 85 divestments and acquisitions over the past five years.

Nestlé shares are trading around a record high set in November last year because investors recognise that an overhauled company with great brands is enjoying a virtuous cycle kicked off by digitalisation. The enhanced consumer insights improve innovation, which leads to the creation and successful launch of better products produced at economies of scale that bestow an unassailable competitive advantage on the company.

Nestlé has 31 'mega-brands' including Coffee mate, Haagen-Dazs ice cream, Maggi noodles, Milo, Nescafé, Nesquik, Nespresso, Purina pet care and San Pellegrino mineral water. Each has loyal consumers, which means these products command a premium price and superior access to supermarket shelves. Each generates global sales of more than one billion Swiss francs every year.

Nestlé, in all, boasts 2,000-plus brands that are sold in 186 countries, and many hold the No. 1 or No. 2 positions in their categories. The brands are split across seven segments. These are in order of fiscal 2021 sales: powdered & liquid beverages (28%), pet care (18%), nutrition & healthcare (15%), prepared dishes & cooking aids (14%), milk products & ice cream (12%), confectionery (9%) and water (5%).



Nestlé's great brands mean the company has steady cash flow and earnings streams no matter the state of the economy. As such, the stock has a 'defensive' appeal, which is why it's held up better than most during the market-wide share slide so far in 2022. Since Nestlé is well positioned to achieve its organic sales growth target of 4% to 6% in coming years, the stock is likely to generate superior returns for investors for a long while yet.

To be sure, Nestlé products face ferocious competition. Some products (confectionery) are struggling to boost sales. But the success of coffee and pet foods make up for these laggards. The health push exposes the food manufacturer to charges of hypocrisy because many of its goods are unhealthy and cannot easily be made wholesome. But the company is out to reduce that percentage with new product offerings, acquisitions of healthy brands and increased vitamin fortification in emerging markets. For all its global reach, Nestlé is overexposed to a downturn in the US, where it sources about 33% of its sales

and profits. The company has warned that higher costs for its agricultural ingredients, packaging, energy and shipping threaten margins. Russia's invasion of Ukraine has intensified that challenge, especially that wheat and energy prices are rising. However, as a third of sales come from premium products, and its economies-of-scale advantage keeps unit costs low, Nestlé is better placed than most of its peers to manage and pass on rising costs in time.

A business that has changed so much since two Americans established the Anglo-Swiss Condensed Milk Company 156 years ago (that eventually merged with a company Henri Nestlé founded to sell milk-based baby food one year later) is used to overcoming challenges. If Nestlé can make such a successful start even to going vegan (sales of 800 billion Swiss francs in fiscal 2021), what can't it do?

Sources: Company filings and website, Bloomberg News and Dunn & Bradstreet.

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