Magellan – In The Know: Episode 33

Consumer deep dive — how best to weather the storm

Announcement (00:00):

The information contained in this podcast is for general information purposes and does not constitute investment advice. You should seek investment advice tailored to your circumstances before making an investment decision.

Host (00:14):

This is In The Know, a monthly investment podcast brought to you by Magellan Asset Management.

Hannah Dickinson (00:20):

In a market like this, there are a couple of characteristics that we are focused on. First of all, we want to protect against the prospect of continued inflation repressures. We are looking for companies with business models that offer a structural inflation protection or companies with an ability to offset inflation through pricing. That's what we would call pricing power. Secondly, we want to protect against a downturn in consumer spending, so we want to own companies with resilient demand profiles, healthy margins, and strong balance sheets.

Host (00:53):

That's Hannah Dickinson, Magellan's sector head of franchises and healthcare, describing the consumer sector companies Magellan seeks out. Welcome to Magellan In The Know. In this episode, Hannah Dickinson is joined by Magellan's head of listed funds, Jennifer Herbert, and investment analysts Lucina Martin and James Macdonald for a deeper dive into the consumer sector. They look at the macroeconomic factors influencing the levels of consumer spending and explain how companies that are either protected from inflation or can offset it are performing well in the current high inflation environment. It's a fascinating discussion that breaks down the relative performance of sectors as diverse as travel, luxury goods, and snack food. But first, here's a warm welcome from Jennifer Herbert.

Jennifer Herbert (01:46):

Hello and welcome to Magellan's podcast, In The Know. As many of you will know, Magellan's a significant investor in the consumer sector. In fact, the consumer sector accounts for around a third of the current Magellan Global portfolio. It's a sector we know very well and we believe it provides exposure to some fantastic quality companies, which are compounders supported by thematic tailwinds. To do a deep dive on this topic today, I'm thrilled to be joined by three of our investment professionals who are experts in this space. Firstly, I'd like to introduce Hannah Dickinson and Lucina Martin from our consumer team who cover a wide range of consumer goods from snack foods, apparel, and alcohol brands, all the way through to travel and luxury. Welcome Hannah and welcome Lucina.

Hannah Dickinson (02:27):

Thanks Jen.

Lucina Martin (02:27):

Thanks Jen.

Jennifer Herbert (02:28):

I'd also like to introduce James Macdonald who we fondly call Jimmy. Jimmy's part of the macro team and I believe is no stranger to the microphone. As a little birdie told me, he used to Host a radio show. True or false, Jimmy?

James Macdonald (02:40):

It was a long time ago, Jen, but yes, it's true.

Jennifer Herbert (02:42):

Nice. Well, this should be an engaging chat then. Welcome, Jimmy.

James Macdonald (02:45):

Thank you.

Jennifer Herbert (02:46):

Okay, let's start by talking through the journey of consumers. They've been through quite a lot. They've had to weather a pandemic, lockdowns, war, inflation, and even bank failures. Jimmy, how resilient have consumers been through the recent volatility and what's the outlook from here?

James Macdonald (03:01):

It's a great question, Jen. I'll start with the first part of the question just about how resilient the consumer's been to date. Really, at an aggregate level, at a macro level, consumers have held up a lot better than many people have expected. If you look at the US, which is the world's largest economy and the world's largest consumer market, consumers spent more adjusted for inflation once we account for the impact of inflation. Consumers spent more last year and in 2021 than they did in 2019 before all of these challenges kind of started to emerge. Consumers have been holding up pretty well, especially in the US. In places like Europe, they're not doing as well, but catching up.

(03:34):

In general, I would say that cohort of consumers has been very resilient. There's a couple reasons for this. You kind of think, firstly, during the pandemic, governments were very generous with handouts. Consumers were supported, but not just consumers, small businesses and large businesses as well, and that helped households build up a nice buffer of savings. They had enough income to spend and maintain their consumption habits during some of those challenges during 2020 and the challenges that emerged post. The other thing that's kind of a more recent phenomenon is just how strong the labour market's been. We've seen very tight labour markets around the world. Employers can't find workers and that's been really good for wage growth, and so consumers have been supported by strong growing nominal incomes that they've been able to go out and spend.

(04:16):

The other thing I'll touch on is... And it's quite topical in Australia right now. But in the United States, consumers have these incredible 30-year fixed rate mortgages. In Australia, we talk about this mortgage cliff, two to three-year mortgage cliff as interest rate rise and consumers move from fixed to floating mortgages. In the US, they fix them for 30 years, so they really haven't experienced the growing cost

pains from higher interest rates. It's more a US phenomenon than here in Australia, but that's helped consumers maintain their consumption habits as well.

(04:44):

Moving to the second part of your question about the outlook, it really depends on what happens in the labour market. If consumers kind of keep their jobs and kind of keep this strong wage growth, that's really good for the consumption outlook and consumers will still be able to spend. We've seen with inflation in the past kind of year that central banks have been really tightening interest rates really quickly, really rapidly, and that's having an effective slowing economic activity. We think the kind of worst case scenarios, the hard landing scenario where there's a massive spike in unemployment can be avoided, but we still think there'll be some softening, and that will slow consumers a bit at the edge but not materially. The outlook is still, I would say, softening but relatively sound.

(05:23):

The last thing I'll mention is just on the importance of this topic and why it's so exciting to be here today. In 2022, we spoke a lot about how interest rates were driving market outcomes in stocks and bonds. This year, I think what we'll see is that earnings growth will matter a lot more. We need to understand what's going on at the micro level, understand what's happening in different companies. Consumer companies are a great source of info on what's happening, different cohorts and different levels of spend, so it's a great time to be here talking about the consumer with Hannah and Lucina.

Jennifer Herbert (05:52):

I agree, It's a really interesting time to be talking about the health of the consumer. Can you just help us frame how important consumers actually are for the overall economy?

James Macdonald (06:01):

In the United States, the largest economy in the world, the consumer's kind of 70% of GDP, so just a massive part of overall consumption. In places like Europe and even here in Australia, still a very important part. It's about half of the economy comes from consumption activities, so it's a really important piece of the puzzle when we're trying to work out where the economy's going, where firms earnings are going. That's why we spend so long thinking about it.

Jennifer Herbert (06:23):

Okay, so it's comforting to hear that in general the consumer has held up better than expected, but surely consumers at different ends of the world spectrum have had, and I imagine will continue to have, differing experiences. Lucina, perhaps you could break this down and discuss a different types of consumer and how each of them are faring in the current environment.

Lucina Martin (06:40):

Yes, definitely, Jen. In this environment, each income cohort has had a totally different experience, and that sort of resulted in some quite divergent spending patterns. We tend to break the consumer down into three different cohorts: the low income consumer, the middle, and also the high income consumer. I might start with the low income consumer, which has been under the most amount of pressure at this point. Inflation has had such a huge impact on their purchasing power. Jimmy mentioned earlier that excess savings and that government stimulus and some of those pay risers for minimum wage workers, they were helpful buffers initially, but unfortunately those cost of living pressures, the price of food, and petrol have been so extreme at this point that that's depleted their savings. We've seen a very rapid

decline in their level of discretionary spending power and so that consumer's under a lot of pressure at this point.

Jennifer Herbert (07:30):

It's really unfortunate that low income consumers are often the ones who face the biggest challenges in economic downturns. How about the middle and high income consumers? How are they doing?

Lucina Martin (07:39):

The middle income consumer in comparisons actually held up a little better. They still have jobs and some excess savings as well. We are still seeing them prioritise spend in categories like travel and beauty, but they are starting to sort of defer purchases in other areas. Some classic examples of that, maybe general apparel and electronics as well. We'll probably start to see them over the next little while become a little more selective in those discretionary expenditure as that inflation cycle continues and their pool of excess savings continues to shrink. There's definitely some emerging cracks there.

(08:12):

When we think about the high income consumer, those inflationary pressures have had a much lower impact, and so their discretionary and non-discretionary consumption has remained pretty resilient. Generally speaking, their spending patterns and confidence levels in this cohort tend to be more influenced by what we call sort of asset price movements rather than the price of household essentials. The reaction times there tend to be a bit slower than in other cohorts.

Jennifer Herbert (08:36):

Jimmy talked earlier about the importance of monitoring macro data points, like statistics around the labour market, et cetera. Can you talk about some of the micro data points that you're keeping an eye on?

Lucina Martin (08:46):

Yeah. There are a few different data points that we're keeping our eyes on at this point in the cycle. First one that I'll point to is retail traffic. When consumers start to feel a little more value conscious, we start to see them sort of shift away from a mainstream supermarket to a discount or think of Aldi here in Australia or a club store like Costco. Now, recently in some of these channels, we've started to see them gain share of that middle income consumer. That's particularly the case in Europe. Many retailers are also reporting and discussing that the average size of the basket of that consumer is starting to shrink as well, and that becomes a sign of the consumer that's starting to tighten its purse string. That's something that we're watching.

(09:26):

The other dynamic that we are sort of monitoring at the moment is any changes in brand share and what we call the fast moving consumer goods sector. Are consumers switching from a more expensive branded tomato sauce or a paper towel to a cheaper unbranded or home brand alternative? What we're monitoring for here is where the top brands with that strong innovation capability and differentiated product. Think of maybe your favourite packet of chips. We expect demand to be relatively unfazed in these types of areas of the market, but then when there are less popular brands with lower market share, which may compete in a more commoditized category, so think of maybe the paper towel example, they might lose share to an unbranded alternative.

(10:09):

Finally, the last sort of data point that we're thinking about as well is around the middle income consumer. I mentioned before we've seen a shift away from household goods such as apparel and electronics, and what we're monitoring for here is any sort of changes in mid-level of discounting. It's been starting to pick up a little bit recently, so it's a sign that brands and their retail partners are trying to clear some of that excess inventory ahead of what could be a weaker demand environment. That's some of the things that we're keeping our eyes on and a bit of a snapshot of what we're thinking about.

Jennifer Herbert (10:38):

Okay. It sounds like we could be seeing the leading indicators of a broader slowdown then. Hannah on the back of Lucina's comments, what are the types of consumer companies we would want to own in this kind of environment?

Hannah Dickinson (10:48):

In a market like this, there are a couple of characteristics that we are focused on. First of all, we want to protect against the prospect of continued inflation repressures. We are looking for companies with business models that offer structural inflation protection or companies with an ability to offset inflation through pricing. That's what we would call pricing power.

(11:11):

Secondly, we want to protect against a downturn in consumer spending. We want to own companies with resilient demand profiles, healthy margins, and strong balance sheets. This second point is becoming even more important as the macro landscape gets a bit shakier. The classic examples I would give would be quick service restaurants, like McDonald's and Yum! Brands. They offer affordable products and a really strong consumer value proposition. They might actually be net beneficiaries as consumers start to tighten the purse strings and maybe trade down from some of the more expensive meal options that they might have been buying before.

(11:49):

The great thing about the restaurants, the quick service restaurants, is that they have franchised business models. That means that they don't own the underlying restaurants; instead, they earn a royalty fee on restaurant revenues while the franchisees manage the costs associated with things like ingredients and labour. The franchisees can choose to raise their menu prices in response to their inflationary pressures, and then the revenue that the franchisor, the head company earns, can actually go up so they can be net beneficiaries again.

(12:20):

The other example I would mention of the sort of company that we'd like to own in an environment like this is Pepsi. Pepsi's a leading manufacturer of snacks and beverages in the US. It doesn't have the structural business model advantages that McDonald's and Yum! have, but it does have really stable demand and strong pricing power. We've seen Pepsi increase prices by 14% over the past year, which is a modern day record for the company. Pepsi's consumer really hasn't taken issue with that at all. They've maintained the same level of consumption of snacks particularly over that period. I think it's quite clear that we are creatures of habit and we're incredibly loyal to our preferred snack brands, so we really like what Pepsi's been able to do and we consider it a really good portfolio position.

Jennifer Herbert (13:07):

If we're leaning into consumer defensives, how are you thinking about some of the more discretionary names in the consumer space and what's the rationale for continuing to hold a luxury player like Louis Vuitton Moët Hennessy or LVMH as it's known in the market?

Hannah Dickinson (13:21):

Our consumer portfolio is tilted towards defensives at the moment, but it doesn't mean we are avoiding discretionary sub-sectors altogether. We're just trying to be more selective in the risks that we'll take. I think, at this point in the economic cycle, competition is one of the risk factors that we are really paying extra close attention to. Our investment philosophy always places a lot of importance on economic mode, which means we're focused on the sustainability of a company's competitive advantages. But in a challenging economic environment like this, a company's competitive positioning can really mean the difference between failure and survival.

(13:58):

Lucina mentioned that we've started to see a buildup of inventory in certain categories like apparel and electronics, and those categories are highly competitive and product is often seasonal, at least in apparel, and that means that the only way to clear that inventory is through discounting and promotions. Then to protect margins, those companies might be forced to pull back on marketing spend and other investments, so brand awareness and product innovation might start to suffer. You can see how this can become a bit of a doom loop as consumers get drunk on discounting and they start to change their perception of the desirability of the brand, which can have a huge impact on returns in the medium to long term. I think it's easy to talk about these things and maybe it seems obvious, but it's very easy to look at the share price of companies in these sub-sectors and think that it's a bargain when in reality it's actually a dangerous value trap.

(14:53):

To your second question on why we would continue to own a company like LV in an environment like this, I would say that, yes, luxury demand can be cyclical, but at least we don't have to worry too much about competitive pressures for a company like LV. It has really strong brand differentiation in luxury and it has the financial firepower to continue to make strategic investments when weaker players pull back, and that's something we see from LV all the time. It has really strong control of its distribution, which is another thing we look for. You'll never see its products discounted or sold in, say, an off-price retail channel. This is super important as we're thinking about how a company manages and preserves brand equity.

(15:35):

The other important part to the LV thesis is really its exposure to China. Before COVID, Chinese consumers accounted for about one third of luxury demand globally and 60% of that spending happened abroad. But of course China's now reopening, and so we're going to see this huge wave of pent-up demand in the luxury sector that should help cushion the impact of a slowdown in the west.

Jennifer Herbert (16:02):

Yes, China's reopening has certainly created a lot of excitement in markets during the first few months of 2023. Lucina, what implications will this have for the consumer sector and how are we positioning the portfolio to gain from what feels like a very significant opportunity?

Lucina Martin (16:15):

While it's still, I guess, early days, China's reopening will have a positive impact on the consumer sector. We've seen years of rolling lockdowns and that's created a lot of uncertainty for consumers. They've not really been willing to spend at normal levels, and that consequently has created quite a difficult environment for our companies to even predict some of those underlying trends. Now, with a more stable domestic environment, that's certainly a breath of fresh air for everyone, and we expect to see the consumer in China start to spend some of their excess savings again. However, I guess the

magnitude of that spend is quite a live debate that we're having at the moment and we're quite mindful that the economic activity and that reopening benefit from China could fall short of these lofty market expectations that you mentioned, Jen.

(17:00):

Why is that? Unlike in the US and Europe, that low and middle income consumer is facing a higher level of unemployment in China. That combined with some lower business sentiment and a lower entrepreneurial spirit as well, we might start to see a consumer that looks to hold onto some of these savings just a little longer maybe for the next rainy day. But on the positive side, though, I will point to one consumer sector that we feel most optimistic about at this point, and that's the travel sector. The global fund has exposure to that thematic through our luxury and beauty holding, so LVMH, as we've been talking about, and also L'Oreal.

Jennifer Herbert (17:35):

Now, Lucina I do like my data points. Are there any early ones that can give some colour on the piece of this recovery in China?

Lucina Martin (17:41):

It's really interesting. We are seeing some really positive signs of what is quite a swift recovery and domestic mobility and travel spend in China. In particular, demand surged quite phenomenally during the Chinese New Year holidays. You might be familiar with Global Hotel Chain Marriott. They actually saw guest revenues return to 2019 levels during this period, some really impressive rebounds in guest revenue when you think that it was down nearly 40% versus pre-COVID levels just a few months ago. We're also seeing some positive forward booking data from a number of different travel providers and players in the sector, and that's indicating that the strength of this travel boom is continuing post that holiday season.

Hannah Dickinson (18:24):

Maybe just to add to that, we've recently had 1Q '23 results from both LVMH and Hermes, so two luxury players. They've both posted really strong results ahead of expectations and a lot of that strength was coming from the recovery in Mainland China or at least the signs of pent-up demand there.

Lucina Martin (18:44):

Yeah. We're definitely seeing some positive indicators there on that domestic recovery. But on the other hand as well, when we think about that outbound tourism, which is another piece to the trend travel reopening story, so far this year it's been much slower to recover than what we've seen domestically. Now, the main reason and the main driver behind that is sort of airline capacity constraints out of China. We're seeing capacity down sort of 80% below pre-COVID levels. However, the important thing to think about is the airline ticket prices are actually up nearly two or three times higher than normal levels, and that's quite a positive sign of sentiment and pent-up demand as well. While the recovery may be a little slower from an outbound perspective over the next few years, it's quite a compelling opportunity for a company like LVMH, given that their demand, as Hannah's mentioned, is quite closely tied to some outbound Chinese tourism.

(19:39):

Under normal circumstances, China is the world's largest outbound travel market. To think about the size of this opportunity, just in 2019 alone, Chinese travellers took over 150 million trips and spent a staggering $250 billion. There's lots of latent demand there and these Chinese travellers are typically

from a high income cohort. We have more conviction around the level of spending that will return for that cohort over the next few years, if not earlier.

(20:07):

As we see Chinese tourists travel across the world to the Asia Pacific region and to the US and Europe, we'll start to see that support what's already a very robust accommodation and leisure market. I'm sure everyone's well aware of the fact that their recent hotel or Airbnb, the price of that is well above pre-pandemic levels. Even if the global economy weakens from here, we expect global travel expenditure to maybe turn out to be a little more resilient than it has been in prior downturns, given some of those positive tailwinds we're seeing coming out of China and just sort of pent-up demand globally as well.

Jennifer Herbert (20:41):

Yeah, the travel bug is certainly alive and well. I agree with you that people are prepared to pay more for the opportunity to go overseas now than they may have been in the past. In fact, the perfect example of this is my son who's planning a backpacking holiday with his uni mates around Europe. They're budgeting $100 a night for the **Host**els. I remember budgeting around $25 a night when I did it. I mean, it's crazy expensive for the boys, but after being locked down during the final years of school, they want the freedom to travel so much that they'll worry about the financial side of all later. I think that's a very common attitude post-COVID.

(21:12):

One more question on China before we move on, and I'll direct this one to you, Jimmy. Clearly, China's reopening is creating some exciting growth opportunities for consumer companies, but how are we thinking about some of the downside risks that come with investing in China, whether it be directly or indirectly?

James Macdonald (21:27):

Sure. That's a very important question, Jen. When we invest in any market or any stock, there's different types of risk. I'll try and bucket your question into three different types. I think the first one is economic risk, which we've kind of been talking about. It's looking a lot better. The Chinese economy is reopening the PBOC's cutting rates, there's a lot of pent-up demand. On the economic risk, everything we've been talking about in today's discussion, that's a positive. That's something that we want exposure to as much as we can.

(21:53):

The other types of risk we're more cautious on, so the second type of risk I'll discuss is political risk. We've seen Chinese president, President Xi Jinping be elected for his third term. We've seen across time he's not necessarily a friend of capital providers and so we're cautious on that type of risk.

(22:09):

The third type of risk is geopolitical risk and geopolitical tensions between China and the West seem to be quite elevated at the moment. Just this year, we've seen the Chinese spy balloon shot down by a US jet. We've seen China and Russia tighten their friendship. We've seen an ongoing war in Ukraine and Russia that's causing this tension between east and west. Geopolitical risk is something that we want to be really cautious about and really think about what types of exposure we're taking. The good news is we can find some stocks that kind of satisfy all this criteria, a stock that is exposed to this nice economic risk that we want a piece of that doesn't come with the political and geopolitical risk that we're more cautious on and more worried about.

(22:49):

One example is one we've spoken a lot about today about LVMH. They make these incredible goods that China can't create themselves because they don't have the brand heritage and the history something like LVMH. The French president, Macron, was just in China and he's kind of helping this Chinese side in the European tensions over where they go with China, do they harden their stance, are they not. He's kind of saying, "Let's be friends here." That kind of helps a company like LVMH. Another one is Apple. Great consumer company. Everyone's familiar with their products, but Apple employs a lot of people in China. That kind of helps them when we're thinking about this geopolitical tension.

(23:25):

The other thing we really think about when we're thinking about China risk, and we saw it with the Russian invasion of Ukraine, is firms are really starting to think about their supply chain reliance on certain geographies. You really don't want to be reliant on a supply chain in one country that could be wiped out by, say, pandemic or by sanctions from the US government. We're seeing this increased decoupling or increased rethinking of supply chains, maybe reshoring, maybe friendshoring, where you bring production to a country that's close to home that's a friend that you know can rely on. That's another way we kind of think about this geopolitical risk we're talking about and we're seeing it all throughout all different types of companies.

Jennifer Herbert (24:05):

I do like that term, friendshoring. The strategy, it does make sense as we see the decoupling take place across the globe, but surely there'll be further inflation and perhaps even other implications on the back of all of this.

James Macdonald (24:17):

Yeah, certainly, Jen. It's a good point. The way we kind of think about it is we broke down the aggregate firm input cost structure. This is just for an aggregate level; it's not an individual company. Each company is different, but roughly 60% of a firm's input costs are labour costs. If you move from a low cost geography to a high cost geography, that will come with added costs and it could put pressure on inflation and it won't be offset by transport costs. We think transport costs are about 5%. Even if you're making something at home and you don't have to ship it across the world, that's really not going to move the needle. Certainly, friendshoring and reshoring will see some price inflation.

(24:52):

The way we think about it is the most critical stuff will come back first. So, you can't be reliant on an unreliable supply chain for something like a medical mask during a pandemic. You need to be able to have access to that when you need it. Those kind of critical industries, healthcare defence, they'll come back first and then consumer goods companies will come back when it makes sense. We think they'll make use of innovative technologies, they'll make use of productivity enhancements where they can, and they'll make sure they do it in a way that allows them to offer attractive products at good prices to consumers and protect their margins.

(25:26):

Another thing to think about is part of this reshoring and friendshoring is a lot of high quality jobs that kind of went overseas could start coming back. That's a potential small positive in all of this.

Jennifer Herbert (25:36):

So the silver lining could be higher employment locally, but Hannah, how are the consumer companies themselves responding to issues like decoupling?

Hannah Dickinson (25:43):

Consumer companies across the board are really rethinking their investment priorities, and I'd say they're bracing for a period of higher capital expenditure. It's not just coming from decoupling. Decoupling is one piece of it certainly, so they're thinking about how they can rejig their supply chains to become more agile and less dependent on countries like China and Russia. But to Jimmy's point earlier, I think we are not quite seeing that just yet from consumer companies. It's other sectors that are moving first.

(26:11):

There are other pressure points. One is regulation. I think that's playing a major role. Companies are really having to adapt to an increasingly strict and complex set of regulations on issues from climate change to data privacy. Then the other piece is digitalization. It's, of course, a long-term trend that really accelerated through COVID, but there are ongoing investment requirements as companies adapt their front end and backend systems to align with new consumer expectations of an omnichannel shopping experience.

(26:46):

All of these pressures are converging and it means the CapEx requirements for companies are increasing, and that's one of the reasons why we like to own capital light businesses like McDonald's and Yum!, which have franchise business models. But it's also a good reminder of the importance of scale as a competitive advantage, because as Jimmy said before, scale is really helping companies offset some of the costs of these investments through technology. Companies like Amazon are really well positioned. They're ahead of the curve in finding ways to automate their supply chains, so their distribution and fulfilment centres are becoming increasingly automated, and that helps them to reduce labour costs, but it can also improve supply chain speed and quality. We're also seeing or we probably will see more advances in AI that affect other spending buckets like marketing, but I think that might be a topic for another podcast.

Jennifer Herbert (27:39):

I have one final question which I'd like to direct to you, Jimmy, as it's around the funding environment and how it's changed dramatically over the past year or so. Initially, we saw central bank rate hikes in response to inflation, and more recently we've seen bank failures and credit tightening. How's this affecting the ability of consumer companies to access capital for their critical investments?

James Macdonald (27:59):

I think what we're really talking about here is access to capital is becoming more important as a competitive differentiator. During a period of low interest rates, there's a lot of money floating around, there's incentives for investors to finance ambitious growth plans and chase consumer growth, grow their market share in consumer markets as quickly as they can with aggressive tactics. As a consumer, that's actually quite good, right? You get a lot of cheap rides from Uber, you get quick delivery in Australia. It's quite topical at the moment, the fast delivery business, MilkRun, and that's something you see in a low interest rate environment. When funding gets a bit tighter, investors have different priorities, they want to see positive cash flow growth, they want to see profitable business models. So, the business mix really shifts. This is not just a tech sector thing. Most people think it's just a tech sector thing. It's a consumer brand thing as well.

(28:47):

In this low interest rate environment that we've had in the past, consumer companies were able to use the money that was freely or readily available and chase consumer growth by things like marketing and

Instagram ads and all this kind of different approaches to attract consumers. That was seeing this kind of fragmentation of the consumer landscape because there was all these different firms able to get a piece of the consumer pie. Going forward, I think it's going to be a bit different, I think. Companies, whether they're consumer companies or tech companies, are going to have more trouble going after this growth. They're going to need to have a proven business model, you're going to have to have a high quality balance sheet, and a proven business plan.

(29:24):

I think larger companies are going to win in this environment. We're going to go from a world of fragmentation to consolidation, and that's going to benefit high quality companies, big brands that have the power to go after these markets through all types of different market cycles. We're going from a world where the rising tide was kind of lifting all boats to now we have to look at which type of boats we think are going to rise with the tide. It's a really important time to think about all these things we've been talking about today.

Jennifer Herbert (29:50):

Well, we certainly have covered a lot today. For our listeners, there's a lot of noise in the media which can sensationalise the headwinds facing the consumer sector. But if you can cut through the noise and focus on quality companies, there are certainly gems to be found. We look for quality companies with pricing power, inflation-protected business models, and durable competitive advantages. These are all characteristics that make for a compelling investment case. Having a strong team of investment professionals dedicated to researching and analysing consumer companies in such depth is an invaluable resource for us here at Magellan. On that note, I'd like to thank our wonderful speakers for their time today. Hannah, Lucina, and Jimmy, thank you for your insights and thank you to you, the listener. We really hope you enjoyed today's discussion as much as we did. Until next time.

Host (30:33):

That was Magellan's head of listed funds, Jennifer Herbert, in discussion with sector head of franchises and healthcare, Hannah Dickinson, and investment analysts, Lucina Martin and James Macdonald. We trust you've enjoyed this episode of Magellan In The Know. Join us in a month's time for the next episode. For more information on upcoming episodes, visit magellangroup.com.au/podcast, where you can also sign up to receive our regular investment insights programme. Thanks for listening.

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