

Consumer Goods Hit Trouble in Digital Era

By STEPHEN WILMOT

Consumer-goods stocks often are seen as “bond proxies.” This makes sense only as long as dividends look secure. In the digital age, this no longer can be taken for granted.

The likes of **Procter & Gamble**, **Nestlé** and **Unilever** earn profits by selling branded household products to consumers around the globe. Their margins are

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protected by expensive marketing, vast distribution networks and clout with retailers. Their growth has long been assured by rising incomes in the emerging world.

The investment case looks fragile. The slowdown in emerging markets is well documented. E-commerce and digital media also have made the competitive moats surrounding established brands easier to bridge.

The country where these challenges coincide is China.

In the first half, Unilever's Chinese business was flat year over year, with rapid growth in e-commerce offset by declines in bricks-and-mortar retailing as stores reduced inventory.

Just as many emerging-world consumers leapfrogged landlines and moved straight to mobile phones, in China they may be skipping modern supermarkets, observed Unilever Chief Executive Paul Polman.

E-commerce threatens consumer-goods companies because online retailers have unlimited shelf space, giving new brands ready market access.

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Continued from the prior page cess. Consumer reviews also affect choices, subordinating the role of branding.

Meanwhile, digital media can reduce marketing costs. Dollar Shave Club, the four-year-old male-grooming brand bought last month by Unilever, is a case in point: Since a promotional video went viral, its subscription-based model for razor deliveries has rapidly taken U.S. market share from Procter & Gamble's Gillette business.

This kind of problem helps explain why P&G's underlying companywide growth decelerated to just 1% for the year to 30 June; management said the company was losing share in many categories. Brand building used to take years, costly TV commercials and supermarket contacts. Now it can just take a smart idea and a lot of luck.

Against such a backdrop, it can be hard to understand why investors pay ever-higher multiples for shares in P&G and other consumer-goods compa-

nies. Five years ago, they traded for about 14 times earnings. Even as global growth has slowed and digital disruption has become a live threat, the average price/earnings ratio has risen to 22.

The global hunt for yield is the most plausible explanation. Even after massive stock-market gains, shares in the sector yield about 3%. Selling branded shampoo or mayonnaise—inexpensive yet high-margin products—to a globally diffuse set of consumers remains a steady business, whatever competitive challenges the digital age has unleashed. When bonds pay next to nothing, a steady income is prized above all else.

The problem with this thinking isn't just that competition has intensified. It is also that dividend yield has come at the expense of dividend cover: Management teams have doled out an ever-higher proportion of earnings to keep shareholders on board. This squeezes the money available for reinvesting in brands.

Global staple companies are in a trickier spot than their formidable track records or high stock-market valuations imply.