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Food & Beverage

Pricing Power: Who Has It?

Bottom Line: The overall pricing power of US consumer staples companies continues to diminish; though relatively scarce and spread unevenly, pockets of pricing opportunities do exist across several categories and brands.

Based on an in-depth look at three critical drivers, beverage categories have the most pricing power, followed by HPC and Food categories. While all three staples segments lean heavily on innovation and premiumization to generate pricing, beverages and select beauty categories have shown a much greater focus on smaller packages to realize higher pricing than implied by the overall sector CPI. In contrast, food categories show both smaller and larger pack size adjustments, with greater emphasis on larger or "value" pack sizes recently. As expected, high private label penetration signals relatively low pricing power in most food/beverage categories; however, some HPC categories show that high private label penetration can coexist with pricing power.

Key Points

We ranked consumer companies on pricing power based on the three critical drivers: 1) underlying category/brand volume trends; 2) category concentration/fragmentation; and 3) private label penetration. Key takeaways include:

- Beverage categories rank highest in pricing power amongst consumer staples, enabled by dominant brands, advanced price/pack architecture, low private label penetration, and higher exposure to small stores. First, STZ and TAP are best positioned to take pricing in the alcoholic beverage segment; STZ – given its solid volume/share trends and TAP – given disciplined competitive dynamics in the domestic beer segment. Second, MNST is just as well positioned, given high exposure to the less price-sensitive c-stores, low private label share, and solid volume growth. Third, despite volumetric challenges, the CSD category ranks well amongst all staples categories, enabling CSD companies (KO, PEP, DPS) to take adequate pricing to offset heightened inflationary pressures.

- Food companies found pockets of pricing power, especially those with US exposures to frozen meals, snacks, and crackers. First, we would not be surprised if PF, MDLZ (albeit only 20% of its sales are in the US), and K were best positioned to take pricing given their exposure to frozen meals, snacks, and crackers. Second, despite making inroads recently, GIS may have the most untapped potential across its top categories. Third, KHC may be most challenged on pricing given its higher exposure to more commodity-driven categories such as snack nuts, natural cheese, and lunchmeat.

- Within HPC, pet food/treats, charcoal, air fresheners and family planning showed the greatest pricing power, driven by high concentration of top brands, strong volume growth and low private label share gains, while mass beauty (hair care, cosmetics, skin care and fragrance) showed the least pricing power due to share fragmentation. Within our coverage, SPB (pet care, pest control) has the most exposure to high pricing power categories, followed by CLX (coal, laundry, pet care), and then CHD (laundry, family planning, pet care). COTY and ELF have the least pricing power given their exposure to the mass beauty category. That said, both ELF and COTY continue to drive pricing through innovation and the introduction of higher price-point products.

Please refer to pages 26 to 28 for Important Disclosures, including Analyst's Certification.

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Food & Beverage

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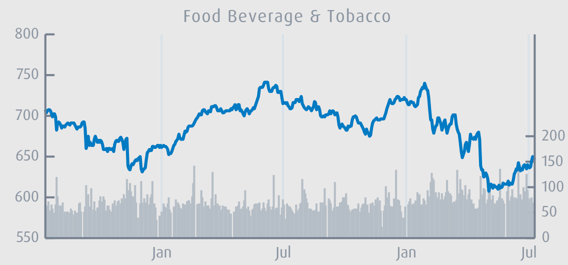
What's Inside

BMO's food, beverage, and household research teams joined forces to write a series of collaborative reports to assess pricing power of consumer staples companies and answer the important questions – 1) what creates pricing power? 2) who has it? and 3) what is the outlook? Our first note addresses key drivers of pricing power and identifies categories/companies with sustained pricing power based on our analysis of 60+ top categories across the US food, beverages, household and personal/beauty segments.



LHS: Price / RHS: Volume (k) Source: FactSet

BMO Top 15 List Member

Constellation Brands (STZ) U.S. Large Cap Stock

BMO Top 15 List

Investment Conclusion

BMO's food, beverage, and household research teams joined forces to write a series of collaborative reports to assess pricing power of consumer staples companies and answer the important questions: 1) what creates pricing power? 2) who has it? and 3) what is the outlook? The first note in this series addresses key drivers of pricing power and identifies categories/companies with sustained pricing power based on our analysis of 60+ top categories across the US food, beverages, household and personal/beauty segments. This report will be followed by two others on: 1) categories/companies with unexercised pricing power; and 2) the emergence of flanker brands and their impact on pricing power for current category leading brands.

The recent surge in freight, fuel, and aluminum costs has created a heightened focus on pricing trends and outlook across consumer staples companies. We took a broad/deep approach to assess the underlying pricing power and identify which US consumer companies are structurally better-positioned than peers to systematically raise prices without penalizing their strategic initiatives to accelerate volume growth, particularly in the face of rapidly-changing consumer buying/consumption trends. **In this report, we ranked consumer companies on their ability to raise prices** – and not just in the current inflationary environment – **based on three drivers we identified as critical determinants of pricing power: 1) underlying category/brand volume trends (40% weighting); 2) category concentration/fragmentation (30% weighting); and 3) private label penetration (30% weighting).** The key takeaways include:

- **Overall pricing power remains challenged and spread unevenly across the US staples industry, though pockets of pricing opportunities do exist across several categories and brands.** Underlying staples inflation moderated steadily from nearly 4% over the last fifty years to 2.3% over the last 25 years, and a measly 1.2% over the last three years, with broad-based weakness across food, non-alcoholic beverages, and household/personal care segments, based on government pricing data for retail outlets. In fact, food prices declined in the last three years while tobacco and alcoholic beverages are the only two segments with increasing pricing trends.

- **A greater focus on optimizing price/pack architecture has enabled beverage and select beauty categories to generate more pricing than that implied by sector CPI,** based on our analysis of pricing trends in more than 60 food/beverage/HPC categories. First, nearly half of these categories show a high degree of pricing power (i.e., 1.5% or higher annual growth) over the last three years. Second, packaging mix unfavorably impacted overall staples pricing by 20 bps, largely driven by food (40 bps) and HPC (30 bps). Third, in contrast to beverages, food categories have adjusted pack sizes both smaller and larger with a greater emphasis on larger, or "value," pack sizes recently in an effort to generate pricing. For instance, in the 17 food categories in which pricing increased annually over the last three years, only three benefitted from a shift to smaller packs while eight benefitted from larger/more "value" packs. We believe there is a long runway remaining for food companies to optimize price pack architecture by shifting to smaller pack sizes similar to the inroads the beverage industry has made. Fourth, HPC categories appear to be the least reliant on price/pack strategies for pricing.

- **Beverages show the highest pricing power** due to low private label penetration, high share concentration, and high exposure to small format stores while being the furthest along in gains from packaging mix**.** **HPC ranks second** due to higher innovation, premiumization, and successful strategies to combat private label (HPC categories with high private label share exhibited the same pricing power as one with low private label). **Food categories ranked lowest,** in large part reflecting recent private label share gains, significantly lower exposure to small format stores, and fewer inroads as a sector in generating consistent gains from mix.
  - Alcoholic and non-alcoholic beverage categories rank highest in terms of pricing power amongst the overall consumer staples segment. In fact, even the largest beverage categories

with relatively weak volume trends – CSDs and beer – show solid pricing power as it benefited from rational pricing behavior among top competitors, high category consolidation (top three companies 75%), low private label penetration (0%), and greater exposure to small-format stores (42%). We expect KO, PEP, and TAP to benefit from disciplined competitive behavior while STZ's prodigious volume growth and premium positioning creates its own pricing power. Energy drinks are also well-positioned and we expect MNST to successfully implement +msd% pricing later this year.

- Despite relatively less mix benefit compared to beverages, food companies still found pockets of pricing power, especially those with exposures to frozen meals, snacks, and crackers. Frozen dinners, salty snacks, chocolate candy, RTE cereal (albeit the shift to box to bag has created a favorable pricing dynamic), and crackers showed the greatest degree of pricing power (+2.1% vs. average pricing of 1.8%), while frozen veggies, snack nuts, natural cheese, lunchmeat, and fresh bread demonstrated the least pricing (+0.3%) due to low brand strength and greater commodities exposure. First, we would not be surprised if PF, MDLZ (albeit only 20% of its sales are in the US), and K (two-thirds of its sales in North America) were best positioned to take pricing given their exposure to categories with the strongest ability to take pricing power – frozen meals, snacks, and crackers, which all fit the rubric of positive volume growth, high branded concentration, and low private label penetration. Second, despite making inroads recently on taking more pricing, we believe GIS (two-thirds of its sales are in the US) may have untapped potential across its top categories. In fact, the top three branded companies in GIS's top five categories (e.g., RTE cereal, yogurt, refrigerated dough, soup, snack bars) have all taken pricing annually over the last three years (0.7% in RTE cereal, 2.9% in yogurt, 1.3% in refrigerated dough, 1.5% in soup, 1.3% in snack bars), while GIS has taken less pricing with the exception of yogurt (recent innovation following lost Yoplait distribution in 2016) and snack bars (GIS focused on innovation with its strong Nature Valley brand). Third, KHC (over 83% of its sales are in North America) may be most challenged on pricing given its higher exposure to more commodity-driven categories such as snack nuts, natural cheese, and lunchmeat.

- Within HPC, the 34 categories we analyzed showed an equal amount of volume growth and pricing, each up ~1%, with 28 of the categories registering positive average pricing over the past three years. Pet food/treats, charcoal, air fresheners and family planning were the categories with the greatest pricing power, driven primarily by high market concentration of top companies (69% vs. 55% avg.), strong volume growth (+1.4% avg.) and low private label penetration growth between 2014-2017 (-0.4% vs. +0.7% for the broader group). On the other hand, mass beauty (hair care, cosmetics, skin care and fragrance) showed the least pricing power due to fragmentation. Key HPC takeaways include: 1) innovation and a shift toward product premium have driven pricing across major categories; 2) high private label penetration can coexist with pricing power; 3) laundry appears to have pricing power for now though that could erode given increased intense competition; 4) mass beauty (hair care, cosmetics, skin care and fragrance) categories were among the categories with the least pricing power based on our analysis, hurt by an increasing share fragmentation; and 5) within our coverage, companies with the most exposure to high pricing power categories are SPB (pet care, pest control), followed by CLX (coal, laundry, pet care), and CHD (laundry, family planning, pet care), while COTY and ELF are the two companies with the least pricing power given their exposure to the beauty category.

Exhibit 1: Pricing Trends in Selected HPC, Food, and Beverage Categories

Household Products

Category	LTM Sales ($ m)	3Y Avg $	3Y Avg Volume	3Y Avg Price/Brand Mix↓	3Y Avg Package Mix	Top 3 Company $ Share	PL Share
Children's Art Supplies	$574	9.8%	-0.4%	10.2%	9.5%	50.8%	9.2%
Pet Treats	$2,603	6.8%	1.4%	5.4%	2.9%	69.0%	9.7%
Household Plastics/Storage	$3,637	7.0%	2.2%	4.8%	4.7%	38.7%	22.2%
Cat/Dog Litter	$1,622	4.1%	0.6%	3.5%	0.4%	80.2%	11.9%
Nutrition/Weight Loss	$7,678	3.2%	0.2%	3.1%	1.4%	22.5%	17.0%
Health Remedies	$16,960	3.0%	0.1%	2.9%	0.4%	26.3%	28.8%
Baby Care	$7,460	-1.7%	-4.3%	2.6%	2.8%	47.4%	16.7%
Cosmetics	$5,318	3.2%	0.6%	2.5%	-0.1%	54.5%	8.7%
Laundry Care	$1,033	3.6%	1.3%	2.3%	0.1%	60.8%	2.1%
Hair Care	$7,827	0.9%	-1.1%	2.0%	-0.3%	48.4%	4.6%
Writing Instruments	$335	1.5%	-0.4%	2.0%	0.3%	58.1%	11.3%
Air Fresheners	$2,281	4.1%	2.2%	1.9%	0.0%	59.7%	9.8%
Family Planning	$1,372	1.8%	0.3%	1.5%	-0.4%	60.7%	9.8%
Feminine Products	$2,697	-0.1%	-1.5%	1.4%	-0.1%	65.7%	17.7%
Mouth Care	$5,655	0.6%	-0.8%	1.4%	-0.3%	60.0%	9.5%
Bleach	$568	-1.3%	-2.7%	1.4%	0.4%	64.1%	34.5%
Pet Food	$9,870	2.5%	1.1%	1.3%	0.7%	81.0%	10.7%
Charcoal	$487	3.3%	2.1%	1.2%	-0.5%	72.7%	19.2%
Water Treatment	$417	-2.1%	-3.2%	1.1%	0.0%	73.7%	6.2%
Food & Trash Bags	$3,449	1.1%	0.1%	1.0%	-0.1%	47.8%	44.7%
Skin Care	$4,793	0.8%	-0.1%	0.9%	1.9%	36.1%	9.5%
Laundry Detergent	$4,420	0.3%	-0.4%	0.7%	0.2%	93.3%	2.4%
Pest Control	$1,079	5.5%	4.8%	0.7%	0.0%	57.9%	3.0%
Razor	$327	1.9%	1.3%	0.6%	-0.1%	77.8%	10.9%
First Aid	$2,833	2.6%	2.2%	0.4%	-1.1%	32.7%	31.4%
Foils & Wraps	$895	1.0%	1.0%	0.1%	-1.6%	57.3%	39.0%
Disposable Tableware	$3,837	3.0%	3.0%	0.1%	-2.0%	26.9%	59.6%
Fragrance	$1,109	-1.7%	-0.3%	-1.4%	-2.4%	39.6%	2.2%
Automotive	$3,498	-0.3%	1.3%	-1.5%	-0.9%	40.7%	16.0%
Household Cleaning	$8,761	1.8%	3.8%	-2.0%	-3.7%	46.1%	10.4%
Grooming Supplies	$1,575	-0.4%	2.1%	-2.5%	0.1%	36.8%	15.7%
Blades	$1,388	-9.2%	-5.9%	-3.3%	2.3%	83.7%	13.0%
Personal Cleansing	$6,912	3.2%	6.5%	-3.4%	-4.8%	58.2%	10.0%
Office Products	$789	5.9%	11.7%	-5.8%	-5.6%	56.2%	8.6%

Packaged Food

Category	LTM Sales ($M)	3Y Avg $	3Y Avg Volume	3Y Avg Price/Brand Mix↓	3Y Avg Package mix	Top 3 comp $ share	PL share (2017)
Yogurt	$5,212	1.0%	-0.4%	4.1%	-2.7%	68.2%	8.8%
Rfg side dishes	$2,195	8.4%	1.8%	3.8%	2.8%	42.7%	19.4%
Spices	$3,202	6.4%	1.3%	3.3%	1.8%	51.3%	21.4%
Fzn dinners	$6,708	3.5%	2.0%	3.0%	-1.6%	55.8%	4.3%
Salty snacks	$12,685	2.7%	1.2%	2.3%	-0.8%	66.1%	6.9%
Chocolate candy	$7,755	1.9%	-1.0%	2.3%	0.7%	80.5%	1.6%
Coffee	$5,995	3.7%	0.8%	2.2%	0.7%	53.6%	15.6%
Snack nuts	$3,303	-0.7%	-2.0%	2.1%	-0.8%	46.9%	23.8%
Cookies	$5,005	2.7%	0.9%	2.1%	-0.3%	58.5%	14.4%
Soup	$4,074	1.1%	0.2%	1.9%	-1.0%	61.6%	11.5%
Crackers	$4,214	1.2%	0.2%	1.5%	-0.5%	67.8%	8.7%
Fzn breakfast food	$2,544	4.3%	3.7%	1.1%	-0.5%	63.7%	26.9%
Lunchmeat	$4,048	-0.9%	-2.7%	1.0%	0.8%	47.6%	17.6%
RTE cereal	$5,656	-1.0%	-0.9%	0.9%	-1.0%	81.2%	8.5%
Fresh bread	$8,967	-0.4%	-1.4%	0.8%	0.2%	50.8%	23.5%
Salad dressing	$1,474	0.7%	1.2%	0.2%	-0.6%	44.5%	14.5%
Breakfast meats	$3,645	1.7%	1.9%	0.0%	-0.3%	43.6%	18.7%
Fzn plain veggies	$1,703	-1.1%	-2.4%	-0.2%	1.5%	43.0%	25.1%
Dinner sausage	$2,118	-2.0%	-1.5%	-1.1%	0.5%	46.4%	10.4%
Natural cheese	$8,508	0.0%	1.4%	-1.2%	-0.2%	28.3%	40.1%

Alcoholic and Non-Alcoholic Beverages

Category	LTM Sales ($ m)	3Y Avg $	3Y Avg Volume	3Y Avg Price/Brand Mix↓	3Y Avg Package Mix	Top 3 Company $ Share	PL Share
Rfg Coffee & Tea	$1,218	12.1%	4.4%	3.0%	4.6%	32.4%	13.9%
RTD Coffee & Tea	$4,173	5.3%	1.3%	3.0%	1.0%	68.9%	1.3%
Beer	$25,505	2.4%	0.0%	2.5%	-0.1%	75.2%	0.0%
Bottled Water	$10,211	6.3%	7.2%	2.1%	-2.9%	55.1%	22.8%
SS Coffee	$2,374	11.7%	15.8%	1.7%	-5.8%	61.1%	20.8%
Wine	$7,280	5.2%	2.9%	1.6%	0.8%	43.7%	0.2%
CSDs	$14,132	-0.5%	-2.5%	1.6%	0.5%	91.2%	3.9%
Sports Drinks	$3,327	-0.2%	-0.9%	1.2%	-0.6%	98.6%	0.3%
Bottled Juice	$5,302	1.0%	-0.6%	0.9%	0.8%	35.5%	13.0%
Energy Drinks	$7,338	1.0%	2.5%	0.7%	-2.2%	86.5%	0.6%
Rfg Juice	$4,421	-0.1%	-1.2%	0.2%	0.9%	68.3%	10.4%
Milk	$12,524	-6.1%	-4.0%	-3.0%	0.9%	28.8%	45.4%
Spirits	$4,903	5.9%	3.5%	-4.2%	6.6%	38.9%	0.2%

Note: Represents full-priced sales

Source: IRI and BMO Capital Markets

Who Has Pricing Power? Category Rankings Across Segments

We ranked more than 60 key categories in the beverages (both alcoholic and non-alcoholic), food, and HPC segments based on their underlying pricing power.

Alcoholic and Non-Alcoholic Beverages

Amongst the 13 key US alcoholic and non-alcoholic beverages categories, beer and energy drinks show greatest pricing power, largely driven by dominant market position of top brands/companies, disciplined pricing, and low private label penetration. While wine and spirits categories do not have "pricing power" in the traditional sense (i.e., ability to raise absolute prices), both of these categories are benefitting from strong premiumization (or trade-up) trends as consumers eschew discount, mainstream, and even premium offerings in favor of super-premium and luxury products. That said, though the carbonated soft drinks (CSD) category does not rank very highly in this analysis (#9 among 13 beverage categories), we believe that the category has shown better-than-expected pricing trends, especially in the more inelastic, immediate consumption channels, owing to rational competitive dynamics as well as an increasing focus on price/pack architecture, particularly by KO.

Exhibit 2: Pricing Power Rankings - Beverage Categories

Category	Volume	Top 3 Company Share	PL Share	Total
Beer	8	4	1	4.7
Energy Drinks	6	3	5	4.8
Wine	5	9	2	5.3
Spirits	4	10	3	5.5
Sports Drinks	10	1	4	5.5
SS Coffee	1	7	11	5.8
RTD Coffee & Tea	7	5	6	6.1
Bottled Water	2	8	12	6.8
CSDs	12	2	7	7.5
Rfg Coffee & Tea	3	12	10	7.8
Rfg Juice	11	6	8	8.6
Bottled Juice	9	11	9	9.6
Milk	13	13	13	13.0

Source: BMO Capital Markets

Based on category rankings within our beverage coverage, the winners are:

- **Beer (STZ and TAP, but for different reasons).** STZ's robust volume growth and on-trend offerings will continue to allow it to take consistent pricing in the 1-2% range. On the other hand, despite declining volumes, rational behavior by both TAP and ABI in the domestic premium light beer category has supported incrementally higher prices. Specifically, TAP and ABI have posted average price/brand mix of +1.8% and +2.2%, respectively, over the last three years, even as their full-priced volume declined by 1.4% and 2.4%, respectively. For STZ, the company has been able to take average pricing of +1.1% over the past three years even as imported beer maintains a roughly 50% price premium over domestic premium beer brands.

- **Energy Drinks (MNST)** as solid +dd% volume growth in the US, market leadership (39.4% share versus Red Bull 38.5%), de Minimis private label competition (0.6%), and small format store exposure (c-stores account for nearly 75% of MNST's measured channels sales) should give it solid, hitherto untapped, pricing opportunities. In fact, after not raising list prices for nearly three years, MNST recently signaled price increases by year-end to offset commodities/freight inflationary pressures. While we expect Red Bull to raise prices as well, MNST's pricing opportunity likely lies in the wider price gap between MNST's 16-ounce can and Red Bull's 8-ounce can offerings – implying a +msd% price increase.

- **CSDs (KO and to a smaller extent PEP and DPS).** The competitive environment in the CSD category remains rational and given inflationary pressures, we expect all three major CSD companies to implement price increases in the near term, likely to be led by KO. While PEP has noted that it will compete for its fair share, it intends to do so "responsibly" and stressed that it does not want to engage in a price war. The category is also benefitting from greater focus on price-pack architecture, a form of pricing, as companies sell smaller pack sizes (e.g., 7.5-ounce mini cans) at higher per-ounce prices. Over the past three and five years, the CSD category has benefitted from 0.5% and 1.0% from package mix, respectively (i.e., faster unit growth versus volume growth, does not account for higher per-ounce prices). We note that DPS is a price follower but benefits from actions of KO and PEP.

Based on our rankings and category dynamics, losers within our coverage include:

- **Milk (DF)** as category dynamics including declining consumption and high private label penetration (highest among all beverages) suggest that brands have very little pricing power in the commodity-based fluid milk category.

Packaged Food

Frozen dinners, salty snacks, chocolate candy, RTE cereal, and crackers realized the greatest pricing power with an average of 2.1% pricing for this cohort relative to average pricing of 1.8% for the broader sample we analyzed. Interestingly, above-average pricing came at the expense of adverse packaging mix (-60 bps vs. -30 bps for the food group), as brands benefitted from: 1) the expansion to larger pack sizes; 2) higher list pricing; 3) less deep discounting; and 4) modest benefit from premiumization and consumer trade up. Volume growth was somewhat elusive across the five categories with the exception of salty snacks and frozen dinners; however, all the categories possess strong market share positions and benefit from low private label penetration. Second, with average pricing of 0.3% (relative to industry average of 1.8%), frozen plain veggies, snack nuts, natural cheese, lunchmeat, and fresh bread demonstrate the least degree of pricing power, due to low brand strength and greater reliance on commodities for higher prices. Notably, all these categories face greater private label penetration and limited concentration of market by brand leaders. Based on our category analysis, there were distinct winners within our coverage group, including:

- **Frozen players (e.g., PF, BGS, TSN, KHC).** We believe that PF, BGS, TSN, and KHC (albeit a relatively smaller component of KHC's overall portfolio) should capture superior pricing opportunities, as two of the three categories (frozen dinners and frozen breakfast food, which includes breakfast entrées and handhelds and waffles) generated above-average volume and held strong brand concentration levels. First, even frozen veggies, which fell toward the bottom third in terms of volume growth, brand concentration, and private label penetration, showed solid pricing as greater innovation (following the purchase of Green Giant by BGS) more than offset commodity reliance and market share gains from private label and smaller brands. Second, the top three brands in frozen breakfast collectively outperformed the strong growth of the category (3.9% vs 3.7%) despite market share gains by private label and more moderate pricing. Notably, we would not be surprised if the frozen breakfast category presents a strong opportunity for unexercised pricing power, which we expect to explore in our next report.

Exhibit 3: Food Segment Category Rankings

Category	Volume	Top 3 comp share	Private label penetration	Total
Fzn dinners	2	9	2	4.1
Salty snacks	7	5	3	5.2
Chocolate candy	15	2	1	6.9
RTE cereal	14	1	4	7.1
Crackers	12	4	5	7.5
Yogurt	13	3	6	7.9
Fzn breakfast food	1	6	19	7.9
Cookies	9	8	9	8.7
Soup	11	7	8	8.9
Breakfast meats	3	17	13	10.2
Spices	6	11	15	10.2
Coffee	10	10	11	10.3
Salad dressing	8	16	10	11
Rfg side dishes	4	19	14	11.5
Dinner sausage	17	15	7	13.4
Natural cheese	5	20	20	14
Fresh bread	16	12	16	14.8
Lunchmeat	20	13	12	15.5
Snack nuts	18	14	17	16.5
Fzn plain veggies	19	18	18	18.4

Source: BMO Capital Markets

- **Snack players (e.g., PEP, K, HSY, MDLZ, GIS).** Snack categories – primarily salty snacks, crackers, and yogurt – possess strong pricing power characteristics, including volume growth in the top third, very high brand concentration levels, and the lowest level private label exposure of food categories. However, we maintain a degree of concern with key snacking categories, particularly chocolate, given the onset of online shopping (less ability to generate instant consumption in addition to a less inelastic demand curve compared to brick and mortar channels) and the expansion of snacking to beyond conventional categories. First, despite smaller flanker brands chipping away at its dominant share leadership, PEP, with 63% share of the $12 billion snacking category, still maintains excellent pricing power as evidenced by 2.6% pricing annually over the last three years. Second, despite middling volume growth, both chocolate candy and crackers ranked high in our pricing power rubric with high brand concentration and low private label exposure. The top three brands in chocolate candy (e.g., HSY, Mars, Lindt) generated sales growth entirely from pricing (2.2% vs. 2.0% for the top three brands) as well as small contribution from packaging mix (30 bps) as the category incorporated more mini packs over the last several years (overall volume declined 60 bps). HSY drove pricing of 2.5% annually over the last three years – higher than the top three brand average and higher than the category overall – but it suffered from volume declines worse than both the top three brand average and the category (-1.2%) and did not benefit from mix gains any more than the category. Third, crackers was one of the few categories in which the top three brands gained share and private label lost share as MDLZ, Campbell, and K all generated sales growth and realized better-than-average pricing power (i.e., MDLZ realized 0.6% pricing and average annual growth of 0.5%, K generated 1.5% pricing and 6% sales growth). Fourth, the yogurt category realized the greatest degree of pricing annually over the last three years among food, beverage, household products, and beauty. Interestingly, GIS drove the majority of the pricing with more than 5% pricing annually while both Danone and Chobani posted price declines. The yogurt category benefited from brand mix (i.e., annual volume and packaging mix declines) over the last three years, as the category realized an acceleration of consumer demand, innovation, and the introduction of new yogurt varieties (e.g., high protein, higher probiotic concentration, Icelandic/Australian/French).

Household Products and Beauty

Exhibit 4: HPC Segment Category Rankings

Category	Volume	Top 3 Company $ Share	Private Label $ Share Growth	Top 3 Distribution Share	Average
Pet Food	15	3	6	16	10.0
Charcoal	10	7	3	24	11.0
Air Fresheners	6	14	24	1	11.3
Pet Treats	11	8	17	12	12.0
Family Planning	19	12	16	2	12.3
Cat/Dog Litter	18	4	10	19	12.8
Laundry Care	14	11	12	17	13.5
Personal Cleansing	2	15	23	15	13.8
Laundry Detergent	25	1	14	17	14.3
Nutrition/Weight Loss	20	34	2	2	14.5
Razor	12	5	33	10	15.0
Household Cleaning	4	25	18	13	15.0
Health Remedies	21	33	4	2	15.0
Pest Control	3	17	21	20	15.3
Feminine Products	30	9	20	2	15.3
Bleach	31	10	1	22	16.0
Foils & Wraps	16	18	9	24	16.8
First Aid	7	31	29	2	17.3
Grooming Supplies	9	29	30	2	17.5
Writing Instruments	26	16	5	24	17.8
Office Products	18	19	11	24	18.0
Mouth Care	28	13	26	9	19.0
Water Treatment	32	6	15	24	19.3
Baby Care	33	24	7	14	19.5
Blades	34	2	34	10	20.0
Children's Art Supplies	27	21	8	24	20.0
Hair Care	29	22	25	8	21.0
Cosmetics	17	20	28	21	21.5
Automotive	13	26	27	24	22.5
Household Plastics/Storage	8	28	31	24	22.8
Food & Trash Bags	22	23	22	24	22.8
Disposable Tableware	5	32	32	24	23.3
Skin Care	23	30	19	23	23.8
Fragrance	24	27	13	34	24.5

Source: BMO Capital Markets

Within HPC, pet food/treats, charcoal, air fresheners and family planning were the categories with the greatest pricing power, with an average pricing of +1.7% for the group, driven primarily by high market concentration of top companies (69% vs. 55% avg.), strong volume growth (+1.4% avg.) and low private label penetration growth between 2014-2017 (-0.4% vs. +0.7% for the broader group). On the other hand, mass beauty (hair care, cosmetics, skin care and fragrance) categories showed least pricing power, hurt by an increasing share fragmentation, with the top three brands losing an average of 4.4% points over 2014-2017 to smaller, indie brands and private label (+0.8% points on average). First, innovation and a shift toward product premium have driven pricing across major categories. In particular, pet care pricing has benefited from premiumization, with owners (particularly millennials) choosing higher-quality, higher-priced products that closely align with current dietary trends (e.g., natural, grain-free, organic and raw) over their mainstream counterparts. Meanwhile, steady innovation provides pricing power even in categories where our analysis would predict the contrary, with ELF's strong innovation pipeline leading to three-year average pricing growth of 19.6% YoY, despite its exposure to low pricing power categories (skincare, cosmetics). Second, high private label penetration can coexist with pricing power. While CLX is highly exposed to private label in several categories, including bleach (35%), food & trash bags (45%), foils & wraps (39%) and charcoal (19%), its focus on innovation and value proposition has given it pricing power in Foils, wraps & bags (+0.8% three-year avg.) and barbecue (+0.4%). Third, laundry appears to have pricing power…for now. Laundry categories, including detergents (+0.5% pricing) and laundry care (+2.3%) are among the categories with the highest pricing power driven by innovation (unit dose, scent boosters) and the introduction of pricier, environmentally-friendly products; that said, laundry pricing power could erode in the future due to a lack of innovation driving volume growth (unit dose has slowed down recently), and more intense competition.

Potential winners within our coverage include:

- **SPB:** Within our coverage, SPB has the highest exposure to high-pricing power categories, including smart locks (not tracked in IRI), Pet Care, which is its biggest tracked category (27% of tracked sales), and Pest Control (18%) in the top half of pricing power, where it also enjoys a #2 market position. Of note, SPB has generated three-year average pricing of +1.9% YoY in the latter category. In the near term, SPB's pricing power is being dampened by operational issues in its distribution centers, so we expect muted margins; however over the long term, we believe SPB is in a good position to take pricing.

- **CLX:** CLX is exposed primarily to three high-pricing power categories: Coal (12%), Laundry Care (11%) and Pet Care (10%), for which it has achieved positive three-year average pricing of +0.4%, +2.6% and +1.1%, respectively. Furthermore, we believe that our rankings might understate CLX's ability to raise prices in other categories, with recent pricing actions in disinfecting wipes well received, and more than 30+ products over the past five years given the strength of its brand and value proposition. Besides coal (#1 market position) and cat/dog litter (#2), CLX is also strongly positioned in other categories in the top half of our rankings, including bleach (#1 market position), household cleaning (#2), and foils & wraps (#3).

- **CHD:** Based on our analysis, CHD is highly exposed to several high pricing power categories including Laundry (39% of tracked sales), Family Planning (15%) and Pet Care (12%), with the company generating positive pricing in Laundry (+2.4%) and Pet Care (+2.7%) on average over the past three years.

Based on our rankings and category dynamics, losers within our coverage include:

- **ELF / COTY:** Given their exposure to the beauty category, which features loss of market share by top brands due to the influx of smaller, indie brands and private label across retail channels, ELF and COTY rank Low in pricing power. That said, ELF has generated three-year average pricing of +19.6% YoY, primarily as a result of management's commitment to increase AUR through product innovation and higher price point categories (e.g., skincare) at the expense of slower volume trends in order to drive brand productivity.

Exhibit 5: HPC Company Rankings

Company	Weighted Avg Category Rank	Pricing Power Level
SPB	11.3	High
CLX	12.7	High
CHD	13.9	High
NWL	15.2	Mid-High
ELF	21.2	Low
COTY	21.7	Low

Source: BMO Capital Markets

Key Drivers of Pricing Power

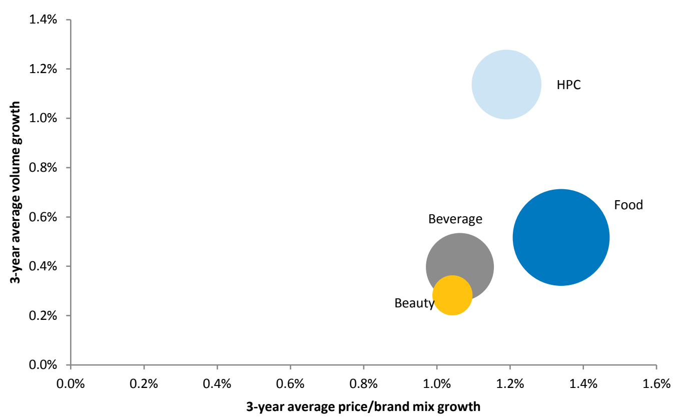
With the backdrop on more companies seeking to take pricing, we analyzed the data to best assess the key attributes that determine the success (or failure) of pricing power. In our view, the categories that maintained pricing power share one or more of the following key traits: 1) growing volumes; 2) high market share concentration of the top three brands (60% or above); 3) low private label penetration; and 4) greater channel diversification and ubiquity. We determined that yogurt, refrigerated side dishes, spices, frozen dinners, RTD coffee & tea, beer, sports drinks, salty snacks, chocolate candy, CSDs, energy drinks, pet food/treats, charcoal and air fresheners enjoyed the highest degree of pricing power while cheese, dinner sausage, milk, fresh bread and rolls, bottled juice, refrigerated juice, fragrances, skincare and disposable tableware experienced the lowest degree of pricing power.

Specifically, the key drivers of sustainable pricing power are:

Volume Growth

Volume growth – through a shift toward larger unit sizes – has created pricing power recently. With the backdrop of an exceedingly low volume growth environment, the categories experiencing volume growth have gained the additive benefit of pricing in large part reflecting higher leverage with retailers and stronger consumer demand. Overall, those food categories with volume growth (12 of 20 categories) took average annual price/mix of 1.7% over the past three years relative to 1.2% price/mix for categories with declining volumes (eight categories). Within the 13 beverage categories we looked at, both alcoholic and non-alcoholic, seven showed positive average volume growth over the past three years with average price/mix of +1.4% (+2.3% excluding single-serve coffee) relative to +1.0% average price/mix for the six categories with average volume declines. Lastly, HPC categories with positive average volume growth over the past three years (22 of 34 categories) took pricing of 1.4% relative to 0.4% pricing for categories with declining volumes (12 categories). This excludes office products and automotive, which are exposed to distribution channels that are experiencing significant declines in foot traffic.

Exhibit 6: Price/Mix vs. Volume Growth in Food, Beverage, HPC, and Beauty



Source: IRI and BMO Capital Markets

- **Food:** Volume growth largely – albeit not exclusively – begets pricing within the food category largely through larger packaging with greater price realization while the contribution from packaging mix remains minimal.
    - Volume and price/mix have more than a 65% correlation excluding some outlier categories, as shown in Exhibit 8. Note that the volume growth-pricing relationship was severely skewed by the inclusion of natural cheese, breakfast meat, frozen breakfast, and

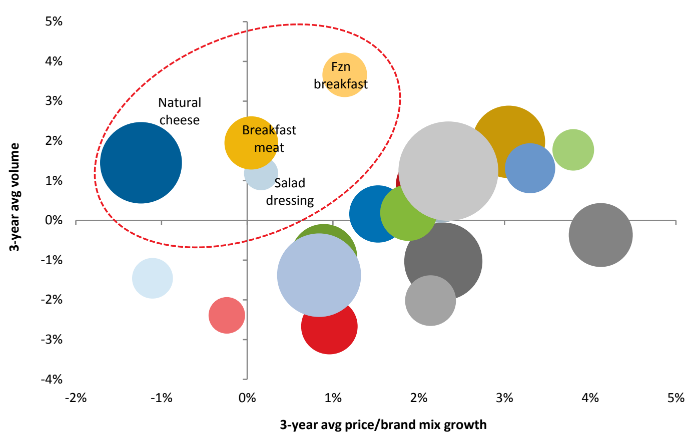
salad dressing (see Exhibit 7), as these categories generated volume growth but lower packaging mix (i.e., a shift toward larger unit sizes) and inconsistent pricing in part reflecting either a commoditized nature and/or extreme promotional pressure.

- Pricing power expands with the magnitude of volume growth, as food categories in the top quartile of volume growth took an average of 3.2% price/mix versus a 0.5% price reduction for categories in the bottom quartile of volume growth.

- Many food companies continue to seek the most optimal price pack architecture; however, the recent shift in packaging, contrary to popular opinion, has tended to result in an increase in both price and unit size (albeit not consistently in a one-to-one relationship) rather than reducing the size of product. For instance, while 17 of the 20 food categories generated positive annual pricing over the last three years, only three categories (e.g., chocolate candy, lunchmeat, fresh bread) generated higher pricing from product or pack size reduction (i.e., lower volume, higher mix) while eight categories generated higher pricing through larger or "value" pack sizes (i.e., higher volume, lower mix). Moreover, seven (e.g., frozen dinners, cookies, soup, crackers, frozen breakfast food, salad dressing, breakfast meat) of the 12 categories in which volume increased, pricing improved despite unfavorable packaging mix while the five categories in which volume declined and mix improved (i.e., a shift toward smaller pack sizes), only three benefited from higher pricing (e.g., chocolate candy, lunchmeat, fresh bread) and only one generated annual growth (e.g., chocolate candy) over the last three years. Notably, two categories (e.g., frozen plain veggies, dinner sausage) attempted to improve mix through decreasing pack size but failed to generate pricing.

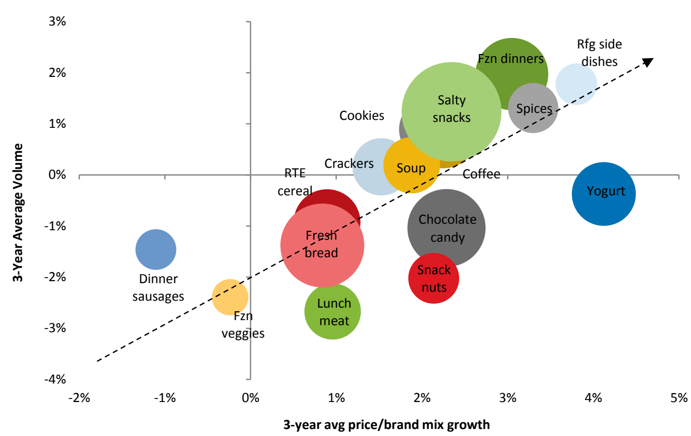
- To be fair, volumes are not a panacea for pricing, particularly for the more commoditized categories, as evidenced by at least a few food categories, such as cheese, frozen veggies, and dinner sausages, with higher volume or mix but lower pricing.

Exhibit 7: Price vs. Volume Growth for Select Food Categories



Source: IRI and BMO Capital Markets

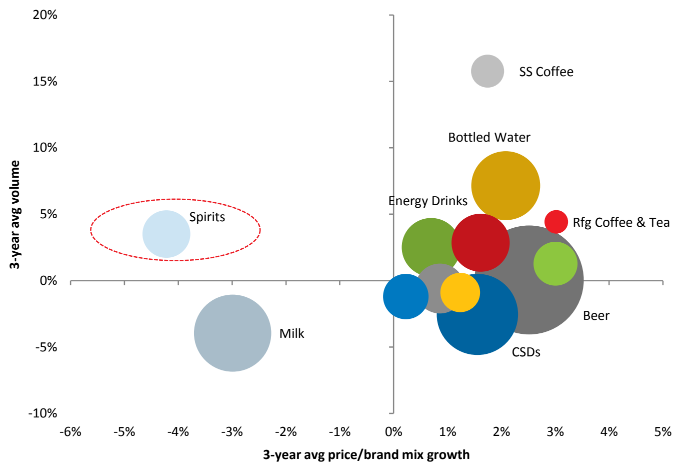
Exhibit 8: Price vs. Volume Growth for Select Food Categories
(excluding Cheese, Breakfast Meat, Frozen Breakfast, Salad Dressing)



Source: IRI and BMO Capital Markets

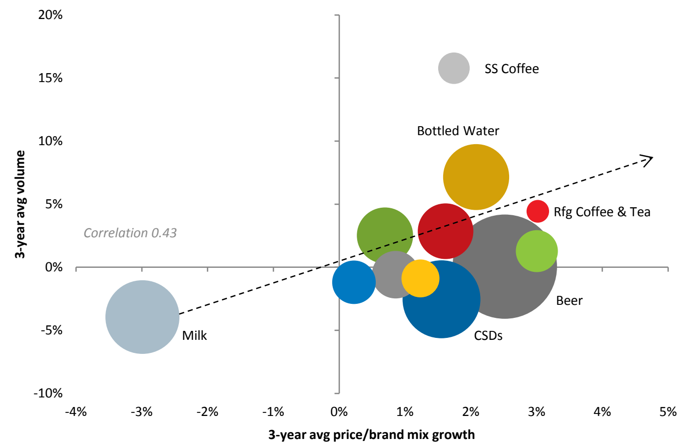
- **Beverages:** Beverage categories within the top quartile of volume growth (excluding spirits) generated more pricing power with average price/brand mix of +2.3% vs. average price/brand mix reduction of 0.4% for categories in the bottom quartile by volume growth. Overall volume growth showed a 60% correlation with price/brand mix for beverage categories (excluding spirits and single-serve coffee). Note that this relationship would have been notably weaker with the inclusion of spirits (+25%), as spirits price/brand mix has been inflated by proliferation of pints and miniature spirits bottles, which served to accelerate unit sales while having minimal impact on volume. Similarly, inclusion of single-serve coffee would have pushed down this correlation to 40% as the 16% average volume growth in this category was largely driven by private label and larger pack-sizes (-5.8% package mix for the category). Moreover, given the well-established consumer shift to premium offerings, categories with stronger shift to premiumization showed stronger price/brand mix, including beer (+2.5%), refrigerated coffee & tea (+3.0%), and RTD coffee & tea (+3.0%). In terms of package mix (i.e., pack size), we see four categories in which package mix improved even with lower volumes (i.e., a shift toward smaller pack sizes) – CSDs, milk, refrigerated juice and bottled juice. In contrast, in two categories showed negative package mix even with higher volumes (i.e., a shift toward larger pack sizes) – bottled water and energy drinks.

Exhibit 9: Price/Brand Mix vs. Volume Growth for Select Beverage Categories



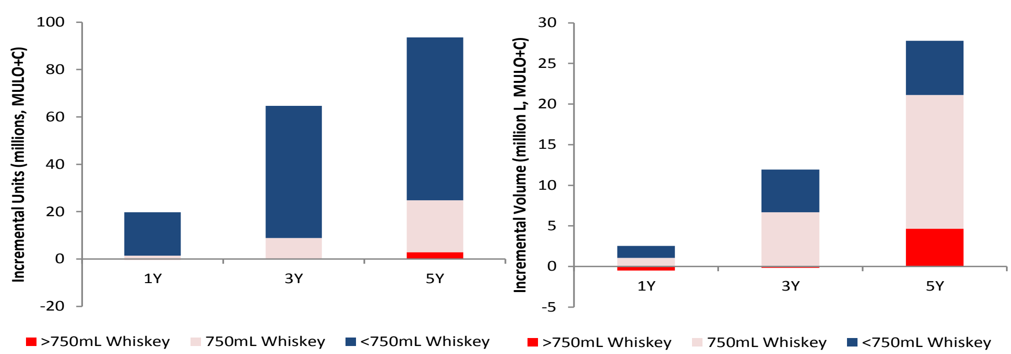
Source: IRI and BMO Capital Markets

Exhibit 10: Price vs. Volume Growth for Select Beverages Categories (excluding Spirits)



Source: IRI and BMO Capital Markets

Exhibit 11: Miniature and Pint Spirits Driving Most Unit Growth but Little Volume Growth



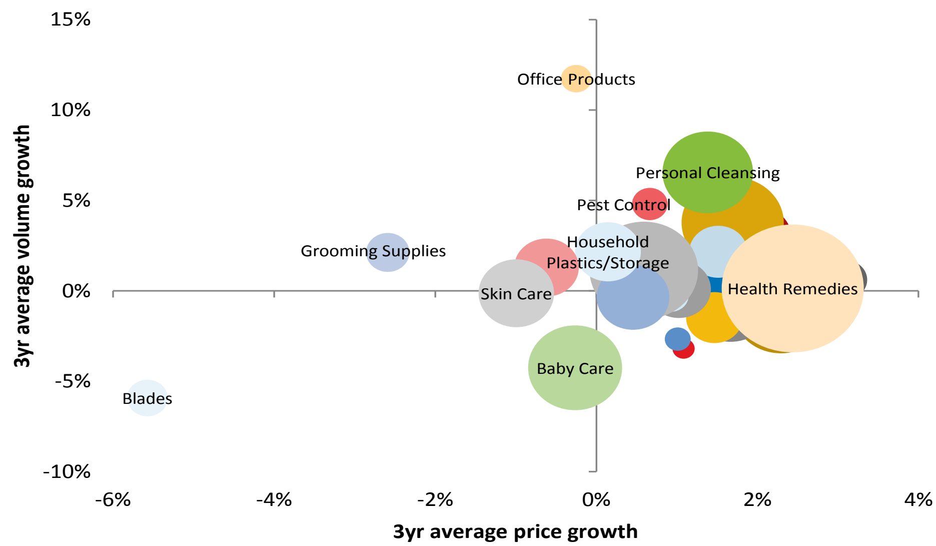
Source: IRI and BMO Capital Markets

- **HPC:** For HPC categories, those with volume growth (22 of 34 categories) took pricing of 1.4% over the past three years relative to 0.4% pricing for categories with declining volumes (12 categories). This excludes office products and automotive, both of which are exposed to distribution channels that are experiencing significant declines in foot traffic.

  That said, the correlation between volume and price is much lower for HPC categories at ~40% than for food and beverage (65% and 80%, respectively), excluding automotive and office products. For HPC, pricing power did not significantly expand with the magnitude of volume growth, as categories in the top quartile of volume growth took 0.7% in pricing versus a 0.3%

price increase for categories in the bottom quartile of volume growth. Razor blades and baby care were two categories with declining volumes and pricing. In addition, while 27 of the 34 HPC categories we analyzed generated positive annual pricing over the last three years, just nine categories (e.g., pet categories, nutrition) generated higher pricing by some extent of product or pack size reduction (i.e., lower volume, higher mix) while 25 categories generated higher pricing through larger or "value" pack sizes (i.e., higher volume, lower mix).

Exhibit 12: Price vs. Volume Growth for Select HPC Categories



Source: IRI and BMO Capital Markets

Market Share Concentration by Top Three Leaders

Market share concentration contributes to pricing power; however, pricing power does not tend to translate into market share gains for the leaders (though market share losses are more contained within categories with greater market share). After reviewing market share concentration by dollar share of the top three companies across several food, beverage, and HPC categories, we determined that categories dominated by a few companies tend to have better pricing power than more fragmented categories. Even in categories in which the traditional big brands cede share to flanker brands (e.g., the majority of categories, including salty snacks, yogurt, soup, cookies), the strength in the absolute level of market share held by the top three companies translated into an ability to take pricing on the shelf.

- **Food:** Controlling market share by the top three branded players in a category provides a clear indication of pricing power; however, RTE cereal may be a more moderate example (or even an exception to the rule) given the moderation of promotional activity, the shift towards bagged product, and more rational pricing behavior within the category. First, all twelve food categories in which the top three branded players held more than 50% of the dollar share (of the 20 categories we analyzed) demonstrated pricing power to a certain degree. Second, despite maintaining the highest share concentration of its top three branded players (81% dollar share) of any category, RTE cereal gained the least amount of pricing, largely a reflection of the secular headwinds of the category (the category sustained a 100 basis point decline annually over the last three years as it lost share to other breakfast alternatives that offered more portability and protein). Third (and contrary to expectations), in those categories that gained pricing through concentrated market share, none of the three market leaders gained more than 80 bps of share (the top three brands within crackers and frozen dinners both gained 80 bps). In fact, category leaders ceded share in six (e.g., yogurt, salty snacks, soup, cookies, coffee, spices) of the 12 categories. Furthermore, in nine of the 20 categories, the top three branded incumbent players ceded more than 100 bps of market share over the last three years, despite all but two categories (dinner sausages and salad dressing – two categories highly impacted by underlying commodity volatility and/or promotional intensity) generating positive pricing. Even in four (e.g., spices, lunchmeat, coffee, dinner sausage) of the five categories that experienced more than 200 bps of share loss by the top three branded incumbents, all but dinner sausage generated positive price/mix.

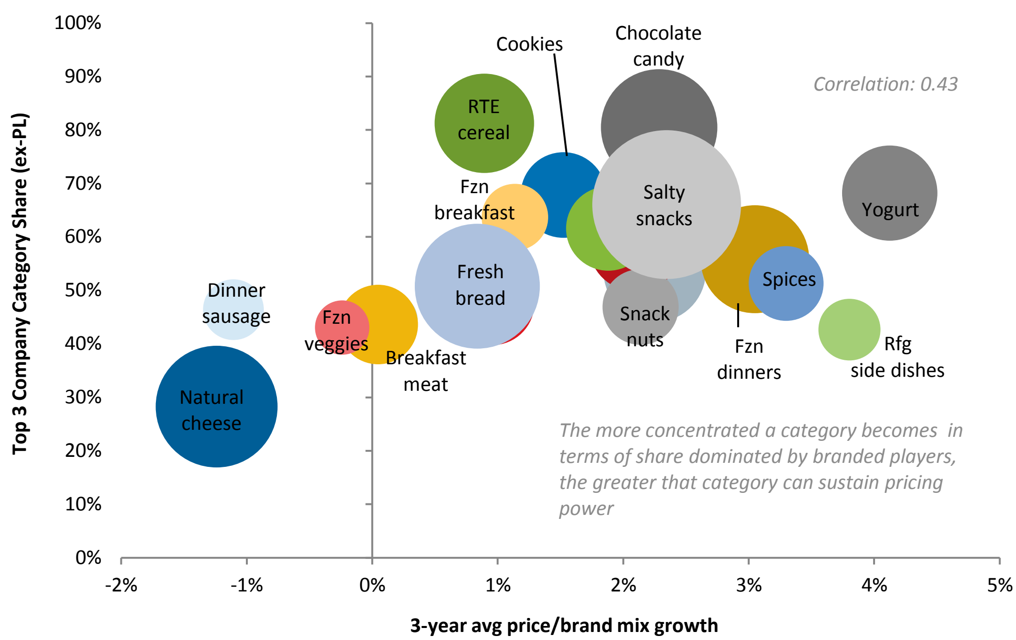
- Within the top quartile of categories in terms of top three brand concentration (average concentration of 72%), the categories gained 150 bps of price/mix; however, the market leaders lost 70 bps of market share. For instance, the top three yogurt companies (Danone, Chobani, GIS) ceded 260 bps of share to smaller companies yet gained an aggregate average annual pricing of 2.9% (the majority of which was by GIS taking 5.1% pricing relative to marginally negative pricing from Danone and 1.2% lower pricing from Danone).

- Within the second quartile of food categories (average concentration of 58%), the categories gained 170 bps of price/mix, but market leaders lost 90 bps of share. For example, the top three branded soup companies (Campbell's, GIS, BGS) ceded 170 bps of share yet gained 190 bps of pricing driven largely by Campbell's (GIS took marginally lower pricing over the last three years).

- Within the third quartile of the food categories (average concentration of 49%), the categories gained 170 bps in price/mix net of packaging mix adjustments. That said, the top three incumbent share loss accelerated from the other quartiles to 180 bps driven largely by the large share losses in spices and lunchmeat. While the top three market leaders in three of the five categories within this quartile all ceded share, the top three branded players gained share within snack nuts and took 510 bps of price/mix while the other four categories only took an average of 90 bps of pricing. Within lunchmeat, the top three branded companies (KHC, TSN, and Land O Frost) ceded more than 500 bps of share over the last three years to competitors but took 1% pricing despite deflationary pressure in meats and distribution losses (primarily KHC as it consolidated its protein footprint following the merger with Heinz). Specifically, KHC drove a large part of the pricing by taking an annual average of 320 bps over the last three years.

- Within the bottom quartile (average concentration of 36%), the categories only gained 10 bps; however, the top three brands within these categories (e.g., salad dressing, breakfast meats, frozen veggies, refrigerated side dishes, natural cheese) gained 60 bps of share driven largely by 220 bps of share gain in frozen veggies (heightened innovation push from both PF and BGS in the category) and 560 bps of share gain in refrigerated side dishes (fragmented category but benefits from rare strong consumer demand as sales continue to increase at a double digit rate). Refrigerated side dishes gained 560 bps of share over the last three years by taking pricing, enjoying a packaging mix benefit, as well as volume gains as the category continues to benefit from strong consumer demand in potato side dishes and a relatively untapped distribution opportunity.

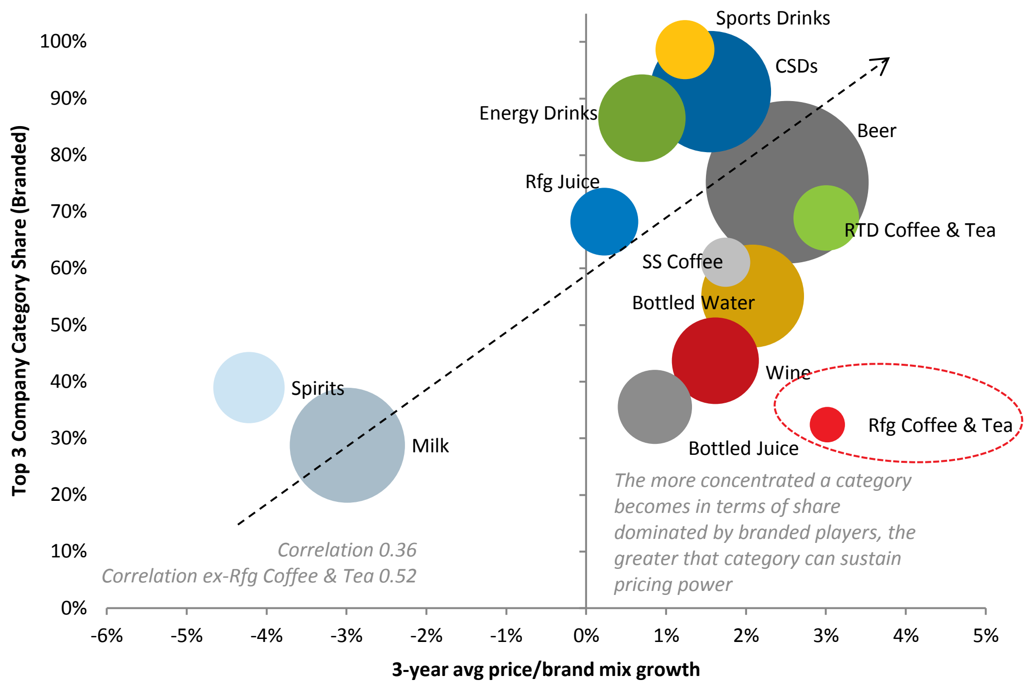
Exhibit 13: Price vs. Branded Share Concentration in Select Food Categories



Source: IRI and BMO Capital Markets

- **Beverage:** All eight of the beverage categories in which the top three branded players held more than 50% of the dollar share (eight of the 13 categories) generated positive price/brand mix (e.g., CSDs, beer, sports drinks, RTD coffee & tea, energy drinks, single-cup coffee, bottled water, and refrigerated juice), though in only one category did the three market leaders gain incremental value share over the past three years (e.g., energy drinks). The correlation between branded company share and price/mix growth was skewed by refrigerated coffee & tea (e.g., cold brew), which is a fragmented category but is growing rapidly with high penetration of premium brands and when excluding that category, we found that branded share concentration had a positive correlation to price/mix growth (52%). We also found that change in market share among the top three companies actually had no relationship to price/mix growth, which signals to us that incumbents still maintain significant clout in their respective categories and seek to mitigate share losses with higher price/mix. For example, even as the top companies gained share (e.g., Monster, Red Bull), the energy drinks category had the second weakest price/mix among the eight more highly concentrated categories, and the second weakest pricing behind refrigerated juice when excluding package mix, likely driven by competition for share and focus on distribution gains. Market leaders in the remaining seven more highly concentrated categories ceded on average 330 bps of share since 2014 yet had average price/mix growth of roughly 1.8% with categories where share leaders ceded more than 300 bps share generating on average 230 bps price/mix (with -190 bps package mix).

Exhibit 14: Price/Brand Mix vs. Branded Share Concentration in Select Beverage Categories



Source: IRI and BMO Capital Markets

- Within the top quartile of the beverage categories based on top three company concentration, the market leaders maintain on average 88% market share and gained average price/mix of 150 bps despite ceding roughly 60 bps market share. Within the top quartile, average volume declined 0.2% with declines in CSDs and sports drinks and flat growth in beer; however, even with declining volume, the highly concentrated nature of these categories allowed for +1.8% average price/mix. Additionally, CSDs had positive package mix driven by a shift to small pack sizes while opportunities in beer to drive smaller packs is more limited. On the other hand, both energy drinks and sports drinks had negative package mix driven by larger pack sizes (e.g., Monster gaining share versus Red Bull).

- Within the second quartile of the beverage categories, the market leaders maintained on average 66% market share and gained average pricing of 170 bps despite ceding on average a whopping 440 bps of market share since 2014. We also note that within these categories (e.g., single-cup coffee, refrigerated juice, RTD coffee & tea), the packaging mix was on average -130 bps driven by a 580 bps decline in single-serve coffee. Volume growth for the quartile was driven by single-serve up 15.8% versus flat volume for refrigerated juice and RTD coffee & tea.

- Within the third quartile of the beverage categories, the market leaders maintained on average 45.9% market share and had average price/mix of -20 bps, though skewed by spirits' -4.2% average price/mix. In these categories, the market share leaders ceded 290 bps of market share, led by bottled water with 610 bps loss in top three company share, while category leaders in spirits and wine ceded 20 bps and 240 bps share, respectively, since 2014. Volume was strong in this quartile, averaging +4.5%, driven by shifting consumer preferences away from high caloric beverages into water and from beer into wine and spirits.

  - Within the bottom quartile of the beverage categories, the market leaders maintained average market share of 32.2% and average pricing of 30 bps. Each of the categories in this group generated positive packaging mix with average of flat volume. Results in this segment were skewed by milk, which has faced declining consumption trends and high private label share (45.4%, highest among beverages)

- **HPC:** The top three branded players that held more than 50% of the dollar share in 21 of 34 HPC categories displayed higher pricing power (+1.1% vs. +0.8% for the more fragmented categories), though we see in many categories that power eroding. First, despite maintaining the highest share concentration of its top three branded players (93% dollar share) of any category, laundry detergent took just 0.5% in pricing. Second, the top three branded players in blades that now hold 83.7% of share, lost 750 bps of share over the last three years, and hence took a 6% reduction in pricing. In addition, the top branded players in the most concentrated categories lost 400 bps of share over the same timeframe. Furthermore, the top players in the least concentrated lost 280 bps of share. In fact, in only nine of the 34 categories did the top three players gain share (laundry care, bleach, cat/dog litter, automotive, foils/wraps, food & trash bags, health remedies, household cleaning and laundry detergent). The categories took 1.7% in pricing compared with the 0.8% in the categories losing share (mix drove half of the 0.8% gain).

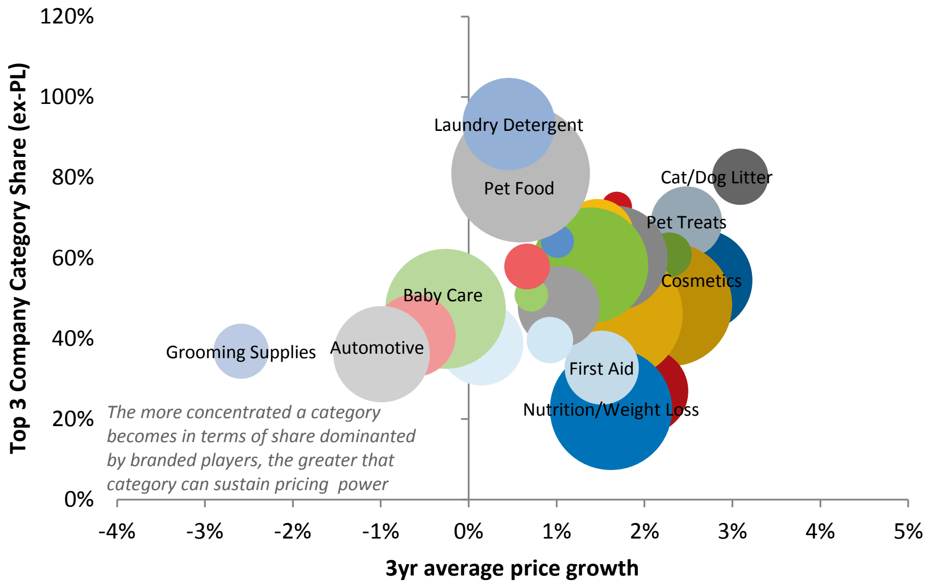
  - Within the top quartile of categories (average concentration of 77.5%), the categories gained 70 bps of pricing; however, the market leaders lost 400 bps of market share. The most pronounced losses were, not surprisingly, in razors and blades, followed by pet categories, charcoal and water treatments.

  - Within the second quartile of HPC categories (average concentration of 59%), the categories gained 160 bps of pricing power, but share remained flat driven by large gains in bleach and laundry care offset by air fresheners, personal cleansing, writing instruments, family planning and mouth care.

  - Within the third quartile of the HPC categories (average concentration of 49%), the categories gained 110 bps in pricing. That said, the top three incumbent share loss accelerated from the second quartile to 290 bps driven largely by share losses in cosmetics, hair care, baby care and office products.

  - Within the bottom quartile (average concentration of 33%), the categories experienced a 0.6% price increase, and the top three brands within these categories lost 280 bps of share driven household plastics/storage, skincare and paper plates.

Exhibit 15: Price vs. Branded Share Concentration in Select HPC Categories

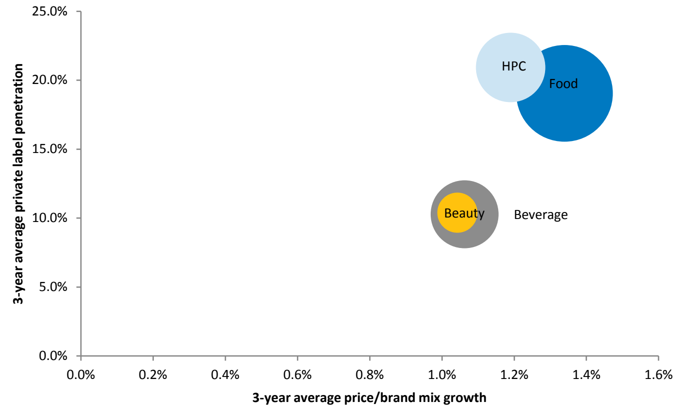


Source: IRI, BMO Capital Markets

Private Label Penetration

Higher private label penetration tends to limit, if not pressure, pricing power. Pricing power tends to be weak in those categories with higher private label penetration even in cases in which branded products gained dollar share relative to private label. First, pricing was flat across beverage categories in which private label lost share to branded but maintained below-average market share of 7%, while pricing increased 1.4% across beverage categories in which private label maintained above-average share of 16% even when private label gained share. Second, within food, the absolute level of private label penetration proved more significant of an impact to pricing power than whether or not private label gained share within the category. Those categories in which private label maintained more than a 20% share realized a modest 1% price/mix while those categories in which private label share fell below 10% realized above average pricing of 2.4%. Third, within HPC, there appears to be zero correlation between pricing power and private label dollar share, with the highest private label share categories (20%-60%) having roughly the same amount of pricing power (+140 bps) than the categories with the lowest private label penetration (0%-10%/+130 bps); in fact, the change in private label penetration appeared to be a more meaningful variable, which we incorporated into our ranking.

Exhibit 16: Price/Mix vs. Private Label Penetration in Food, Beverage, HPC, and Beauty



Source: IRI and BMO Capital Markets

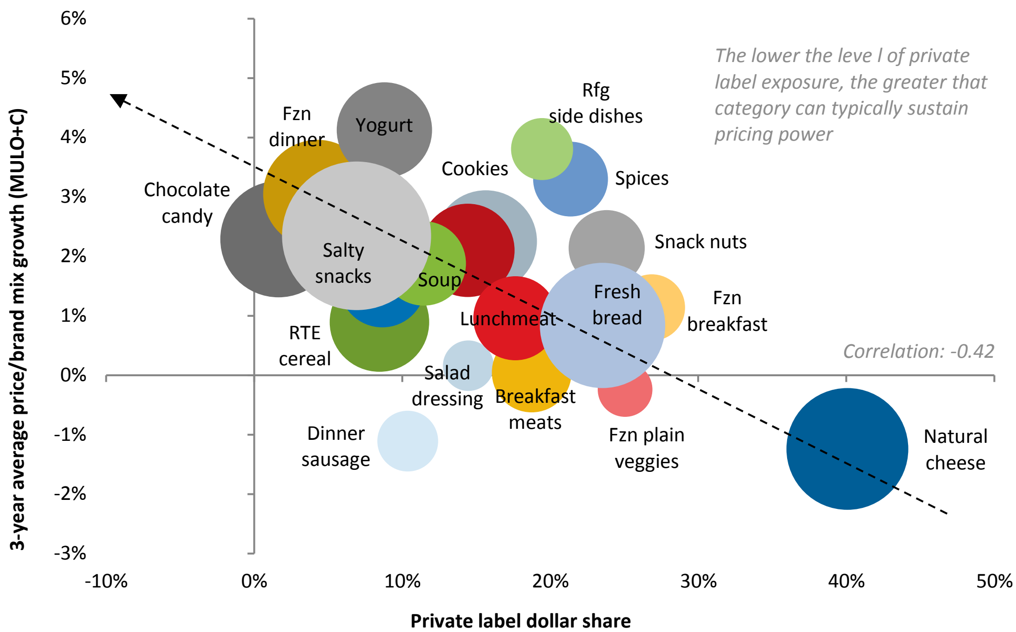
Food: The relationship between pricing and private label dollar share is most material at levels in which private label maintains a controlling market share. Specifically, we calculated an inverse correlation of negative 0.42 between the pricing and the private dollar share within a category, while the rate of private label share gain does not tend to correlate to pricing power. First, price declined from 2.4% in those categories in which private label maintained a modest share (less than10%) of the category to 1.0% in those categories in which private label share maintained a strong market share (20+%). Second, the pricing contraction accelerated to a 0.1% decline as private label share increased to 25% and to 1.2% decline as private label share eclipsed 30%. Third, the top five categories in price/mix averaged private label market share of less than 15% with only one category maintaining private label share above 20% (spices). In contrast, four of the bottom five categories in price/mix averaged private label dollar share of 18% with each maintaining private label exposure more than 10%.

- Within categories with private label concentration less than 10%, pricing net of packaging mix increased 2.4%. Private label share in those categories fell an average of 80 bps. Three categories within this group drove a significant portion of the pricing, including yogurt (more than 4% pricing with private label ceded over 220 bps of share), crackers (1.5% pricing with private label ceding 200 bps of share), and RTE cereal (0.9% pricing with private label ceding 180 bps of share).

- Within categories with private label concentration less than 15%, pricing net of packaging mix increased 1.7%. Private label share in those categories declined an average of 40 bps. Interestingly, none of the categories with low private label penetration experienced private label share gains of more than 70 bps.

- With categories in which private label share exceeded 20%, pricing declines accelerated. In fact, categories with private label share of more than 25%, pricing began to decline as private label share increased an average of 70 bps. Natural cheese, which maintains private label share above 40%, posted 1.2% pricing declines while frozen veggies, which maintains private label share above 25%, generated 0.2% price declines.

Exhibit 17: Price vs. Private Label Dollar Share in Select Food Categories

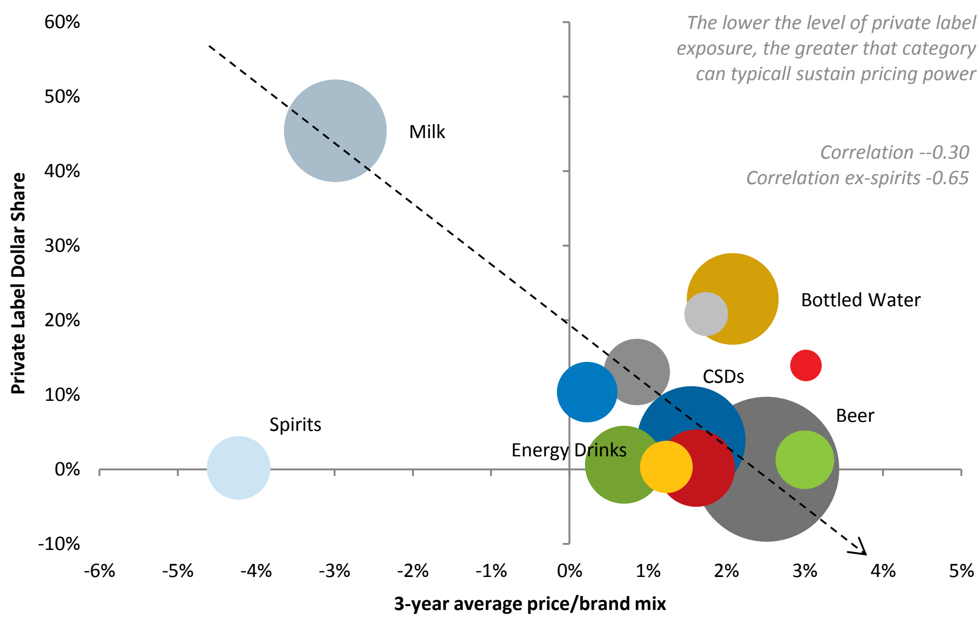


Source: IRI and BMO Capital Markets

- **Beverages: beverage categories have much lower private label penetration relative to food and therefore are less pressured by lower private label pricing.** Consumers typically buy branded product in beverages due to relatively low prices for drinks (e.g., soda) or perceived better quality (e.g., beer, wine spirits) and brand equity. Overall, there is an inverse correlation of approximately -0.3 between the amount of price/mix and the private label dollar share within a category and the relationship is even stronger excluding spirits with correlation of -0.65. Specifically, in the six categories with private label penetration in excess of 10% (average 21.1% private label share), average price/mix growth was 0.8%, whereas in the seven categories with private label penetration below 10%, average pricing growth was 0.9% or 1.8% excluding spirits (average 0.9% private label share). Overall, there is an inverse correlation of negative 0.3 between the pricing and the private dollar share within a category.
  - Private label gained value share in just three beverage categories (single-cup coffee, bottled water, and RTD coffee & tea), though all three of these categories generated positive price/brand mix (+2.3%) as the categories still enjoyed relatively high levels of top three company concentration (61.7%). Two of the categories, bottled water and single-cup coffee, generated negative packaging mix driven by larger pack sizes, which is a way of lowering "price" and competing with growing private label.
  - Despite private label milk ceding 520 bps dollar share to branded, price/mix still declined 2.1% on average, reflecting declining consumer demand and branded players maintaining price gaps to private label, which itself has seen retailer price investment to drive foot traffic, as well as overall declining milk prices from excess supply.
  - While beer and CSD volume sales have been flat to declining in recent years, strong mix (i.e., pack size in CSD, premiumization in beer) and some underlying pricing, along with de Minimis private label competition, has allowed the category to drive sales growth over the past three years. The categories have also benefited from an overall rational price competition environment among the top players with all companies benefitting from avoidance of a price war to take volume share. While in CSDs KO and PEP lead pricing and

the distant third player, DPS, follows, in beer, the third player, STZ, can largely take pricing on its own owing to its above-premium positioning and strong consumer demand, while the two larger companies, ABI and TAP, compete against each other on price, though behavior has been rational.

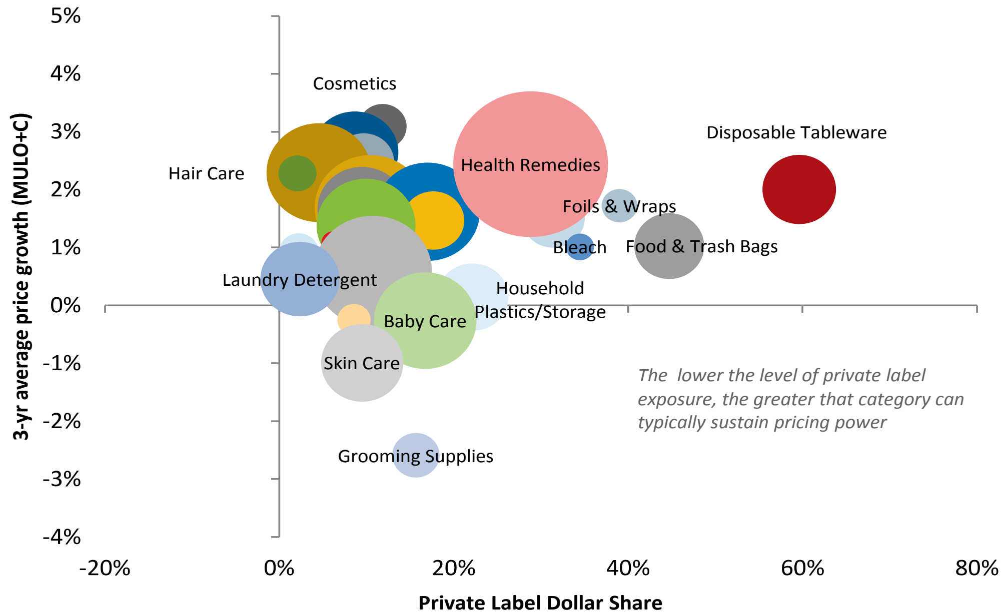
Exhibit 18: Price/Brand Mix vs. Private Label Dollar Share in Select Beverage Categories



Source: IRI and BMO Capital Markets

- **HPC:** On the surface, there appears to be zero correlation between pricing power and private label dollar share in HPC categories. In fact, the highest private label share categories (20%-60%) have roughly the same amount of pricing power (+140 bps) than the categories with the lowest private label penetration (0%-10%/+130 bps). Further, private label is gaining share at about the same rate (+40-60 bps) for the top and bottom-penetrated categories. Interestingly, when we look at the categories with private label penetration in the 10%-20% range, which coincides with the greatest private label market share gains (+120 bps), those categories have less pricing power (-0.1%). As a result, we view those categories in HPC at higher risk than the top/bottom categories and believe higher private label share doesn't necessarily lead to a doomsday scenario.
    - By category, disposable tableware, food & trash bags, foils & wraps, and bleach have the highest private label dollar share, yet they took 140 bps of pricing on average over the past three years (and the top three companies gained ~100 bps of share). Laundry care, fragrance, laundry detergent, pest control and haircare each have private label dollar shares below 5%, and pricing was actually down 50 bps.
    - Also, in the categories private label gained the greatest dollar share (>100 bps), pricing was only down in two categories, blades (-560 bps) and grooming supplies (260 bps).

Exhibit 19: Price vs. Private Label Dollar Share in Select Beverage Categories

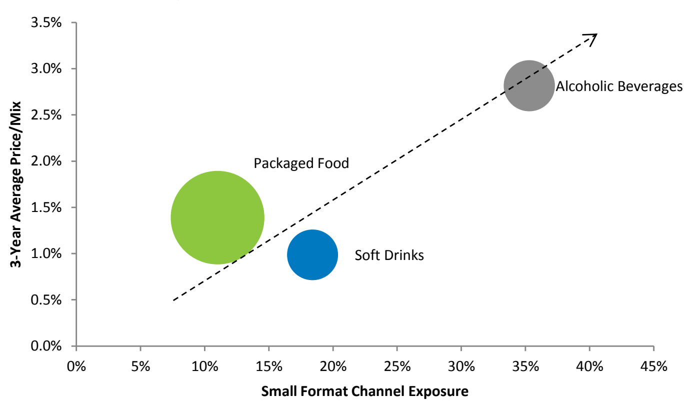


Source: IRI, BMO Capital Markets

Channel Diversification

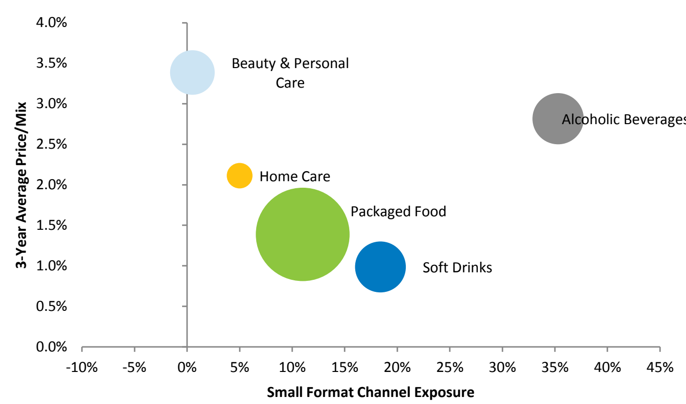
Greater channel diversification and ubiquity contributes to pricing power. We believe that a brand's ability within a category to rely less on only one or two channels should contribute to better pricing power, particularly in light of a more difficult operating environment in which large retailers have gained more leverage over suppliers.

Exhibit 20: In Food and Beverage, Higher Small Format Exposure Correlates to Price/Mix...



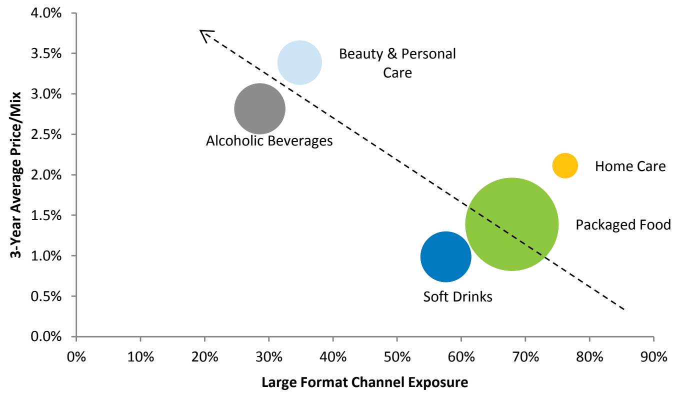
Source: Euromonitor and BMO Capital Markets

Exhibit 21: ...However, Little Correlation Between Price/Mix and Small Channel When Including HPC



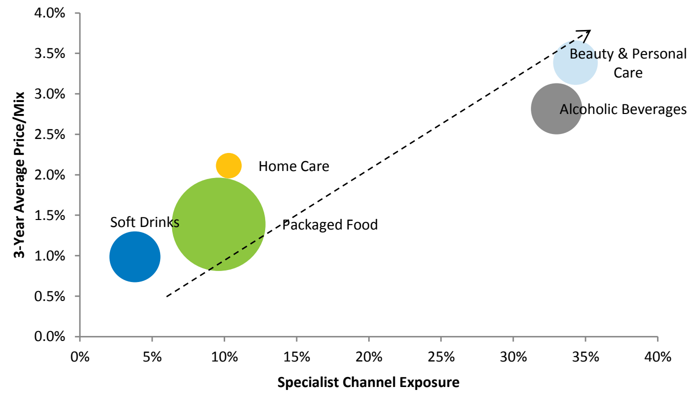
Source: Euromonitor and BMO Capital Markets

Exhibit 22: Exposure to Large Format Stores Inverse Correlation to Price/Mix



Source: Euromonitor and BMO Capital Markets

Exhibit 23: Exposure to Specialty Stores Strong Correlation to Price/Mix



Source: Euromonitor and BMO Capital Markets

- **Food:** Albeit a small sample size (i.e., four food categories), categories with less reliance on traditional hypermarket and supermarket channels, which tend to possess a more equal mix of products from the three temperature states (e.g., ambient, refrigerated, frozen), maintain greater pricing power. First, categories with less than two-thirds (i.e., average for the packaged food industry) of total sales in hypermarket and supermarket channels generated average pricing of 230 bps while those categories with above average exposure to hypermarket and supermarket channels generated only 145 bps of pricing. Second, channel mix is largely skewed by the categories' temperature state. For example, both cheese and yogurt generate more than 80% of their US sales from the traditional hypermarket and supermarket channels while ambient product categories like chocolate and coffee generate only 39% and 50% of their sales from these channels.

Exhibit 24: US Channel Diversification for Select Packaged Food Categories

	2012	2013	2014	2015	2016	2017	3 yr bps share Δ	3 yr bps price Δ	5 yr bps share Δ	5 yr bps price Δ
Hyper/Supermarket share amongst sales through store-based retailing										
Packaged food - US	66.9%	66.7%	66.8%	66.7%	66.5%	66.3%	-49		-60	
Coffee - US	52.2%	49.9%	50.6%	50.8%	49.9%	50.4%	-27	225	-180	80
Chocolate - US	39.1%	39.3%	39.2%	39.2%	39.0%	38.8%	-38	229	-22	206
Cheese - US	83.4%	83.5%	83.5%	83.4%	83.6%	83.9%	39	-124	49	35
Yogurt - US	80.9%	80.7%	81.0%	81.1%	81.0%	80.9%	-7	412	-3	371

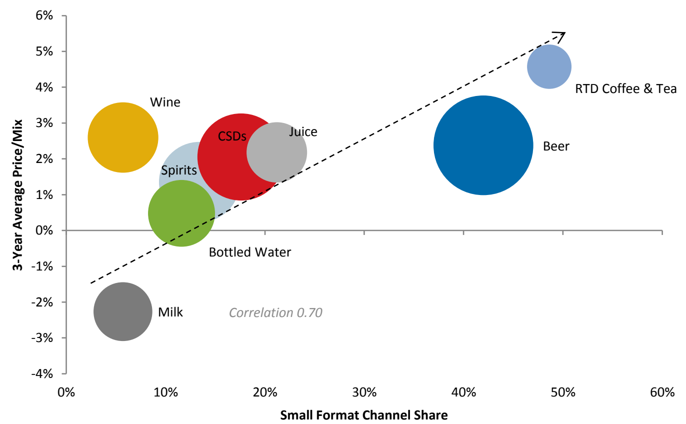
Source: Euromonitor

- **Beverage:** Within beverage categories, the relationship between price/all mix growth and channel distribution data for large beverage categories was quite strong with those categories more exposed to smaller format stores (e.g., c-store, gas station, independent small grocers) showing greater pricing power relative to those categories more exposed to larger format stores (e.g., hypermarkets, supermarkets, discounters), which agrees with the widely-held notion that immediate consumption consumers are more price inelastic, giving categories/companies more exposed to small format channels greater ability to take price. Specifically, we found a 70% correlation to exposure to small format stores and average price/mix and a -60% correlation to exposure to larger format stores and average price/mix. Of the eight large beverage categories for which data is available:
  - The four categories with the highest exposure to small format stores (e.g., RTD coffee & tea, beer, juice, CSDs; average exposure 32.4%) generated average price/all mix of +2.8% over the past three years while the four categories with the least exposure to

small format stores (e.g., milk, bottled water, spirits, wine; average exposure 9.1%) generated average price/mix of +0.5% over the past three years.

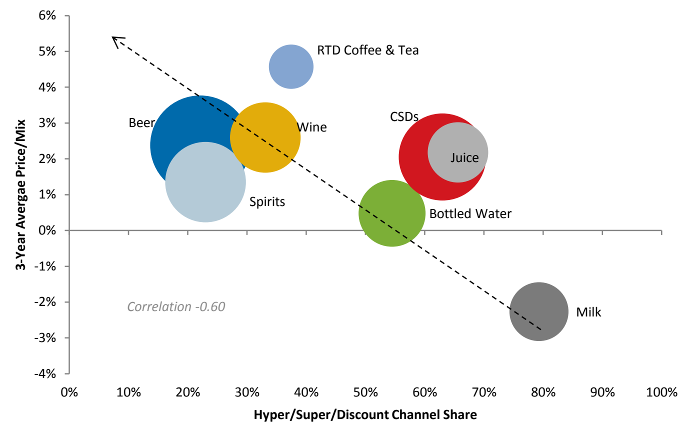
- The four categories with the highest exposure to hypermarkets, supermarkets, and discounters (e.g., milk, juice, carbonates, bottled water; average exposure 65.6%) generated average price/all mix of +0.6% over the past three years while the four categories with the least exposure to larger format stores (e.g., RTD coffee & tea, wine, spirits, beer; average exposure 28.9%) generated average price/all mix of +2.7% over the past three years.

Exhibit 25: Price/Mix has a Positive Relationship to Small Format Store Distribution



Source: Euromonitor and BMO Capital Markets

Exhibit 26: Price/Mix has an Inverse Relationship to Large Format Store Distribution



Source: Euromonitor and BMO Capital Markets

- **HPC:** For HPC categories the relationship between price/mix growth and channel diversification appears to hold, with less concentrated categories enjoying better pricing power than their more concentrated counterparts. In detail, the less concentrated categories (less than 70% concentrated in top three distribution channels), which include pet food, hair care and air care, generated average price/mix of +2.5% over the past three years, while the more concentrated categories (fragrances, skincare, bleach, dishwashing and toilet care) generated average price/mix growth of +1.7% over the same period. Additionally, the six categories with the highest exposure to large store formats (e.g., bleach, dishwashing, laundry, polishes; surface/toilet care – exposure >80%) generated average price/mix of +1.4% over the past three years while the four categories with the least exposure to larger format stores, all of them beauty categories (cosmetics, skincare, haircare and fragrance) generated average price mix of +3.5% over the past three years.

Exhibit 27: US Channel Diversification for Select HPC Categories

	Beauty and Personal Care	Color Cosmetics	Fragrances	Hair Care	Skin Care	Home Care	Air Care	Bleach	Dishwashing	Home Insecticides	Laundry Care	Polishes	Surface Care	Toilet Care	Pet Care	Pet Food	Pet Products
Specialists	32.8	41.3	45.4	28.8	30.9	10.3	28.9	4.7	5.5	35.0	5.3	7.9	5.0	7.3	36.2	35.3	37.7
Non-Store	18.1	21.4	21.2	6.0	37.1	3.0	5.1	0.8	2.6	0.9	2.7	1.5	3.0	1.6	12.4	8.6	19.5
Mass Merch	12.8	12.2	4.4	13.0	7.7	27.0	18.3	21.6	27.7	25.1	29.3	24.2	30.5	29.0	5.6	5.9	5.1
Hypermarkets	10.9	3.5	1.0	14.0	5.3	15.7	13.8	20.3	21.8	11.6	14.1	17.0	17.5	18.5	17.0	18.1	15.1
Dept Stores	8.9	15.9	24.4	0.2	13.8	0.1	0.7	-	-	-	-	1.1	-	-	0.3	-	0.8
Supermarkets	8.5	4.0	2.8	10.3	1.7	25.9	14.0	39.1	30.1	17.3	27.4	36.0	29.3	31.9	13.8	16.8	8.3
Non-Retail	3.3	-	-	22.4	-	-	-	-	-	-	-	-	-	-	6.5	5.6	8.2
WH Clubs	2.6	1.1	0.8	1.8	2.5	7.0	5.2	4.7	3.3	2.0	10.4	4.2	4.7	2.0	5.5	6.7	3.2
Other Mixed	1.1	0.5	0.1	2.7	0.4	5.4	5.5	3.0	3.5	5.4	6.4	1.8	4.2	3.3	1.7	1.8	1.6
Other Grocery	1.0	-	-	0.9	0.6	5.6	8.6	5.8	5.5	2.7	4.4	6.3	5.7	6.4	1.0	1.2	0.6
Total	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100

Source: Euromonitor, BMO

Companies Mentioned

	Ticker	Rating	Target Price	Price (as of 7/10/18)	Analyst
B&G Foods	BGS-NYSE	Outperform	$ 37.00	$ 31.40	Kenneth Zaslow
Church & Dwight	CHD-NYSE	Market Perform	$ 47.00	$ 54.47	Shannon Coyne
Clorox Company	CLX-NYSE	Outperform	$ 131.00	$ 132.48	Shannon Coyne
Coca-Cola	KO-NYSE	Market Perform	$ 48.00	$ 44.97	Amit Sharma
Constellation Brands	STZ-NYSE	Outperform	$ 275.00	$ 217.98	Amit Sharma
Coty	COTY-NYSE	Outperform	$ 18.00	$ 14.44	Shannon Coyne
Dean Foods	DF-NYSE	Market Perform	$ 10.00	$ 10.80	Amit Sharma
Dr Pepper Snapple Group	DPS-NYSE	Market Perform	$ 122.00	$ 22.19	Amit Sharma
e.l.f. Beauty	ELF-NYSE	Market Perform	$ 19.00	$ 16.61	Shannon Coyne
General Mills	GIS-NYSE	Market Perform	$ 51.00	$ 44.69	Kenneth Zaslow
Hershey	HSY-NYSE	Market Perform	$ 93.00	$ 93.81	Kenneth Zaslow
Kellogg	K-NYSE	Market Perform	$ 78.00	$ 70.64	Kenneth Zaslow
Kraft Heinz Company	KHC-NSDQ	Market Perform	$ 67.00	$ 64.00	Kenneth Zaslow
Molson Coors Brewing	TAP-NYSE	Outperform	$ 85.00	$ 68.39	Amit Sharma
Mondelez International	MDLZ-NSDQ	Outperform	$ 50.00	$ 42.08	Kenneth Zaslow
Monster Beverages	MNST-NSDQ	Outperform	$ 68.00	$ 59.57	Amit Sharma
PepsiCo	PEP-NYSE	Market Perform	$ 110.00	$ 112.89	Amit Sharma
Pinnacle Foods	PF-NYSE	Market Perform	$ 68.00	$ 65.80	Kenneth Zaslow
Spectrum Brands Holdings	SPB-NYSE	Outperform	$ 95.00	$ 86.14	Shannon Coyne
Tyson Foods	TSN-NYSE	Outperform	$ 89.00	$ 66.67	Kenneth Zaslow

Source: BMO Capital Markets

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Buy	Outperform	48.9%	21.1%	55.8%	50.8%	57.5%	55.3%
Hold	Market Perform	48.8%	16.1%	42.3%	47.0%	41.7%	39.7%
Sell	Underperform	2.3%	15.4%	1.9%	2.2%	0.8%	5.0%

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