## Contents

**Executive Summary: Consumer Staples Industry** ................................................................. 1

**Industry Overview** .............................................................................................................. 1

  - Home and Personal Care Industry ................................................................................... 1
  - Food and Staples Retailing Industry ................................................................................. 2
  - Tobacco Industry .............................................................................................................. 2
  - Food and Beverage Industry ............................................................................................ 3

**Demand and Supply Analysis** .......................................................................................... 5

  - Home and Personal Care Industry ................................................................................... 5
    - Demand Analysis ........................................................................................................... 5
    - Supply Analysis .......................................................................................................... 6
  - Food and Staples Retailing Industry ................................................................................. 6
    - Demand Analysis ........................................................................................................... 6
    - Supply Analysis .......................................................................................................... 7
  - Tobacco Industry ............................................................................................................. 8
    - Demand Analysis ........................................................................................................... 8
  - Food and Beverage Industry ............................................................................................ 11
    - Demand Analysis ........................................................................................................... 11
    - Supply Analysis .......................................................................................................... 12

**Products Analysis** .......................................................................................................... 13

  - Home and Personal Care Industry ................................................................................... 13
    - Home Care Products ...................................................................................................... 13
    - Beauty and Personal Care Products .............................................................................. 13
  - Market Dynamics ........................................................................................................... 13
    - Barriers to Entry .......................................................................................................... 13
  - Shifting of Demand .......................................................................................................... 14
    - Convenient and Time-Saving Solutions ...................................................................... 14
    - Organic Products ........................................................................................................... 14
  - Food and Staples Retailing Industry ................................................................................. 15
    - Supermarkets ............................................................................................................... 15
    - Hypermarkets .............................................................................................................. 15
    - Convenience Stores ...................................................................................................... 15
  - Market Dynamics ........................................................................................................... 15
    - Barriers to Entry .......................................................................................................... 15
  - Shifting of Demand .......................................................................................................... 16
    - Halal Groceries ............................................................................................................. 16
    - Lacklustre performance from convenience stores ......................................................... 17
  - Tobacco Industry ............................................................................................................ 18
    - Tobacco Products ......................................................................................................... 18
  - Market Dynamics ........................................................................................................... 18
    - Barriers to Entry .......................................................................................................... 19
  - Food and Beverage Industry ............................................................................................ 21
    - Food Products ............................................................................................................. 21
    - Beverage Products ......................................................................................................... 21
  - Market Dynamics ........................................................................................................... 22
    - Barriers to Entry .......................................................................................................... 22
    - Shifting of Demand ...................................................................................................... 22

**Prevailing preference for natural products** ...................................................................... 22
Key Drivers:.................................................................................................................. 24
Home and Personal Care Industry:.................................................................................. 24
Overview............................................................................................................................ 24
Short Run Drivers: Social Media Influences...................................................................... 24
Short Run Drivers: Viral and Disease Concerns................................................................. 25
Long Run Drivers: Travel Retail Growth............................................................................ 26
Long Run Drivers: Increasing Consumer Awareness....................................................... 28
Long Run Drivers: Strengthening Asian Demand............................................................ 29
Food and Staples Retailing Industry.................................................................................. 30
Overview............................................................................................................................ 30
Short Run Drivers: Robust end demand for food............................................................... 30
Short Run Drivers: Exploring untapped frontiers............................................................. 30
Long Run Drivers: Rising middle class............................................................................ 30
Long Run Drivers: Urbanisation and increasing income/capita....................................... 31
Long Run Drivers: Change in lifestyle............................................................................. 31
Tobacco Industry.............................................................................................................. 32
Short Run Drivers: Increasing consumption in developing Asian economies.................. 32
Short Run Drivers: Stricter trade regulations................................................................. 32
Long Run Drivers: Resistant demand for tobacco products............................................ 32
Long Run Drivers: Low regulations in developing economies......................................... 32
Food and Beverage Industry............................................................................................ 33
Short Run Driver: Products’ Visual Appeal...................................................................... 33
Short Run Driver: Sustainability Efforts......................................................................... 34
Long Run Driver: The Online Revolution....................................................................... 35
Long Run Driver: Perpetuation of a Healthy Lifestyle.................................................... 36
Case Study – AmorePacific Corp ..................................................................................... 38
Company Description.................................................................................................... 38
Key Financials................................................................................................................ 38
Investment Thesis......................................................................................................... 38
Large Exposure to growing Travel Retail....................................................................... 38
Benefits from Growth Opportunities in Chinese Market.............................................. 39
Poised to capture growing demand for Natural Products.............................................. 39
Valuation....................................................................................................................... 41
Case Study – Dairy Farm................................................................................................. 42
Company Description.................................................................................................... 42
Key Financials................................................................................................................ 42
Investment Thesis......................................................................................................... 42
Growth Opportunities from the demand of higher end consumers............................... 42
Growing Economic Moat ............................................................................................... 43
Strengthening Operational Efficiency Regionally.......................................................... 43
Valuation....................................................................................................................... 44
References..................................................................................................................... 45
Executive Summary: Consumer Staples Industry

Industry Overview

The consumer staples industry encompasses various types of companies, ranging from food manufacturing to tobacco. These companies create products which consumers rely on for daily necessities and are therefore generally less sensitive to economic cycles and business cycles. This industry can be broken down into smaller sub-industries, namely Home and Personal Care, Tobacco, Food and Staples Retailing and Food and Beverages industries. The competition in these industries is usually intense, as companies have to compete and entice consumers to choose their brands over competitors’. As a result, product differentiation, good marketing and branding is imperative to a company’s success.

Home and Personal Care Industry

The home and personal care industry is a submarket of the consumer staples industry. Companies in this sub-industry produce household products (laundry detergent, cleaners, diapers) and personal care items (hair care, cosmetics, toothpaste). Finished products are usually distributed through third party wholesalers and examples of retail channels used to reach end consumers include drug and groceries stores, mass merchandisers, warehouse clubs and specialty retailers. This industry can also be further broken down specifically into the home care industry and the personal care and beauty industry. Big name companies such as Unilever, Proctor and Gamble, Kao Corporation and Shiseido Company are some of the industry’s key players. Over the first three quarters of 2016, the home and personal care industry in US and Asia have done well, outperforming the MSCI ACWI index. The beauty and personal care industry has a forecasted 5 year compounded annual growth rate (CAGR) of 4.5% and the home care industry has a forecasted 5 year CAGR of 3.9%.

Figure 1: Performance of home and personal care industry (Source: Bloomberg)
Food and Staples Retailing Industry

The food and staples retailing market is a submarket of the consumer staples industry. The food and staples retailing industry group is broken into four main sub-industries: drug retail, food distributors, food retail and modern grocery retailers. Drug retail includes pharmacies and any other stores that sell pharmaceutical drugs. Food distributors are companies that distribute or wholesale food to other companies but they do not sell directly to consumers and do not necessarily produce the food. Food retail includes speciality food stores or small markets. Modern grocery retailers are supermarkets, hypermarkets and convenience stores that sell a wide range of food and other staple items. In view of the growth potential and general long run trends of the economy, we will focus on the modern grocery retail segment of the food and staples retailing market.

Tobacco Industry

The Tobacco Industry comprises of corporations that grow, sell and distribute tobacco and related products globally. Consumer tastes are covered by the variety at difference prices. Prospects of growth are limited due to primarily health concerns which bring out legal and regulatory pressures on the relevant corporations. Governmental restrictions on marketing hampers pose a challenge to growth of the industry as well as make the barriers to entry tough for newer firms. The small set of consolidated companies have created an oligopoly and sales and earnings are fairly stable throughout the economic cycle.

To combat against tough operating environment, companies use industry realignment in the form of M&A to improve market position and help cope with competition from smaller counterparts.

Weak economic outlook and tightening regulations are pressing down on global tobacco volume consumption. The downwards trend has been constant for several years up till date. To counter this, developing Asian economies provide a safety net or even growth opportunities due to favourable consumer dynamics.
Sales get depressed due to lowered spending as a result of weakening key market outlook and consumer economic prospects. Large industry players such as British American Tobacco Plc (BAT) and Philip Morris International Inc (PMI) have reported declining volumes over the previous years and this trend is likely to continue over the next few years. On the other hand, Asia’s tobacco market will become more dynamic and will likely continue to present strong growth windows for manufacturers. Emerging Asia will increasingly become an attractive tobacco market on the back of favourable demographics; retail formalization and rising disposable incomes.

**Food and Beverage Industry**

The food and beverages market is a subsector under the Consumer Staples Industry, which includes other subsectors such as tobacco and household and personal items.

The food and beverages sector grew from $5,213 billion in 2010 to $6,318 billion in 2014 at a compound annual growth rate of 4.9%. The food and beverages market is fragmented. The top five competitors in the market made up 5.7% of the total market share in 2014. Nestle was the largest competitor with 1.4% of the market, followed by Archer Daniels Midland with 1.2% and Philip Morris with 1.2%. With the consumer lifestyle becoming busier, there has been an increasing demand for healthy ready-to-go meals, meal kits and other convenience food. Consumer packaged food manufacturers should introduce convenience food products that not only offer health benefits but that can also be prepared easily at home.
Specifically, the Asia Pacific food and beverage industry is expected to achieve a turnover of US$3.23 trillion in 2016. With a projected year-on-year growth of 11% in 2016, the industry will outpace Western Europe and North America, both of which will see relatively modest expansion rates of 2% and 4%, respectively.

**Figure 2:** Performance of APAC food manufacturing industry (Source: Bloomberg)

**Figure 3:** Performance of global beverage industry (Source: Bloomberg)
Demand and Supply Analysis

Home and Personal Care Industry

Demand Analysis

The home and personal care industry is a growing part of the larger consumer staples segment, with the beauty and personal care and the home care sub-industries seeing a 4 year CAGR of 4% and 4.7% respectively. Asia clearly leads the way in demand for skincare products, with Hong Kong and China, South Korea, Japan, Taiwan and Singapore having per capita spending of US$147, US$111.5, US$111.2, US$80.5 and US$74.2 respectively. While these Asian countries do not lead in other segments of the beauty and personal care industry such as hair care, oral care and fragrances, the per capita expenditure on skin care is the highest among all segments. For the home care industry, the highest per capita expenditures come from European countries, but the expenditure amount is much lower as compared to that in the beauty and personal care industry.

These consumer staples tend to have a low price elasticity of demand, which means that the demand for such goods change to only a small extent with changes in price. While there are no substitutes for home and beauty care products, there are a plethora of options that consumers can choose from between producers, who then have to differentiate their products based on appearance, features, smell and results. Because of the everyday nature of home care products and the fixed beauty regimes of personal care product users, the home and personal care industry is relatively stable, and demand does not fluctuate to a great extent. Even with slowing growth in most Asian countries like China, Japan and Singapore, we expect to see continued stable growth in the home and personal care industry.

Figure 4: Share of global beauty and personal care market (Source: Bloomberg)
Supply Analysis

Consumers are spoilt for choice when it comes to the supply of home and personal care products. Within this industry, there are a myriad of brands to choose from, each with a differentiated and unique selling point to meet specific needs of various consumers. However, many popular brands are owned by a few large global players, such as Unilever, Proctor and Gamble, Colgate-Palmolive, Kao Corp, Lion Corp, Shiseido and even LVMH. When broken down into individual components such as hair care, skin care, fragrances, laundry care and dishwashing, the top 10 firms for each component have market shares of between 43% to 73%. The reason why these companies can retain relatively large market share with their brands is due to strong research and development (R&D) efforts, good understanding of consumer needs, desires and trends and strong ties with chemical suppliers who satisfy the demand for ingredients that go into home and personal care products. Furthermore, the industry faces regulation from authorities such as the US Food and Drug Administration (FDA) and the ASEAN Cosmetic Directive (ACD), an ASEAN-wide initiative that seeks to harmonize standards and requirements for cosmetic products across ASEAN in line with international guidelines. The experience and economies of scale enjoyed by key players allow them to launch new products and brands that meet government requirements with greater ease, allowing them to be at the forefront of meeting the constantly changing consumer trends.

Food and Staples Retailing Industry

Demand Analysis

The food and staples retailing industry is a submarket under the consumer staples industry, which includes other submarkets such as food & beverages, tobacco, and household and personal items. Driven by urbanisation, rising disposable incomes and higher living
expectations especially in the developing countries, the global annual demand of food and staples retailers are expected to surge despite sluggish global economic growth.

In ASEAN, we are optimistic with continued urbanisation and the rising middle class that demands a higher standard of living, modern grocery retail will grow faster than traditional grocery retail channels. Modern grocery retail in 5 key ASEAN nations today is worth an estimated of US$60bn with an overall market penetration rate of 15%.

Also, higher education and literacy rates will support the new generation’s appetite for higher quality products and a more organised/conducive shopping environment. The middle-class population in ASEAN is forecasted to grow at a 9.8% CAGR compared to the rest of population’s 8.7% from 2012 to 2020. Average urbanisation rate from 2010-2015 of ASEAN 5 countries is 2.3%, outstripping the long-term population growth rate of 1.5%. Therefore, we believe that developing nations will be the main driver of future growth in the industry.

Lastly, due to a hectic work schedule and numerous commitments, consumers value convenience and prefer modern grocery retailers as they can purchase what they need in a clean, comfortable, and air-conditioned environment.

**Supply Analysis**

The supply of the modern grocery retail outlets is concentrated in the number of companies in their respective countries. For instance, Walmart is the market leader in USA while Tesco is the market leader in the United Kingdom. Closer to home, in Singapore, NTUC Fairprice dominates the supermarkets category with 50.2% market share, Giant dominates the hypermarkets segment with 55.5% market share and 7-11 leads the market for the convenience store segment with 75.7% market share.

Evidently, the oligopoly market structure is present in most of the countries for the modern grocery retail industry and there are a few factors that resulted in this. Firstly, the cost of renting large amounts of space and the purchase of equipment are very capital consuming. It is unlikely that a small firm will have the amount of human and financial capital to expand and dominate the market. Therefore, the major firms, usually conglomerates can sustain a sizeable portion of the market share.

Also, as large chains, such as Walmart and NTUC Fairprice continue to grow, they can leverage on fixed infrastructure costs and their significant scale, allowing for efficiencies within its private label manufacturing, distribution network, and ability to offer more competitive pricing given its purchasing power with suppliers. This ensures it will usually get a better price from the suppliers as they buy in larger quantities and suppliers cannot afford to lose their patronage. This reduces their variable cost which translates into lower prices for consumers. Coupled with their widespread geographic reach in the country with their large number of stores, these advantages mean that can they spend less on advertisement and marketing and still achieve top of mind awareness amongst the consumers.
Tobacco Industry

Demand Analysis

The United States, Europe and China account for 68.7% of global tobacco spending. Estimates by BMI research put developed states real GDP growth at 1.5% on aggregate in 2016, a substantial decline from 1.9% in 2015, fuelled by weak growth outlook in the core tobacco market weighing in on sales. Scepticism in Europe’s political events adds uncertainty on the euro’s future which makes Europe long-term growth outlook appear bleak. According to the recent forecast released at the FOMC meeting on December 14, 2016, not taking into account the impact of Trump’s possible policies, the US GDP growth will rise to 2.1 percent in 2017. This is better than 1.9 percent estimated for 2016 and the same as 2015’s growth rate of 2.1 percent.

Over the longer term outlook, there has been a ramp up in tightening regulation in Europe, the US and China over the past year. For example, the EU Tobacco Products Directive that came into force May 2016, while last year Beijing banned smoking in public places and is considering ramping up regulation on packaging. China accounts for 68.6% of the Asia-Pacific tobacco market value. China’s real GDP growth will slow over the coming years as structural weaknesses remain, we forecast real GDP growth to slow to 6.3% in 2016 and 5.9% in 2017. These developments, combined with our weaker macro and consumer spending outlook, poses significant long-term risks for tobacco companies in their major markets.
Emerging Asia will increasingly become an attractive tobacco market on the back of favourable demographics; retail formalization and rising disposable incomes. The percentage of global tobacco spending in Asia is forecasted to grow from 41.9% in 2016 to 44.5% in 2020. Strong growth opportunities exist in Asia's developing economies, which boast of a large young adult (20-39 years) consumer group which will boost staple spending.
Indonesia tobacco market is well-positioned to outperform due to its impressive growth trajectory on the back of favourable demographics and on the back of rising household incomes in lower income brackets. Indonesia has the biggest tobacco market after China in the Asia region and it is believed that there are still opportunities. The WHO forecast that the prevalence of smoking among people aged 15 years and above to rise from 35.7% in 2010 to 44.9% in 2025, which is indicative of a growing consumer base. Tobacco spending is forecasted to grow at a five year compounded annual growth rate of 10.7%, growing from USD23.6bn in 2016 to USD36bn in 2020.

Favourable demographics in Indonesia is distinguished by a growing workforce and falling dependency ratio, which implies that the percentage of population aged 0-15 and above 65 is falling. This translates into favourable consumer dynamics, especially for a consumer staple market such as tobacco.

Consumption pattern changes as well as they are bound to stray away from “kretek” cigarettes (cigarettes made with a blend of tobacco, cloves and other flavours) and consume more “white” cigarettes. Increasing household incomes of the lower income brackets also spurs more consumption of higher value mainstream tobacco products, which tend to be predominantly western. According to BMI Research, The USD5,000-USD15,000 income bracket will experience sizeable gains over the forecasted period below. They forecast that the number of households within this bracket will grow from 61.2mn in 2015 to 116.5mn in 2020. They note that the income gains will be largely concentrated in the USD5,000 to USD10,000 bracket.
Food and Beverage Industry

Demand Analysis

The food and beverage industry in APAC specifically is likely to exceed global gains by 2020, according to Euromonitor, as diets in emerging markets converge with those in developed nations.

Globally, we can expect the food market to bring in revenue by 2020 of $3.03 trillion, with a CAGR of 4.5 percent from 2015 to 2020. While the APAC region remains behind North America as the largest market in the industry, the diets of the citizens in APAC’s emerging markets are starting to converge with those in developed nations in the coming years; APAC ranks as having the fastest CAGR of 5.4 percent from 2015 to 2020. The APAC food industry continues to boom in the halal food sector specifically, as Asia hosts 1 billion of the world’s 1.6 billion Muslims, accounting for 62% of the world’s Muslim population. Countries such as Indonesia will likely serve as the engine driving most halal food demand growth in the coming years, next to the Middle East.

![Figure 6: World’s Largest Halal Markets (Source: Bloomberg)](image)

Isolating the beverage industry, it is expected to recover from its current underperformance from November 2016 as compared to the MSCI World Index. The beer market specifically is expected to garner $688.4 billion by 2020, registering a CAGR of 6% during the forecast period 2015-2020. Besides this, the industry is likely to register a CAGR of 6% during the 5-year forecast period from 2015. A significant increase in the consumption volume is believed to fuel the market growth across developing regions, such as those in the APAC region.
Supply Analysis

The food & beverage industry has a unique role in expanding economic opportunity because it is universal to human life and health. These consumer staples, while necessary, also boast a large range of differing food and beverages for the general population, and will continue to do so – propelled by the increasing disposable income. The food & beverage sector is changing its consumption pattern. The emergence of developing nations coupled with their population growth as well as increasing government regulations are impacting food manufacturing companies and their business strategies. The superior economic growth of APAC countries such as China and India gives billions of people the ability to choose wide variety of foods and creating a new market with many products.

The top companies heading the industry remain in the North America territory, led by household names such as Coca-Cola, PepsiCo, Mondalez International and Nestle. These companies have a market share of close to 10% in each of its respective industries. While the figure may seem small, in the food and beverage industry, where competition and variety is abundant, 10% is a relatively large figure. However, to analyse the future growth of the food and beverage industry, we should also take into account the companies that have had the largest growth in stock prices: winemaker Andrew Peller Ltd and APAC’s Nippon Suisan reflect the consumer’s changing mind set on trading up to premium products as well as reflecting investor optimism for growth in future earnings.

The growth of the food and beverage sector as a whole can also be attributed to the recent bout of mergers and acquisitions, especially in the beverages industry. In November 2016, the global beverages peer group's EV-to-forward-Ebitda multiple was 11x as of Nov. 30, 12% higher than the MSCI World Index – reflective of recent M&A activity that reached 256 in 2016, the second highest in five years.
Products Analysis

Home and Personal Care Industry

Home Care Products

Home care products can be broken down into the following categories: Laundry care, Insecticides, Surface care, Dishwashing, Air care, Toilet care, Polishes and Bleach. Of these categories, laundry care and surface care have seen the highest 4 year CAGR of 5.4% and 5.9% respectively. Looking ahead, toilet care products are expected to perform the best, with a forward 5 year CAGR of 6.1%, with surface care products following behind at 5.3%. These products are household necessities which consumers rely on for maintenance purposes. The products tend to contain harsh chemicals for effective cleaning of dirty surfaces and objects.

Beauty and Personal Care Products

Beauty and personal care products can be broken down into the following categories: Skin care, Hair care, Colour cosmetics, Oral care, Bath and shower, Men’s grooming, Fragrances, Baby care, Sun care, Deodorants and Depilatories. Of these categories, Baby care and Depilatories have enjoyed the highest 4 year CAGR of 9% and 7% respectively. Looking ahead, baby care products are expected to perform the best with a forward 5 year CAGR of 12.3%, with deodorants following behind at 9.6%. Beauty and personal care products tend to be indispensable once a consumer has a habitual beauty or personal care regime. These habits and rituals vary based on geographical locations with Asian consumers spending more on such products.

Market Dynamics

Barriers to Entry

Artificial barriers to entry such as government regulations are not very high, especially in Asia Pacific as many countries consider these products as lower risk than health products. Most regulations are centred around monitoring, sampling, labelling and declaration of products and ingredients used. For instance, in Singapore, the Health Sciences Authority (HAS) strictly disallows the use of prohibited and risky substances and requires companies to report all serious adverse events related to the use of products. In the US and EU, laws require manufacturers to ensure product safety prior to taking marketing actions, and independent safety review of ingredients are conducted but home and personal care products do not require FDA approval before being sold on the market.

Production of home and personal care products require chemical knowledge and expertise, which large firms have readily. Smaller firms and potential new entrants will find it difficult to gain the required capabilities to produce quality products that can compete with the brands owned by big name companies. Furthermore, big firms experience economies of scale and have strong R&D capabilities that help deter and drive out competition.
However, competition within these firms and their brands are intense, resulting in a need to differentiate brands and products with unique qualities and selling points.

**Shifting of Demand**

**Convenient and Time-Saving Solutions**

A key trend in the consumer staple industry and more specifically, the home and personal care industry is the demand for convenience. Consumers are increasingly favouring products and retail channels that require low learning and minimal effort. A good indicator would be subscription box services. A good example will be the Dollar Shave Club - a company recently acquired by Unilever – which delivers razors and male grooming products to customers on a subscription basis at affordable prices. The billion-dollar acquisition by FMCG giant Unilever clearly shows the recognition of key industry players of such a trend and indicates actions to better embrace it.

**Organic Products**

Another prominent trend is the greater amount of attention that consumers are now paying regarding ingredients in their home and personal care products. Higher standards of living, rising disposable income, stronger environmental concerns and greater awareness of potential side effects of chemical products is changing consumer perception towards organic products. Thus, there is a growing utilization of environmentally friendly and naturally derived products. This trend is especially prominent in the beauty and personal care industry, where demand is expected to grow at a CAGR of over 10% from 2016 to 2025 and the global organic personal care market is expected to reach a high of USD 25.11 billion by 2025. Currently, North America is the largest single market for the organic personal care industry, with a value of over USD 3.5 billion. However, there is an increasing use of cosmetic products in Asian countries like India and China and coupled with greater awareness of harmful side effects associated with harsh chemical ingredients, these Asian countries can potentially surpass the American market by 2025.

![Figure 8: US organic personal care market revenue 2014 – 2025 (Source: Grand View Research)](image-url)
Food and Staples Retailing Industry

Supermarkets

Supermarkets are commonly found in higher-density areas. Supermarkets retail fresh and packaged food items and have retail space larger than convenience stores but smaller than hypermarkets. Supermarkets position themselves across various consumer segments. Mass market supermarkets include Sheng Siong, NTUC Fairprice, while upscale supermarkets include Cold Storage and Marketplace. Supermarkets are well penetrated in shopping malls of high density areas such as city centres.

Hypermarkets

Hypermarkets provide greater product variety, bigger shopping area and a more wholesome shopping experience. As an extension of supermarkets, hypermarkets carry a wider variety of products which include furniture, electrical and electronic products etc. Hypermarkets are more common in areas with lower population densities, where there is ample space. In high population density areas, such as Singapore, supermarkets are more prevalent than hypermarkets. In Singapore, retailers such as “NTUC Fairprice Extra” offer a hybrid shopping experience between a supermarket and a scaled down hypermarket. NTUC Extra is found in shopping malls, but carry a slightly wider range of products than supermarket variant of NTUC Fairprice.

Convenience Stores

Convenience stores offer more essential items and have a relatively narrower range of products compared to supermarkets and hypermarkets. Key products include ready-to-eat and fresh food, packaged beverage, and personal/essential items. Many convenience stores operate 24 hours to capture “after hours” and “to go” demand. As convenience stores operate around the clock, prices of products are normally higher than supermarkets and hypermarkets to compensate for availability. In ASEAN, 7-eleven is the largest convenience store brand with over 10,000 outlets.

Market Dynamics

Barriers to Entry

Even though new grocery retailers such as Redmart have tried to use online retailing in Singapore to gain market share, they have yet to pose a real threat to physical grocery as majority of shoppers still prefer to purchase their groceries from physical stores. Moreover, grocery retailers such as supermarkets and hypermarkets are highly accessible and cater to consumers of all income levels and lifestyle, thus most consumers do not have the motivation to switch to online shopping as online shopping might be pricier than shopping in physical stores due to the delivery charges. Lastly, consumers prefer to purchase fresher produce select from physical stores what they can pick and choose what to eat, drink, consume.
Although Redmart was not successful in gaining substantial market share, it has reflected the potential of using online sales to reach consumers who work overtime or irregular hours. In recent years, leading supermarket chain retailers actively tried to develop their online channels. For instance, in 2014, market leader NTUC FairPrice introduced a click-and-collect service using its competitive advantage of having a strong physical network. It also revamped its mobile app to make online grocery shopping even more convenient for its customers. Its closest competitor, Dairy Farm, has kept up by creating an online platform for Guardian, Cold Storage, Wellcome and its other major brands.

### Shifting of Demand

#### Halal Groceries

The demand for halal groceries is increasing with supermarket and hypermarket chains such as FairPrice, Giant, and Cold Storage have halal-certified sections that cater to Muslim consumers. Singapore’s Halal industry is on the rise with the number of premises increasing to 5,000 in 2015. Singapore is one of the countries in the world with a Muslim population with the highest purchasing power. Thus, Singapore has a high potential market for Halal food, after Malaysia and Indonesia in the region. In the past, the consumption of Halal groceries was focused in regions that had a predominant Muslim population. However, this has significantly changed in recent years as Halal groceries has become the new benchmark as a safe and hygienic form of food.

**Figure 9**: Reasons for consumers switching
Lacklustre performance from convenience stores

<table>
<thead>
<tr>
<th>Table 13 Forecast Sales in Grocery Retailers by Channel: % Value Growth 2015-2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>% constant value growth, retail value rsp excl sales tax</td>
</tr>
<tr>
<td>Modern Grocery Retailers</td>
</tr>
<tr>
<td>- Convenience Stores</td>
</tr>
<tr>
<td>- Discounters</td>
</tr>
<tr>
<td>- Forecourt Retailers</td>
</tr>
<tr>
<td>-- Chained Forecourts</td>
</tr>
<tr>
<td>-- Independent Forecourts</td>
</tr>
<tr>
<td>- Hypermarkets</td>
</tr>
<tr>
<td>- Supermarkets</td>
</tr>
<tr>
<td>Traditional Grocery Retailers</td>
</tr>
<tr>
<td>- Food/Drink/Tobacco Specialists</td>
</tr>
<tr>
<td>- Independent Small Grocers</td>
</tr>
<tr>
<td>- Other Grocery Retailers</td>
</tr>
<tr>
<td>Grocery Retailers</td>
</tr>
</tbody>
</table>

Source: Euromonitor International from trade associations, trade press, company research, trade interviews, trade sources.
Note: Forecast value data in constant term.

Figure 10: Growth forecasts of the grocery retailers in Singapore.

However, as the larger supermarkets and hypermarkets are witnessing strong growth, smaller stores such as convenience stores are not performing to expectations, reporting a decline in sales of convenience store staples such as tobacco. A major reason for this is due to the proximity of supermarkets and convenience stores in Singapore, consumers tend to frequent the supermarkets as it is cheaper. This led to overall sluggish demand for smaller stores.
Tobacco Industry

Tobacco Products

The tobacco market consists of the retail sale of cigarettes, cigars and cigarillos, smokeless tobacco, and smoking tobacco.

Volume data is measured in millions of pieces and includes only cigarettes, cigars and cigarillos. Market shares and distribution channel data is also measured in volume terms and includes only cigarettes, cigars and cigarillos.

Asia-Pacific comprises Australia, China, Hong Kong, India, Indonesia, Japan, Malaysia, New Zealand, Philippines, Singapore, South Korea and Thailand.

Market Dynamics

The Asia-Pacific market had seen moderate growth overall in the recent years, although this differs from country to country. This trend in the Asia-Pacific market is forecasted to continue till 2020.

With CAGR of 2.5% between 2011 to 2015, the APAC tobacco market had total revenues of $310,498.2m in 2015. This differs based on countries as the Chinese market increased with a CAGR of 2.8% but the Japanese market decreased with a CARC of -2.3% over the same period.

The Chinese tobacco market is the biggest in the world and accounts for 68.6% of the APAC tobacco market value. It is controlled by the State Tobacco Monopoly Administration (STMA) which operates through the Chinese National Tobacco Corporation (CNTC). Market consumption volume increased with a CAGR of 1.2% between 2011 and 2015 and it is bound to increase with a CAGR of 1.1% for the 2015-2020 period.
In Indonesia, the 2nd largest tobacco market in the APAC region, domestic producers have a strong foothold as the local specialties are present. *Kretek* account for over 90% of the market and rising tax imposed on western cigarettes is aiding this segment.

The performance of the market is forecast to accelerate, with an anticipated CAGR of 3.8% for the five-year period 2015-2020, which is expected to drive the market to a value of $374,246.6m by the end of 2020.

**Barriers to Entry**

Top four players account for less than 21% in a highly fragmented market. Degree of rivalry is high due to competitors being major multinationals and large state-owned Chinese powerhouses. Cigarettes account for more than 99% of the market and the degree of product differentiation is low other than for the factor of branded packaging. A seemingly real threat would be that posed by illicit tobacco sales. According to the World Health Organization (WHO), the illicit market accounts for one in ten cigarettes consumed globally, with this lost market share increasing rivalry across the industry. Recently, sales of legal cigarettes have been over-shadowed by sales of illicit cigarettes. These were believed to account for a reduced 20.2% of total consumption in 2013 compared with 29.2% in 2008. Overall rivalry within the industry is moderate.
Electronic cigarettes (E-Cigs) are becoming a global threat as although they might be prohibited in some countries, they are widely sold and are becoming alternatives to main tobacco products to some extent. Major manufacturers have become involved in the market acquiring brands like Blu (Imperial Tobacco) and Vype (British American Tobacco), ensuring that they limit the damage from smokers switching.

For most countries, restrictions on tobacco advertising also play a crucial part in making it difficult for any new entrant to compete effectively in a competitive market. For example, the restriction on advertising and promoting new cigarettes is strict in China as it is prohibited through most major media since the 1990s. Although it is subjected to provincial laws, it would still make it difficult for new brands to establish themselves. This is also the case for the Japanese tobacco sector. Since brand strength is key for this market, the threats of new entrants is relatively weak.
Food and Beverage Industry

Food Products

The food industry chain begins from the harvesting of raw food materials to the processing of these foods into packaged products for distributors such as supermarkets and restaurants. As a whole, the APAC region will continue to see growth, more so than other regions in the world, due to an increasing per capita income, growing levels of education and westernization that are the key factors driving the growth of the food industry. While the economic outlook for APAC countries differ with respect to each country’s level of development, it is clear that regardless of the economic outlook in APAC, the food industry is robust enough to hold steady against future uncertainties. In saying so, the food industry is also unlikely to experience a period of extraordinary growth due to the lack of strong growth drivers and global uncertainty in the coming Trump era for the coming year. According to Euromonitor, he strongest ingredient markets in the APAC region are forecast to be India, Indonesia, Pakistan and Vietnam, all of which will increase at a faster CAGR than China – although China will lead the way in absolute volume growth.

Beverage Products

The beverage industry consists of the categories as seen in the breakdown of Figure xx. Globally, the industry will see growth in large part due to a rising preference for premium products, especially in the APAC region as citizens become more brand conscious. The rising US Dollar is likely to negatively affect sales and profit performance of US companies exposed to international markets, while the converse will occur for APAC’s beverage industry, as the APAC region is becoming an increasingly influential market in the supply of beverage ingredients.

![Figure 11: Breakdown of Beverage Industry (Source: Beverage Marketing Corporation)]
Market Dynamics

Barriers to Entry

Regulation is the main barrier to entry for the food and beverage industry. This is especially so for the emerging markets in the APAC region as the regulation tighten in accordance to the growth of the region. China recently shed light on yet another food scandal as China’s Food and Drugs Administration busts a “production hub” churning out counterfeit seasoning. The International Tax Stamp Association (ISTA) believes that the “tax stamp market will continue to grow over the next 12 months, particularly in emerging economies that lose staggering amounts to the black market and organised smuggling activities.” Generally, the food and beverage industry is dominated by market leaders with an established brand presence that discourages potential entrants, coupled with tightening regulations in the industry.

Shifting of Demand

Prevailing preference for natural products

As the industry continues to emphasize health and promoting fitness for all economic classes, an emphasis has developed for natural products as compared to products that are considered “healthy” alone. Functional beverages are losing popularity, as “high protein” and “vitamin-and mineral-fortified” drinks are bulldozed by an increasing demand for low and no-calorie beverages. The Coca-Cola HBC analysis reports a significant growth in the market for still drinks such as water and juice. Overall, the Beverage Industry reports data that suggests that beverage companies are moving towards natural and organic ingredients to incorporate fresher products and cleaner labels. Consumer demands for natural and “less processed” products in both the food and beverage industries are forcing companies to remove artificial ingredients or suffer consumer scrutiny and loss of market share in the competitive economy. Research by Beneo Asia Pacific suggests that 94% of Indonesians and 91% of Thai respondents consider natural products as better, while 74% of Indonesians and 81% of Thai respondents actively look for natural products when making food purchase decisions.

Higher quality products for a lower price

While the APAC region is slowly catching up to its Western counterparts in terms of economic growth, consumers in the region, especially those in emerging markets such as India, still do not have the purchasing power to afford grossly expensive food and beverage items for their continual use. This has led to a shift in demand of higher quality products for a lower price, to meet consumer demands. While the APAC region is the largest market for food retail, it is still a growing region with ever increasing per capita income, growing levels of education as well as smaller families and increasing urbanization to speed the process. The trend of “cheap chic” can be seen even in the wine industry, which is a premium beverage. Time reported that ‘During the economic downturn, many grocery shoppers started buying cheaper store brands over national brands in order to knock 30%
off their food bills. What they often discovered is that the cheaper generic products’ taste, if not “premium,” was at least as good as the pricier counterparts with big-name brand recognition.’ Thus, consumers have shifted their preferences to quality over price, and dissociating higher prices with higher quality as well.
Key Drivers

Home and Personal Care Industry

Overview

The home and personal care industry will largely be propelled by greater demand for beauty and personal care products. The home care industry is mature and demand is relatively stable and constant, and it is largely unaffected by economic conditions in both the short and long run. On the other hand, there are short and long run demand drivers for the beauty and personal care industry. In the short run, social media, coupled with the “selfie” craze and viral or disease concerns will drive the industry. In the long run, the industry will likely be driven by travel retail, increased consumer awareness and Asia’s demand for skin care products.

Short Run Drivers: Social Media Influences

The constant growth of social media usage especially among millennials has put individual looks and features into the spotlight. This trend is also marked by a surge in online blogs and video tutorials about beauty regimes and make up tutorials. There is an increasing weight placed on looking good on digital fronts and this results in a strong momentum in demand for colour cosmetics, skin care and hair care products. According to Mintel research, as many as 90% of girls and 69% of boys aged 9 to 17 in America use beauty and personal care products such as hair care, skin care, colour cosmetics, fragrances and deodorants. More than half of these millennial users are driven by the need for personal expression and confidence, which is in turn fuelled by social media channels such as YouTube and Instagram. In the near future, social media influences are likely to persist, capturing adult consumers of beauty and personal care products from a younger age. This will also serve as a driving force for innovations which will result in growth of product lines across premium and mass-market brands.
Short Run Drivers: Viral and Disease Concerns

Demand for home care products are driven by viral and disease concerns, which often are due to sanitary reasons. Since the Zika outbreak in Brazil during 2015, insect repellent revenues in Brazil doubled per Reuters. Likewise, since the discovery of the Zika virus in Singapore during 2016, pharmacies and retail stores have reported a surge in the sale of mosquito repellents. Given the severity of outbreaks such as Zika, Dengue or Hand Foot and Mouth Disease, it is common to see government actions such as education, or even subsidies for home care products to prevent outbreaks from occurring. A clear example in an Asian setting would be the 5 step Mozzie Wipeout launched in Singapore during 2013 to combat Dengue fever. The campaign focuses on encouraging residents to clean out spaces in their homes which are potential mosquito breeding grounds and to use insecticides and repellents to prevent breeding. Campaigns like this, especially when combined with periods of outbreaks will lead to a surge in demand for home care products such as insecticides, surface care and toilet care, and even beauty and personal care products with preventive or protective features.
Currently, some of the key Asian players including South Korea’s Amorepacific and LG Household derive more than 25% of cosmetic sales from duty-free and travel retail channels. With the expected increase in travel market size and much stronger Chinese international travel growth of about 17% a year up till 2020, even Estee Lauder CEO Fabrizio Freda expects robust sales growth in travel retail. This promotes a win – win situation, where beauty and personal care companies sell high margin products at duty free and travel retail venues to boost sales and profits, while travellers are tempted by expensive beauty and personal care products at lower, tax-exempt prices.
Much of the traveller growth will come from China, as BCG estimates that an average of 25 million Chinese take their first overnight leisure trip annually, with that number being expected to at least double by 2020. Middle class and affluent individuals will spearhead this trend, driving growth in the beauty and personal care segment.

Expansion of travel retailers’ online channels further encourages travel retail for beauty and personal care products. The online channels provide services such as click and collect schemes, beauty treatment booking, airport price and inventory information and in-flight mobile applications – all aimed at making shopping for beauty and personal care products while travelling hassle-free. Dufry, a global travel retailer, expects digital services to be a key sales driver in the future and estimates that currently, 43% of travellers use the internet to gather duty free information. We see the partnership between higher travel volume and online retail channels as beneficial in the long run for the industry.
Long Run Drivers: Increasing Consumer Awareness

According to Business Wire, the number of informed consumers who are well aware of product availability and benefits is increasing across the globe. This growing number of informed and knowledgeable consumers can be attributed to their increasing exposure to reliable information about products over the internet, television and other sources such as word of mouth. As global education levels rise, coupled with the urbanization trend in emerging markets like Brazil, India and China, there will be greater demand for home and personal care products.

Consumer Awareness also refers largely to men, of which 52% now consider their looks and appearance to be either very important, according to a KPMG report. Traditionally, men beauty and personal care products were treated like an afterthought to women products but that is changing as men take increasing interest in their looks. Current research conducted by KMPG shows that 29% of men touchup their looks throughout the day and this increases to 39% for teenagers aged 15 to 17. The reason behind this trend is awareness. Awareness of beauty products catering to men, and awareness of the importance of dressing well and looking good. As consumer awareness has much more growing space in emerging markets, men in countries like Brazil are spending more time looking after themselves by using products like hair oils, hair loss shampoos and fragrances as compared to before. As a result, countries like Africa and Brazil are identified as high growth markets that could drive demand for beauty and personal care products in the future. In developed countries, many men already have some form of personal care regime, but the latest development is beard care. There is growing demand for products designed to clean, protect and style beards and moustaches that are specially designed for men’s skin and hair, resulting in a forward 5 year CAGR of 5.5% for men’s grooming products. Global sales for both hair and skin care for men are expected to exceed USD 5 billion by 2020.

![Figure 17: US beauty and personal care men’s grooming retail value sales (Source: Euromonitor)](image-url)
Long Run Drivers: Strengthening Asian Demand

According to KPMG, growth in Asia Pacific constitutes a megatrend itself for the beauty and personal care industry. Asia Pacific is the largest skin care market currently, with 51% share and its colour cosmetics market trails US closely at 28%. Even with a slowing economy, China remains the largest Asian market for personal care products and sales are expected to grow at 8% annually for the next 5 years. New markets are emerging as well, such as Pakistan, Indonesia and Vietnam above current strongholds of Japan, South Korea and China. Those new markets have a relatively young population, an expanding urban middle class and sophisticated beauty habits, all of which support strong sales for the industry.

<table>
<thead>
<tr>
<th>Name</th>
<th>2015</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beauty and Personal Care</td>
<td>134.2</td>
<td>129.1</td>
</tr>
<tr>
<td>Skin Care</td>
<td>56.4</td>
<td>54.3</td>
</tr>
<tr>
<td>4 Yr CAGR</td>
<td>4.4</td>
<td></td>
</tr>
<tr>
<td>9 Yr CAGR</td>
<td>4.9</td>
<td></td>
</tr>
<tr>
<td>Forecast 5 Yr CAGR</td>
<td>5.0</td>
<td></td>
</tr>
<tr>
<td>Hair Care</td>
<td>21.7</td>
<td>21.2</td>
</tr>
<tr>
<td>Colour Cosmetics</td>
<td>15.6</td>
<td>14.9</td>
</tr>
<tr>
<td>4 Yr CAGR</td>
<td>4.3</td>
<td></td>
</tr>
<tr>
<td>9 Yr CAGR</td>
<td>3.2</td>
<td></td>
</tr>
<tr>
<td>Forecast 5 Yr CAGR</td>
<td>4.5</td>
<td></td>
</tr>
</tbody>
</table>

Figure 18: Asia Pacific Beauty and Personal Care market size (Source: Bloomberg)

Recently, China has relaxed its one child policy which is now made into a two-child policy. While the effects of this change in legislation is not yet obvious, the new policy is expected to provide a major boost to the future performance of baby care products. China’s population is expected to hit an all-time high of 1.45 billion in 2029, with an extra 17 million newborns per year for at least the next four years. Not only will there be a surge in demand for baby care products, the development of those babies into teenagers and eventually adults will also help fuel APAC’s demand for beauty and personal care products, enforcing its dominant market position for this industry.

Figure 19: China’s population forecast (Source: Statista)
Food and Staples Retailing Industry

Overview

The modern grocery retailers’ industry is driven in the short run by robust end demand for food and retailers exploring untapped frontiers. In the long run, it is fuelled by urbanisation, rising middle income and a highly urbanised lifestyle.

Short Run Drivers: Robust end demand for food

With the rising middle class and a growing population, food demand is expected to increase in the short run, especially within ASEAN (except Singapore). On a (2013) population-weighted basis, demand for food consumption and per capita food consumption will grow at a rate of 9.6% and 8.6% respectively.

Short Run Drivers: Exploring untapped frontiers

Retailers in larger countries are spreading their resources in expanding into rural areas to serve the consumers and exploit growth from these untapped areas by setting up large hypermarkets and supermarkets to cater to the younger generation.

Long Run Drivers: Rising middle class

A rising middle class will drive food consumption. With rapid economic growth in developing regions such as ASEAN, where it is estimated that ASEAN’s middle class population in 2012 of 190m will double to 400m (55% of population) by 2020. Globally, the middle-class segment has similar growth trends, making up 53% of the US$11.8 Trillion grocery market.

Figure 20: Growth forecasts of the world grocery market.
There is a positive correlation of a rising middle class with rising urbanisation, hence as the society urbanises, more consumers will do their grocery shopping in modern grocery retailers such as supermarkets and hypermarkets instead of traditional grocery retailers due to convenience.

Long Run Drivers: Urbanisation and increasing income/capita

Urbanisation is offering opportunities for the rural population to become affluent. For instance, ASEAN individual economies’ urbanisation rate is estimated to be between 1-3% by the CIA. Moreover, ASEAN’s urbanised population has headroom to grow, with several of its nations’ urbanised population at below 50%. While population growth is a key driver of food demand, urbanisation provides opportunities for modern grocery retailers to grow as higher selling prices in urbanised societies is supported by consumers’ higher disposable incomes/capita and greater marginal propensity to spend.

![Figure 21: Correlation of grocery market growth and per capita income growth](source: World Bank, IMF, IGD Research)

Long Run Drivers: Change in lifestyle

As the younger and more educated generation grows up and enter the workforce, they will likely demand a different lifestyle as compared to their parents. As they are more educated and earn more, they are able to demand better imported and branded food items. In addition, a more educated society with growing white collar workforce will seek convenience and comfort of grocery shopping in a more conducive and organised environment, leading to an increase in the demand of grocery retailers such as supermarkets and hypermarkets that can satisfy their needs.
Tobacco Industry

**Short Run Drivers: Increasing consumption in developing Asian economies**

Significantly for US tobacco producers, a growing share of Chinese can now afford to upgrade to higher quality cigarettes. Consequently, sales in China of premium brand cigarettes are still growing. This increases the demand for US tobacco since Chinese cigarette manufacturers use more flavour style tobacco in premium brands. As incomes increase in many developing countries, this pattern of smokers shifting to more consumption of premium brand cigarettes is likely to spread.

**Short Run Drivers: Stricter trade regulations**

China’s Ministry of Industry and Information Technology (MIIT) recently announced regulations barring foreign investment in the country’s enormous tobacco industry, blocking foreign invested enterprises and individual businesses from participating in tobacco wholesale, retail, and alternative forms of trading. These new restrictions come on the heels of various government efforts to reduce China’s rampant tobacco use.

**Long Run Drivers: Resistant demand for tobacco products**

Smoking is not deteriorating as fast as many people might think. Between 2005 and 2011, the number of US smokers declined from 45.1 million to 43.8 million, representing less than a half per cent drop per annum. The drop in the demand for cigarettes tends to tail off in mature markets, reflecting the existence of a stubborn core of typically poorer smokers who are more difficult to reach with public health interventions.

**Long Run Drivers: Low regulations in developing economies**

Despite the successes of the FCTC (subsequent to ratification 127 parties have strengthened or adopted legislation), tobacco regulation is generally less restrictive in developing and transitional economies and is likely to remain so given that poorer countries have fewer resources to fight the huge range of strategies tobacco companies use to prevent, delay, and dilute public health measures.
Food and Beverage Industry

The food and beverage industry for the APAC region specifically will overall experience greater demand, driven by the perpetuation of health as a key driver in both the food and beverage industries separately. Globally, the food and beverage industry is mature in its own right, thus largely unaffected by economic conditions in both the short and long run. In the APAC region specifically, we can narrow down several short run and long run drivers for the industry: (i) products’ visual appeal, (ii) sustainability efforts (ii) perpetuation of a healthy lifestyle and (iv) the online revolution catching up to the food and beverage industry.

Short Run Driver: Products’ Visual Appeal

The social media wave brings along with it the trend of broadcasting our lives to our friends – the more aesthetically pleasing the better. The food and beverage industry is riding this trend with better and more appealing packages so as to appeal to a larger consumer base. Research by the Can Manufacturers Institute and consulting company FoodMinds state that 85% of consumers believe cans protect the “taste experience” of a beverage, and 74% of frequent beverage consumers rate packaging as very or extremely important in their beverage choices. “Eating with your eyes” has become a trend in the food industry as well. While flavour has long been the core of innovation, visual and share-focused societies call for innovation that is boldly coloured and artfully constructed – worthy of consumer praise and social media posts.
Short Run Driver: Sustainability Efforts

Worries about food and beverage wastes as well as natural phenomena such as droughts not only affect the worldwide food and drink supply but also influence the preparation and production of foods. Last year, sustainability efforts evolved from being a bonus to being a necessity for companies to avoid censure and boycotting from informed consumers on a company’s green habits. In light of the food wastage amounts in Figure xx (shown below), it is definitely a change for the better that companies have actually started adopting measures to mitigate the problems of wastages. In fact, Healthfocus International has determined that 62% of Australian consumers indicate that they are interested or extremely interested in a company’s sustainability efforts when making purchasing decisions.

Figure 23: Statistics on global food wastage (Source: World Bank)
Since 2016, Asia has been in the midst of a great digital revolution, finally catching up to its Western counterparts. The digital retail market in APAC is growing at a rate 10% faster than the worldwide average rate, with APAC retail e-commerce sales anticipated to increase to 20.4% of total APAC retail sales by 2019 from 10.2% in 2015. The region's retail market will continue to expand and is projected to hit US$11.460 trillion by 2019, representing 20.4% of worldwide retail sales. The food and beverage industry is definitely part of the online revolution, as consumers are looking towards online alternatives for food and beverage purchases for the efficiency and convenience. As of 2016, some 5% of U.S. consumers preferred shopping for groceries online. In total, U.S. online grocery sales amounted to about $7 billion in 2015 and are expected to rise to $18 billion by 2020.

Apart from online retail affecting the food and beverage industry, the online revolution also caters to the rising prominence of social media sites such as Facebook, Twitter and Instagram. Even within the short-term drivers of the food and beverage industry, social media plays a part as companies scramble to make their packaging more “Insta-worthy” and appeal to the larger masses. The rise of food-centric media has also sparked a new interest in cooking not just for the sake of nourishment, but also for the purposes of sharing one’s creations on social media; people are cooking to share with friends and followers.
Long Run Driver: Perpetuation of a Healthy Lifestyle

The healthy lifestyle trend is one that has been around for quite a while now, as consumers gain purchasing power and thus have more autonomy in their food and beverage decisions. With this autonomy also carries weight the vast selection of food and beverage options available to consumers. The shift towards a healthy lifestyle globally is finally coming to the APAC region as the emerging markets catch up with Western trends, most notably starting to live a healthier lifestyle. Living healthily not only promotes healthier foods such as organic or low-calorie foods, it also creates a growing market for packaged water in the beverage industry. Packaged water is a key driver of growth of the beverage industry in the APAC region, led by China and India. Asia’s beverage market will experience unprecedented growth, taking two-thirds of global incremental consumption by 2021, according to figures from Canadean.

![Figure 25: Global commercial beverage increment volume growth by region and country, 2016-21F sales (Source: Canadean)](source-image)

Food producers globally have responded to this trend by producing goods that are lower in calories by decreasing the sugar content in product formulation, by applying functional food ingredients such as sugar replacers. While this is an improvement from previously unhealthy foods, many consumers are now also prioritising products that promote digestive health in their food purchase decisions. The Beneo Asia-Pacific Southeast Asia survey also revealed that 74% of consumers in Indonesia and 80% in Thailand consider fibre as an ingredient that can help improve their digestive system. The industry has a long way to go, especially in the APAC region, to be able to effectively capture the consumer’s demands for better, healthier foods.
The trend for healthier foods have also met challenges in the APAC region as the impact of rising commodity prices, together regulation and the ever increasing threat of impending taxes on selected foods and beverages have not yet seen its full impact in this lower-cost region yet.
Case Study – AmorePacific Corp (KRX: 090430)

Company Description

AmorePacific Corp engages in the research, development and marketing of beauty and personal care products. The company has a strong presence in Asia and limited presence in Europe and America. It currently operates 33 international brands under its 3 divisions: Cosmetics, Personal Care and Healthcare. Popular brands include Sulwhasoo, Laneige, Etude House, Innisfree, IOPE, and Ryoe. The company was first started in 1932 and is currently headquartered in Seoul, South Korea.

Key Financials

<table>
<thead>
<tr>
<th>Metric</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Price/Earnings TTM</td>
<td>37.3</td>
</tr>
<tr>
<td>Price/Book</td>
<td>5.0</td>
</tr>
<tr>
<td>Price/Sales TTM</td>
<td>4.4</td>
</tr>
<tr>
<td>Rev Growth (3 Yr Avg)</td>
<td>14.4</td>
</tr>
<tr>
<td>Net Income Growth (3 Yr Avg)</td>
<td>24.6</td>
</tr>
<tr>
<td>Operating Margin % TTM</td>
<td>18.6</td>
</tr>
<tr>
<td>Net Margin % TTM</td>
<td>13.8</td>
</tr>
<tr>
<td>ROA TTM</td>
<td>13.9</td>
</tr>
<tr>
<td>ROE TTM</td>
<td>16.9</td>
</tr>
</tbody>
</table>

*Figure 26: AmorePacific Key Financials (Source: Morningstar)*

Investment Thesis

Large Exposure to growing Travel Retail

At major duty free outlets, sales of AmorePacific products has exceeded the top three non-Korean luxury brands, Louis Vuitton, Hermes and Chanel. According to Lotte Duty Free, AmorePacific accounted for 11% of the retailer’s first quarter sales in 2015, and its largest competitor, LG Household and Health Care accounted for just 7%. Given that the number of global passengers is expected to reach 3.91 billion in 2017 and 6.4 billion in 2030, AmorePacific’s strong presence in duty free shops will allow the firm to capture incremental revenue from international travellers.
Because of its growing brand power and presence, AmorePacific developed a stronger bargaining power when negotiating with duty free shops. This is evident as newly opened Korean duty free shop, Dooty Duty Free, has to engage in lengthy negotiations with AmorePacific in order to secure its products when in the past, AmorePacific had to negotiate its products onto the shelves of duty free shops. This competitive advantage of strong bargaining power will allow the firm to boost margins through pricing agreements with duty free shops and increase exposure of its products through agreeing on prominent display positions for its products and promotional posters within retail outlets.

**Benefits from Growth Opportunities in Chinese Market**

AmorePacific's number 1 market out of Korea is China. Chinese appetite for beauty and personal care products such as skin and hair care has ballooned over the last decade and is showing no signs of slowing. This is largely fueled by the “Hallyu Wave”, a social phenomenon of South Korean pop culture that has swept the globe, especially Asia since the early 2000s. In 2014, AmorePacific was the main sponsor for the No. 1 K-drama, “My love from the star” and its products used by the lead actress surged 75% with its Laneige lipstick sales up by 400%. This year, AmorePacific sponsored top K-drama, “Descendants of the Sun” and once again, this is expected to give a boost to the company’s sales. Many Chinese and Asians want to look like their Korean idols and they believe that using beauty and personal care products promoted by their favorite stars is one step towards their goals. With celebrity endorsements and popular spokespersons such as actress Park Shin-Hye actor Lee Min Ho and singer Krystal promoting AmorePacific’s various brands, AmorePacific’s brands are already established in the Chinese market and have become household names for many Chinese consumers.

On top of product popularity in the Chinese market, AmorePacific also has the right fit of brands to cater to the largest consumer of beauty and personal care products in China – the rising middle class and the affluent. Laneige is the product line most aggressively promoted in China as it is a premium brand of the company that provides the right benefits with the right celebrity endorsements at the right price for the middle class. Its closest competitor, LG Household and Health Care does not yet have such a suitable and prominent product to serve the Chinese market. On top of that, the domestic market in China is fragmented and not dominated by major manufacturers, ensuring that AmorePacific can craft up and hold a strong competitive position there.

**Poised to capture growing demand for Natural Products**

Organic products are expected to outpace most other beauty and personal care products with a CAGR of over 10% for the next decade. This growth is expected to be larger in Asian countries such as China, Korea and India as compared to western countries, and the Asian market is expected to outgrow the western market within the same time period.

AmorePacific prides itself on its 3 heritage ingredients – green tea, ginseng and beans. Many of their brands and products are based on these core ingredients, and the ingredients are directly harvested from their own farms. Not only have they integrated these natural
ingredients into their products, AmorePacific also offers brands that specialize in natural ingredients such as Innisfree, Happy Bath, Ryo and Sulwhasoo. Some competitors such as LG Household and Health Care have launched similar competing brands and others are, or will be following suit as well. However, AmorePacific has a heritage and tradition that is deeply intertwined with natural products since the company was formed on hand-pressed hair oil made from Camellia nuts. This will further enhance the strength of AmorePacific's brands in the eyes of consumers who demand naturally derived products and strengthen its competitive position.
Valuation

DCF

### AmorePacific Corp

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>3,100,413</td>
<td>3,874,008</td>
<td>4,766,627</td>
<td>5,719,952</td>
<td>6,822,344</td>
<td>7,830,043</td>
<td>9,004,549</td>
<td>10,355,232</td>
</tr>
<tr>
<td>% growth</td>
<td>8.9%</td>
<td>25.0%</td>
<td>23.0%</td>
<td>20.0%</td>
<td>17.0%</td>
<td>17.0%</td>
<td>15.0%</td>
<td>15.0%</td>
</tr>
<tr>
<td>EBITDA</td>
<td>483,409</td>
<td>698,806</td>
<td>919,773</td>
<td>1,103,728</td>
<td>1,261,361</td>
<td>1,510,863</td>
<td>1,737,527</td>
<td>1,968,156</td>
</tr>
<tr>
<td>% margin</td>
<td>15.9%</td>
<td>18.1%</td>
<td>19.3%</td>
<td>19.3%</td>
<td>19.3%</td>
<td>19.3%</td>
<td>19.3%</td>
<td>19.3%</td>
</tr>
<tr>
<td>EBIT</td>
<td>369,837</td>
<td>563,751</td>
<td>772,910</td>
<td>927,492</td>
<td>1,086,166</td>
<td>1,269,644</td>
<td>1,460,090</td>
<td>1,679,104</td>
</tr>
<tr>
<td>% margin</td>
<td>11.9%</td>
<td>14.6%</td>
<td>16.2%</td>
<td>16.2%</td>
<td>16.2%</td>
<td>16.2%</td>
<td>16.2%</td>
<td>16.2%</td>
</tr>
<tr>
<td>NOPAT</td>
<td>271,143</td>
<td>409,439</td>
<td>580,734</td>
<td>696,618</td>
<td>813,874</td>
<td>952,233</td>
<td>1,090,068</td>
<td>1,259,328</td>
</tr>
<tr>
<td>% tax</td>
<td>26.7%</td>
<td>37.3%</td>
<td>34.9%</td>
<td>32.0%</td>
<td>29.0%</td>
<td>28.0%</td>
<td>26.0%</td>
<td>25.0%</td>
</tr>
<tr>
<td>Capex</td>
<td>123,972</td>
<td>136,055</td>
<td>149,803</td>
<td>170,238</td>
<td>206,198</td>
<td>241,249</td>
<td>277,438</td>
<td>319,052</td>
</tr>
<tr>
<td>Change in NWC</td>
<td>(342,005)</td>
<td>(323,288)</td>
<td>(276,047)</td>
<td>(313,780)</td>
<td>(313,780)</td>
<td>(313,780)</td>
<td>(313,780)</td>
<td>(313,780)</td>
</tr>
<tr>
<td>FCFF</td>
<td>14,783</td>
<td>129,047</td>
<td>266,402</td>
<td>340,838</td>
<td>566,943</td>
<td>590,295</td>
<td>836,505</td>
<td>991,140</td>
</tr>
<tr>
<td>FCFF (adjusted for valuation date)</td>
<td>14,783</td>
<td>129,047</td>
<td>266,402</td>
<td>340,838</td>
<td>566,943</td>
<td>590,295</td>
<td>836,505</td>
<td>991,140</td>
</tr>
<tr>
<td>Discount period</td>
<td>1.00</td>
<td>2.00</td>
<td>3.00</td>
<td>4.00</td>
<td>5.00</td>
<td>6.00</td>
<td>7.00</td>
<td>8.00</td>
</tr>
<tr>
<td>Discount factor</td>
<td>0.9</td>
<td>0.9</td>
<td>0.8</td>
<td>0.7</td>
<td>0.7</td>
<td>0.7</td>
<td>0.7</td>
<td>0.7</td>
</tr>
<tr>
<td>PV of FCFF</td>
<td>316,127</td>
<td>482,552</td>
<td>470,986</td>
<td>619,041</td>
<td>860,297</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Figure 27: Discounted Cash Flow model of AmorePacific Corp**

A discounted cash flow analysis was used to estimate the intrinsic value of AmorePacific’s share price. The model is forecasted over a period of 5 years. Revenue projections have been conservatively based on historical growth rates, as well as expected growth trends for AmorePacific. Revenue growth has been high due to the Hallyu wave and K-Pop craze, which has been driving sales of Korean products. While the craze has toned down a little from its peak, AmorePacific still has much to gain with its exposure to travel retail, strong presence in the growing Chinese market and prominent organic-based brands. Hence, we expect AmorePacific’s revenues to grow 20% for FY2016, then tapering slightly to a CAGR of 17% and finally 15% at the end of the forecast period. With an exit multiple of 15 times and WACC of 7.8%, the intrinsic value of AmorePacific derived to be at KRW346,360.

At the time of writing, AmorePacific Corp’s shares are trading at KRW310,000. This poses a potential upside of 11.7% to our target price. Given that AmorePacific is also currently trading at a lower P/E (33.88) compared to its industry (58.01), we would recommend a **BUY**.
Case Study – Dairy Farm (SGX:D01)

Company Description

Dairy Farm International Holdings Limited is a Hong Kong-based Asian retailer. The Company operates in four segments: Food, Health and Beauty, Home Furnishings, and Restaurants. Food segment consists of supermarket, hypermarket and convenience store businesses. Health and Beauty segment consists of the health and beauty businesses. The Company's operates its stores under brands, including Wellcome, Cold Storage, Giant, Hero, 7-Eleven, Mannings, Guardian, IKEA and Maxim's.

Key Financials

Table 1: Key Financial Ratios of Dairy Farm International Holdings

<table>
<thead>
<tr>
<th>Key Financials</th>
<th>(SGD mil)</th>
<th>FY13A</th>
<th>FY14A</th>
<th>FY15A</th>
<th>FY16E</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market Capitalization (mil)</td>
<td>14,138.63 SGD</td>
<td>-</td>
<td>15.5</td>
<td>18.7</td>
<td>17.9</td>
</tr>
<tr>
<td>Shares Outstanding (mil)</td>
<td>370.54</td>
<td>-</td>
<td>5.5</td>
<td>5.7</td>
<td>5.1</td>
</tr>
<tr>
<td>Free Float (mil)</td>
<td>299.94 SGD</td>
<td>ROE (%)</td>
<td>39.203</td>
<td>35.015</td>
<td>28.075</td>
</tr>
<tr>
<td>52-Wk High</td>
<td>7.53 SGD</td>
<td>Div Yield (share)</td>
<td>0.29</td>
<td>0.305</td>
<td>0.283</td>
</tr>
<tr>
<td>52-Wk Low</td>
<td>5.56 SGD</td>
<td>Net D/E</td>
<td>-</td>
<td>CASH</td>
<td>0.44</td>
</tr>
<tr>
<td>P/E (ttm)</td>
<td>22.53</td>
<td>EBITDA (mil)</td>
<td>906.808</td>
<td>962.438</td>
<td>917.341</td>
</tr>
</tbody>
</table>

Figure 28: Dairy Farm Key Financials

Investment Thesis

Growth Opportunities from the demand of higher end consumers

With a focus on driving long-term value for the investors, the astute management of Dairy Farm is looking to expand its market leadership by appealing to higher-end consumers with higher spending power but promoting fresh and premium produce for the food segment. Most of their brands, such as Cold Storage and Marketplace cater to the expatriates and affluent locals by selling high quality produce at correspondingly, higher prices. They are also active in developing house brands and products to maximise profit margins.
Growing Economic Moat

To capitalise on the rapid growth of Asia’s economy, Dairy Farm has assets in many parts of Asia, including Taiwan, Malaysia, Hong Kong, Singapore, and Indonesia. Its business interests in these countries are diversified across different industries ranging from supermarkets, convenience stores, health and beauty stores, home furnishing stores and restaurants. Due to high population growth, rising incomes, and a shifting preference towards Western retail formats in these countries, Dairy Farm’s businesses have met with resounding success.

Furthermore, Dairy Farm has been buying brands with a strong local presence, as seen in their recent acquisition of San Miu stores and Yonghui Superstores. These two recent acquisitions, funded largely with cash from operations led to an increase in sales by over $1.5 Billion.

These acquisitions provided synergies in terms of cost savings, quality benefits to Dairy Farm, while increasing its presence in the large and rapidly growing food retail market in China via this strategic partnership. Yonghui is the 4th largest hypermarket chain operator in China and runs a total of nearly 450 stores across the PRC market as of September 2016.

Lastly, moving forward, Dairy Farm aims to bolster its long-term growth by expanding its private label programme and enhancing its distribution centres across all its markets.

Strengthening Operational Efficiency Regionally

As Dairy Farm continues to expand in the North Asia region, it will focus primary on improving its current operating efficiencies by tapping on e-commerce, streamlining its supply chain management and upgrading its IT infrastructure.
Valuation

DCF

Considering that given that revenue growth of Dairy Farm has been quite consistent, we will project revenue over the next 5 years with reference to EBIT margins. Even though growth is expected to be slow for such a large company, given the recent history of acquisitions and joint ventures undertaken in Asia, we can expect a reasonable and healthy 6% CAGR fuelled by both inorganic and organic growth.

With an exit multiple of 10X and a WACC of 5.5%, the intrinsic value of Dairy Farm is $8.7. This value is reverse engineered to calculate the implied perpetuity growth rate of 2.5%, this is in line with the long term organic growth of Dairy Farm and its competitors, adding credibility to our assumptions. Overall, we are confident that Dairy Farm will overcome the headwinds that is plaguing the global economy currently as Dairy Farm has a widening economic moat in Asian retail market and continues to be the most cost-efficient large retail operator in Asia. Hence, we are comfortable with the valuation output.

At the time of writing, the stock price is at $7.2 and there is a lot of headroom for growth, partially caused by a beat down in share price due to short-term exchange rate fluctuation and declining commodity prices that is affecting emerging economies. With rapidly growing sales and a widening economic moat in countries with the highest economic and population growth, Dairy Farm is a growing titan in Asian retail that truly deserves a recommendation of **BUY**.

Figure 29: Discounted Cash Flow model of Dairy Farm
References


Research Analysts

Darryl Poh  
Darrylpoh95@gmail.com

Ayoj Nepal  
Ayojnepal1995@gmail.com

Anisah Bte Abdul Rahman Zamawi  
Anisah.azr@gmail.com

Calvin Wee  
ckweejy@gmail.com

This research material has been prepared by NUS Invest. NUS Invest specifically prohibits the redistribution of this material in whole or in part without the written permission of NUS Invest. The research officer(s) primarily responsible for the content of this research material, in whole or in part, certifies that their views are accurately expressed and they will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this research material. Whilst we have taken all reasonable care to ensure that the information contained in this publication is not untrue or misleading at the time of publication, we cannot guarantee its accuracy or completeness, and you should not act on it without first independently verifying its contents. Any opinion or estimate contained in this report is subject to change without notice. We have not given any consideration to and we have not made any investigation of the investment objectives, financial situation or particular needs of the recipient or any class of persons, and accordingly, no warranty whatsoever is given and no liability whatsoever is accepted for any loss arising whether directly or indirectly as a result of the recipient or any class of persons acting on such information or opinion or estimate. You may wish to seek advice from a financial adviser regarding the suitability of the securities mentioned herein, taking into consideration your investment objectives, financial situation or particular needs, before making a commitment to invest in the securities. This report is published solely for information purposes, it does not constitute an advertisement and is not to be construed as a solicitation or an offer to buy or sell any securities or related financial instruments. No representation or warranty, either expressed or implied, is provided in relation to the accuracy, completeness or reliability of the information contained herein. The research material should not be regarded by recipients as a substitute for the exercise of their own judgement. Any opinions expressed in this research material are subject to change without notice.

© 2017 NUS Investment Society