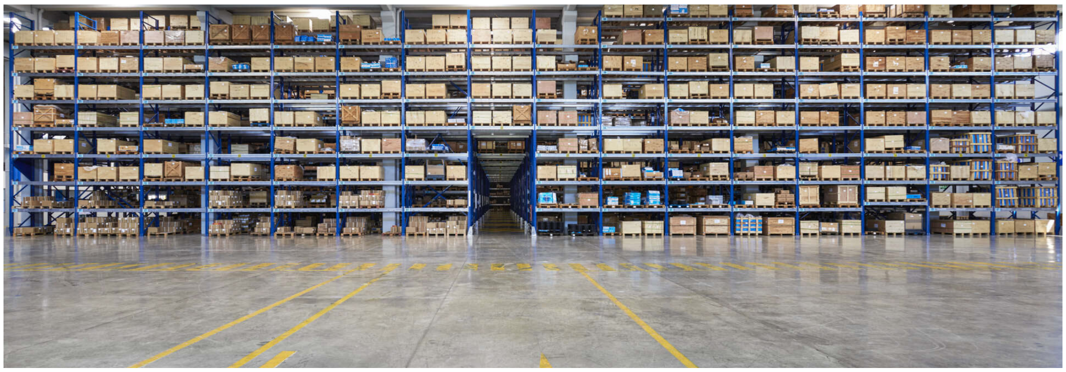
Consumer Products

Carryover pricing boosts margins, as volumes stay subdued

January 9, 2024

This report does not constitute a rating action.



What's changed?

Price increases will wane. Branded consumer product companies will slow their pricing growth to the mid-single digits on average.

Mature markets will face volume compression. As consumers seek value and look for cheaper private-label alternatives, we expect a moderate decline in volumes by low- to mid-single digits.

Working capital management will be critical. Given weaker sales volumes, the ability to optimize inventory will be a key driver of free cash generation.

What are the key assumptions for 2024?

Cost pressures will continue to abate. As input costs decrease, capacity in supply chains is building up, given lower sales volumes and cautious ordering from retailers.

Advertising and promotional spending will increase. As competition intensifies, gross margin gains from lower input costs and carryover pricing gains will be deployed to strengthen brand equity.

Financial policy surprises will be limited. Most of the rated companies will adhere to their financial policies, with minimal revisions to shareholder returns and merger and acquisition (M&A) strategy.

What are the key risks around the baseline?

Sales volumes will decline sharply across both major consumer markets. There will be a sharp pullback by Chinese consumers coupled with a demand contraction in the U.S.

Refinancing conditions will remain tough. Companies with highly leveraged capital structures will struggle to refinance amid weak operating performance and tight capital markets.

Geopolitical tensions will worsen. Spillovers have been lower than we expected, but further escalations could induce commodity price volatility, hurting global trade and consumer sentiment.

Contacts

Raam Ratnam, CFA, CPA
London
+44 20 7176 7462
raam.ratnam@spglobal.com

Sarah Wyeth
New York
+1 212 438 5658
sarah.wyeth@spglobal.com

Chris Johnson, CFA
New York
+1 212 438 1433
chris.johnson@spglobal.com

Rocco A Semerano
London
+44 20 7176 3650
rocco.semerano@spglobal.com

Flavia Bedran
Sao Paulo
+55 11 3039 9758
flavia.bedran@spglobal.com

Aniki Saha-Yannopoulos, CFA, PhD
Toronto
+1 416 507 2579
aniki.saha-yannopoulos
@spglobal.com

Ryohei Yoshida
Tokyo
+ 81 3 4550 8660
ryohei.yoshida@spglobal.com

Maxime Puget
London
+44 7890 900 242
maxime.puget@spglobal.com

Bea Y Chiem
San Francisco
+1 415-371-5070
bea.chiem@spglobal.com

Gerald T Phelan, CFA
Chicago
+1 312 233 7031
gerald.phelan@spglobal.com

Amanda O'Neill
New York
+1 212 438 5450
amanda.oneill@spglobal.com

Ratings Trends: Consumer Products

Chart 1

Ratings distribution by region

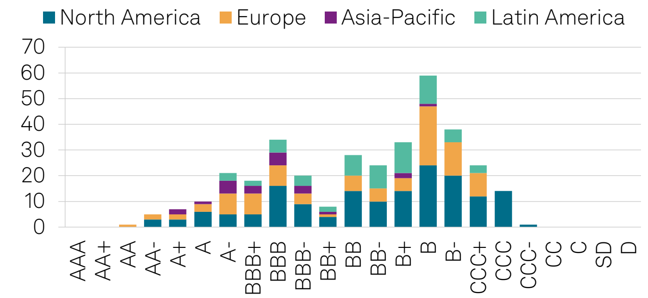


Chart 2

Ratings distribution by subsector

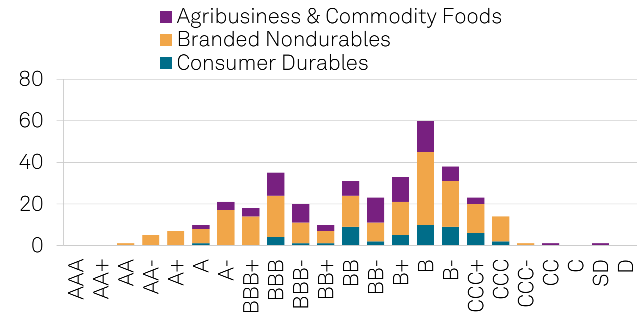


Chart 3

Ratings outlooks by region

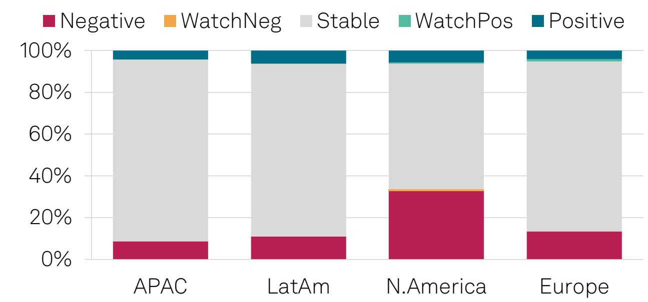


Chart 4

Ratings outlooks by subsector

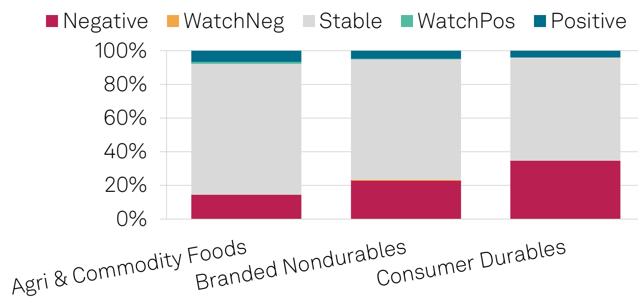


Chart 5

Ratings outlook net bias by region

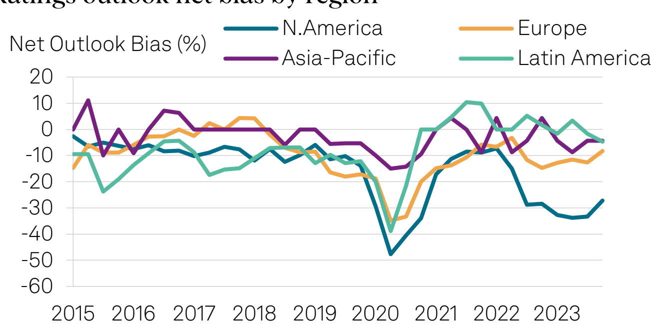


Chart 6

Ratings net outlook bias by subsector

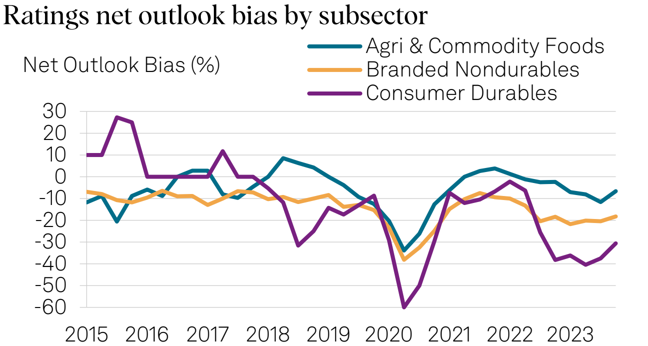


Chart 7

Ratings outlooks

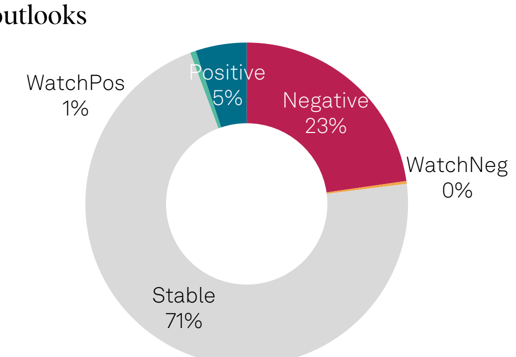
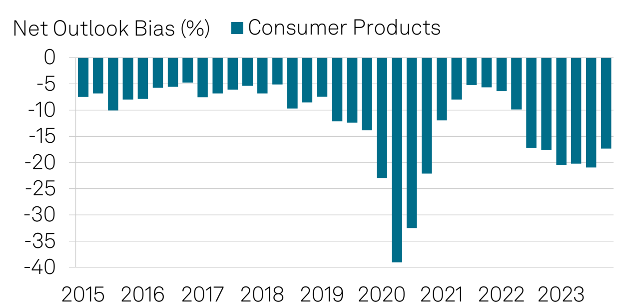


Chart 8

Ratings net outlook bias



Source: S&P Global Ratings. Ratings data measured at quarter-end.

Industry Outlook

Ratings trends and outlook

In 2023, there were 61 downgrades across the global consumer products sector and these outnumbered the 36 upgrades. The bulk of the rating actions were concentrated on speculative-grade issuers. The negative rating actions were primarily due to these companies' higher exposure to inflationary headwinds and weakness in toplines and margins in addition to high leverage and refinancing risks. Many companies navigated higher costs by raising prices and cutting costs, but risks intensified because of higher interest rates and the uncertain macroeconomic backdrop.

Persistent inflation and some weakening of consumer demand also led to the negative outlook bias remaining high. Globally, we have negative outlooks on 23% of the issuers we rate in the sector--almost the same level as a year ago. More negative outlooks in North America reflect the greater proportion of discretionary products manufacturers rather than greater pressure in the region.

Large consumer goods multinationals with strong brands, significant geographical presence, and wide product ranges will strengthen their competitive advantage. These companies have sufficient price and mix flexibility, as well as product range across discount, mass market, and premium segments, to curtail the overall impact of tepid volumes. Accordingly, credit prospects are broadly stable for investment-grade companies, given their strong market positions within their categories, generally good product diversification, sound cash flow characteristics, and potential flexibility to tighten discretionary spending in times of stress.

Still, the 'B' rating category accounts for the highest number of issuers in the sector, at more than one-third. This group includes many smaller and highly leveraged companies with weak business risk profiles. They remain vulnerable to significant volatility in operating performance, and may find it challenging to restore profitability and cash flows. Higher interest rates will also gradually intensify the pressure on many of them, which have already been hit by rising costs. Meanwhile, weaker macroeconomic conditions and a pullback in consumer spending could be a tipping point for many of these issuers with limited financial flexibility.

Main assumptions about 2024 and beyond

1. Inflation will trend downwards, but the easing of operating costs will be gradual.

Both headline and core inflation continue to decline following their peaks in late 2022; however, core inflation remains stubbornly high. Labor markets remain tight across many economies and many consumer-facing business have to bear the brunt of higher wages on their margins. Many businesses have reduced opening hours to save labor costs but retain staff to avoid repeating the difficulties finding workers post-pandemic. Many retailers will remain cautious about ordering, which will free up capacity in supply chains but result in lower bargaining power at the suppliers' end.

2. Moderate improvement in margins on back of carry over pricing and cost savings.

Consumer goods companies will be hard pressed to continue to markedly raise prices. Also, the high price pass-throughs by global consumer goods companies have widened the opening for price competition from private label products. Branded consumer product companies will slow their average pricing growth, and deflationary pressure will be limited to certain niche segments where commodity prices have declined sharply and lower-priced alternatives are available to consumers.

3. Consumers will be cautious, as many households will continue to face cost-of-living pressures.

Consumers in the U.S. will continue to see real income growth slowing, which will keep the savings rate lower than pre-pandemic levels. In Europe, while disinflation is easing household income constraints, employment continues to rise but output is flat, raising questions about productivity and profits. In Latin America, the easing of inflation will help lower interest rates, but the pace will depend on the U.S. Federal Reserve. In China, consumer confidence will remain subdued, while in the wider Asia-Pacific region we expect weaker sales volumes as lower- and middle-income households cut back on discretionary spending, trade down, and become more price conscious.

Inflation will trend downwards, but the easing of operating costs will be gradual. Both headline and core inflation continue to decline following their peaks in late 2022. Headline inflation rose to higher rates than core and is now generally lower, reflecting the recent declines in food and fuel prices. However, core inflation remains stubbornly high--near 5% in several major advanced economies. Labor markets remain tight across many economies and many consumer-facing business have to bear the brunt of higher wages on their margins. Many businesses have reduced opening hours to save labor costs but continue to retain staff to avoid repeating the difficulties finding workers in the post-pandemic period. As inventory levels remain high, many retailers will remain cautious about ordering from the consumer product companies in response to weaker sales volumes. This will free up capacity in supply chains but result in lower bargaining power at the suppliers' end.

Moderate improvement in margins on back of carry over pricing and cost savings. Given the current normalization in commodity and input prices and a weak consumer outlook in addition to the carryover effect of the previous price increases, consumer goods companies will be hard pressed to continue to markedly raise prices at the same pace. Also, the high price pass-throughs by global consumer goods companies have yielded greater ground for price competition from private label products. We expect branded consumer product companies will slow their average pricing growth to the mid-single digits. Along with higher carryover pricing from the previous quarters, this should still result in margin uplift for consumer product companies with strong brands and those well positioned in their categories.

While we expect increased promotional intensity to manage stock levels, we do not expect branded consumer product companies to reduce selling prices directly. Deflationary pressure will be limited to certain niche segments where basic commodity prices have declined sharply and lower-priced alternatives are available to consumers. As we enter a period of normalization and tough competition, we expect most consumer goods companies to launch ambitious cost-savings programs to improve operating efficiency, especially in their supply chains and distribution functions. At the same time, much of the gross margins gains from lower input costs and carryover pricing gains and efficiency savings will be ploughed back into higher investment in brand revitalization and marketing expenses.

Consumers will be cautious, as many households will continue to face cost-of-living pressures. Interest rates will need to stay higher for longer and higher consumer credit costs on mortgages, autos, and credit cards will curtail household disposable income. Consumers in the U.S. will continue to see real income growth slowing, which will keep the savings rate lower than pre-pandemic levels. In addition, the lifting of the student loan moratorium will contribute to ongoing challenging affordability.

In Europe, while disinflation is easing household income constraints, employment continues to rise for a variety of reasons, but with output flat, this is raising questions about productivity and profits.

In Latin America, the easing of inflation will help lower interest rates, but the pace of reduction will depend on the U.S. Federal Reserve and will guide increasing consumption locally.

Meanwhile, in China, consumer confidence remains subdued, while the wider Asia-Pacific region excluding China and emerging markets has shown resilience led by robust domestic demand growth. We expect weaker sales volumes over the next few quarters as consumers--particularly lower- and middle-income households--continue to cut back on discretionary spending, trade down, and become more price conscious to deal with falling real incomes. Home consumption will still be resilient, with strong performance from private-label products as consumers look to tighten spending by eating out less.

Subsector overview for 2024

The five-point scale in chart 9 below presents our assessment of the significance of the forward-looking risk factors for 2024, with the risk level increasing from left to right. For ease of presentation, we combined certain adjacent subsectors like Food & Beverage and Apparel & Luxury goods. Detailed subsector comments follow below.

Chart 9

The key risk factors that we incorporate into our base-case forecasts by subsector

Note: The five-point scale presents our materiality assessment of forward-looking risk factors, with the risk level increasing from left to right. Source: S&P Global Ratings.

Agribusiness. We have a slightly negative rating outlook for the Agribusiness sector reflecting the still weak protein processing cycle in the U.S. We believe a recovery is underway for U.S. poultry processors, which will likely accelerate in 2024 as pricing stabilizes with lower industrywide inventories and declining feed costs. However, the outlook for beef processing in the U.S. will remain very weak for 2024 and into 2025 as cattle costs remain high, with significant herd rebuilding only starting to take hold this year. Pork margins should also rebound in 2024 with better cutout values as farms cut production but remain below historical levels given still excess industry production capacity. We will closely monitor industry conditions in 2024 to assess if credit measures sequentially improve as companies lap last year's depressed margins. A slower-than-anticipated rebound could lead to additional downgrades over the next year.

In South America, the outlook for the beef sector is the opposite of that of the U.S. A positive cycle is boosting beef processors margins, with sound cattle availability lowering cattle prices.

For pork and poultry, on one hand, the consumers' preference for beef can hurt demand, but margins will improve with the record high corn harvest lowering input costs along with some capacity reduction.

Outside of the protein processing segment, we have a stable outlook for the agribusiness sector, underpinned by strong global oilseed demand for biofuel feedstocks and an easier comparison to 2023 for ingredient providers, many of which faced significant volume pressure last year from customer destocking. The sector has benefited from high commodity food market prices (e.g., sugar) and sustained strong demand for large crops (e.g., wheat and soybean), enabling strong operating performance and credit metrics for rated issuers. Given food security concerns and rising population in emerging markets, we continue to see positive demand-led growth prospects for the sector overall. Although El Nino may lead to southern hemisphere drought or flood conditions in certain regions, notably Australia, which would hurt wheat production, we don't expect major crop disruptions to next year's harvests, particularly with Argentina's output likely to rebound after suffering a severe drought in 2023.

Still, South American drought conditions could hurt global soybean and sugar production, especially in Brazil, where the preponderance of agribusiness companies we rate are located. Brazilian sugar refiners in particular could face margin compression. However, downgrade risks are mitigated by the issuers' current very low leverage levels, given the still strong global sugar pricing landscape, despite weaker ethanol profits, with prices about 15% lower than last year.

M&A deals have picked up, with record profits in commodity trading. Notably, the merger of Bunge Global SA and Viterra Ltd. created one of the largest merchandiser and processor of soft commodities (i.e., wheat and soybean mostly) globally. We expect more sector consolidation over the coming years, although this remains subject to commodity cycles.

Alcoholic beverages. We have a stable rating outlook for the alcoholic beverage sector, underpinned by strong cash flow generation and the ability to manage discretionary expenses in what is likely to be a period where demand modestly softens across several regions, both mature and developing.

Sales growth is likely to slow in 2024 to low-single digits from high-single digits, reflecting a variety of factors, including lower volumes after significant pricing actions to offset inflation in 2023, a difficult comparison to a 2023 rebound in on-premise demand in several regions, and the possibility of a temporary and modest negative mix shift away from premium products with a weakening consumer in key economies like the U.S. The emerging market outlook is also mixed, with economies like China (where premiumization is a key performance driver) facing growth headwinds.

Global alcoholic beverages group Diageo has lowered its performance outlook in Latin America and the Caribbean on weaker volumes and also mix due to higher downtrading. In addition, certain issuers have to lap recent dispositions of lower performing brands, including those exposed to geopolitically sensitive countries like Russia, which, coupled with negative foreign exchange rates, may further pressure topline performance in 2024.

Still, this industry performs well through economic cycles given its structurally high margins, ability to cut discretionary expenses in marketing and promotions when demand softens, and strong free cash flow conversion of EBITDA. Therefore, we expect companies to sustain leverage near their stated targets and/or continue to steadily reduce leverage toward their long-term targets for the minority of issuers that are above their targets because of recent M&A.

Apparel. An uncertain macroeconomic landscape and cautious consumer will lead to flat to low growth for apparel companies in 2024. We expect moderate margin expansion as companies continue to cut costs and sell down their excess inventory. Successful remediation of inventory challenges from the past two years without recourse to excessive discounting is key to operating performance and cash flow generation in 2024. As companies work to normalize inventory levels, supply will likely be more aligned with weaker demand trends. We expect share repurchases to be muted as cash flow is managed prudently due to uncertain operating conditions. M&A could pick up as some issuers have announced asset sales to reduce leverage as profitability declined in 2022 and 2023.

Beauty and cosmetics. We expect the beauty segment to continue to benefit as consumers seek affordable indulgences during weaker macroeconomic periods. However, the 2024 forecast for our rated peers differ due to specific business challenges for the small U.S.-based rated peer set. Overall, we expect growth from both price and volume, and margin expansion through lapping higher costs and cost-savings initiatives.

Skincare, making up more than 40% of the cosmetic market by value, has been particularly resilient and remains one of the key growth drivers. Dermo-cosmetics (with health care professional endorsement) retains its long-term momentum and supportive margin. Competition has increased, mainly because of e-commerce penetration, new brands, and a rise in promotional activities for product launches. Additional competitive pressure comes from small, new, and digitally focused regional players.

Global players are experiencing a significant reset in the travel retail business in Asia, mainly due to an uneven recovery in China and the Chinese government's effort to crack down on "daigou" (Chinese shoppers who buy goods abroad and sell them in the domestic markets). Our estimate of mid-single-digit growth in 2024 is in line with historical trends.

Durables. We anticipate 2024 will continue to present challenges for durable goods manufacturers, driven by our expectations for slow economic growth in most parts of the world resulting in ongoing weak demand. We assume flat to modestly lower net sales--the main drivers being lower volumes and increased promotional activity, partially offset by the carryover impact of previous price increases. Consumers are stretched and are delaying discretionary purchases of small and large appliances while prioritizing essentials like food and beverage, household, personal care, and health care products.

Retailer ordering behavior will likely trend toward normalization and the disparity between sell-in and sell-out should narrow. We forecast adjusted EBITDA margins will nevertheless continue to recover in 2024 because of lower commodity costs, better supply chain conditions, higher and more consistent production cadence, and benefits from productivity improvements, partly offset by lower sales volume.

While easing commodity costs provided modest margin tailwinds in 2023, we assume the potential for further disinflation is limited. We expect less volatility around working capital investment following the unwind of excess inventories in 2023. Durables issuers are more likely to be more conscious of inventory levels matching demand trends in 2024 as supply chains are in better shape. We expect companies will increasingly focus on innovations and promotions, which will allow them to compete better as consumer spending tightens.

M&A strategies are unlikely to change from 2023 and will be limited to tuck-ins and potentially include the purchase of distressed businesses. We expect financial policies will largely prioritize credit metric improvement as opposed to large shareholder payments, especially for speculative-grade issuers.

Household products and personal care. Household products and personal care companies are recovering margins as inflationary pressures on input costs have decreased, and supply chains have improved. We expect mid- to lower-income consumers to trade down to private label or mid-tier priced items as prices remain high. We believe the personal care segment will remain more resilient than household products as consumers tend to remain loyal to brands when it comes to personal hygiene products. Accordingly, in 2024, we forecast low- to mid-single-digit revenue growth as pricing normalizes to the low-single-digit area. We also expect modest volume declines to turn slightly positive, depending on the company's mix. We anticipate revenues will be affected by foreign currency effects, especially given the global footprint of many of these companies. We expect large multinational companies' financial policies to remain consistent, with some bolt-on acquisitions, typical dividend payments, and share buybacks.

Luxury. As expected, growth in the luxury industry is normalizing due to the strong comparison base and weak macroeconomic environment, although we expect positive industry fundamentals to remain broadly unchanged in the long term. The personal luxury industry has a long track record of positive performance, with very few negative trends (e.g., the 2008-2009 economic crisis and the start of the COVID-19 pandemic in 2020).

Sales to Chinese customers remain broadly resilient despite economic headwinds, and we expect increasing spending outside Mainland China due to the rebound of international travel.

Still, the personal luxury goods industry is based on discretionary spending, with a focus on high price points. We expect growth to slow, due to lower consumer confidence and a strong comparison base.

Downside risks are mainly based on a drop in U.S. consumers' discretionary spending on personal luxury goods in a weaker macroeconomic environment.

Nonalcoholic beverages. We have a neutral rating outlook for the nonalcoholic beverage sector as dominant manufacturers with little store-brand competition continue developing innovative products by introducing new taste profiles and packaging. We assume no near-term material negative impact from GLP-1 drugs repurposed for weight loss because widespread use faces numerous hurdles in 2024 including cost, availability, and side effects. We expect organic net sales growth in 2024 to moderate to the mid-single-digit percentage area from the high-single percentage area expected in 2023, due to very high pricing that was intended to offset inflation and foreign currency depreciation. We anticipate a more balanced pricing and volume mix in 2024. We anticipate slight adjusted EBITDA margin improvement as supply chain cost volatility lessens and consumers continue to purchase affordable beverage products even if economies weaken as we expect.

Nonalcoholic beverage issuers should capture volumes if they are able to effectively distribute products locally and regionally that meet potential consumer economic behaviors. This could include large quantity volume purchases to maximize spending power contrasted with smaller packaging and serving sizes for more stretched consumers. We anticipate product partnerships with alcoholic beverage manufactures to continue to have a minimal positive impact on nonalcoholic beverage manufacturers' topline given the scale of their core offerings.

Reported sales will be held back by low-single-digit foreign currency translation headwinds, particularly in highly inflationary economies, including certain developing and emerging countries in Latin America, Africa, and parts of Eurasia.

Packaged foods. Volumes largely remain negative through 2023 for most of the industry players as consumers pull back purchases amid extraordinary price increases. We estimate sector revenues, on average, will increase somewhat in 2024 thanks to low-single-digit price increases, partially offset by slightly negative to modestly positive volumes, and increased promotions. We expect ongoing elasticity and cautious consumer behavior to continue, including value-seeking and less pantry loading. We forecast EBITDA margins will continue to recover in 2024 as companies lap price increases, easing inflation, and the return to productivity measures. We believe companies will increase their investments in promotions, innovations, and brand-building to restore volume growth.

While private-label products have gained some share, it is still largely in commoditized categories or where they already have a higher degree of penetration. We expect companies to continue reshaping their portfolios through divestures of noncore assets and acquisitions--most of which will likely be into faster-expanding categories or new regions. Furthermore, we expect continued dividends and share buybacks will be in line with companies' stated long-term targets.

Tobacco. We have a neutral rating outlook for the tobacco sector as elevated cigarette volume declines mainly in the U.S. have been partly offset by strong pricing power. Moreover, issuers are likely to refrain from leveraging their balance sheets given recent demand trends and regulatory risks.

We continue to expect combustible cigarette volume deterioration in 2024, although with a potential for it to ease slightly compared to the 2023 high-single-percentage decline as the rate of inflation wanes.

Discount brands--including those of major manufacturers--are likely to sustain historically strong share in the high-20% area. Our volume expectation assumes limited fuel price volatility, which is a geopolitical risk factor, as well as a minimal impact from the anticipated FDA ban on menthol cigarettes, given industry participants are likely to contest it--which could delay enforcement. We anticipate nicotine users will continue to move between categories, including combustible cigarettes, e-vapor, and oral nicotine, which will incentivize large tobacco companies to continue funding next-generation product initiatives.

Competition in the noncombustible segment in the key U.S. market is set to increase as Philip Morris International Inc. is gearing up to launch the IQOS rollout, following its acquisition of Swedish Match.

Modest declines to tobacco issuers' very high EBITDA margins are possible, though we anticipate still ample cash flow to pay dividends and repurchase modest amounts of stock while maintaining some balance sheet flexibility.

Credit metrics and financial policy

We forecast a moderate improvement in the credit metrics for the global consumer goods sector in 2024. This would follow a very difficult 2023 when companies' high cost headwinds eroded EBITDA margins and drove a peak in the sector's median leverage. Although our forecasts for 2024 indicate broadly flat revenues due to lower volumes and a slowdown in price growth, EBITDA margins across the sector as a whole should expand slightly due to the combined benefit of previous strong price increases, fewer disruptions, and our expectation of waning inflationary pressures in the second half of the year.

The bulk of the global consumer goods companies we rate are mostly speculative grade, with a large majority in the 'B' category (see chart 2). Many of these companies have weak business risks profiles, alongside highly leveraged capital structures. Higher interest rates and tight financing conditions will further constrain these companies' already limited financial flexibility.

At the other end of the spectrum, many large highly rated global multinationals continue to allocate a significant part of their free cash flow to shareholder returns. Based on our estimates, more than one third of the top-rated investment-grade European consumer goods companies typically return surplus capital to shareholders via share buyback programs, in addition to regular dividends. These include companies such as AB InBev, Unilever PLC, Imperial Brands, Henkel AG & Co. KGaA, Nestle S.A., LVMH Group, Pernod Ricard S.A., and Diageo PLC. In the event of any significant operating headwinds, these companies can choose to limit shareholder returns to preserve cash and increase headroom under the credit ratings.

In Europe, we do not expect significant financial policy surprises in 2024. Most of the rated companies will likely maintain their stated financial policy, with limited revisions to shareholder remunerations. Considering that several challenges continue to restrict management bandwidth, higher funding costs and fairly limited financial headroom, we do not anticipate large M&A transactions. We think consumer goods companies will approach sizable M&A with caution, but we continue to factor in portfolio transformation through investment, bolt-on acquisitions, and disposals. This trend also reflects strategies focused more on their core businesses in times of challenging macroeconomics. Companies will continue to invest in developing and strengthening digital capabilities, so we expect that capital expenditures will remain elevated.

In the U.S., we expect financial policies to remain rational, in part due to higher interest rates. Several issuers lowered leverage targets over the past one to two years due to the difficult operating environment and to offset the impact of higher rates on cash flow. In 2024, we believe hurdles stemming from the uncertain macroeconomic environment and higher cost of financing will also limit large M&A. We believe most issuers will focus on portfolio refinements rather than transformational acquisitions.

In 2023, there were two large M&A transactions in packaged food that had an impact on our view of credit quality. When Campbell Soup Co. announced its intention to purchase Sovos Brands Inc., we downgraded Campbell because of elevated leverage and our expectation that metrics would not be restored until 2026. J.M. Smuckers Co.'s planned acquisition of Hostess Brands Inc. led us to revise the outlook to negative due to risk in its ability to lower leverage.

In Latin America, we expect to see lower dividends, M&As, and share buybacks, as leverage is picking up from weaker domestic consumption across countries, lower export profits amid stronger foreign exchange rates, and fierce competition, while producers adjust volumes after a weak year of consumption. The high interest rates also reduced companies' cross-border debt issuances, while heavy interest burden pressured cash flows.

In Canada, operating performance was characterized by lackluster EBITDA and margins as well as inventory destocking by key retailers and tightening consumer spending, not fully offset by the easing of raw material and supply chain costs. As most speculative-grade Canadian companies have U.S. exposure, we expect profitability dynamics to be similar to that of the U.S. issuers.

In Asia-Pacific, pressure on profitability will ease thanks to ongoing markup efforts by consumer goods companies and lower input cost inflation. This, along with prudent financial policies, will likely support the credit profiles of consumer-product companies in 2024. We expect that global multinationals in Japan and China such as Japan Tobacco Inc., Suntory Holdings Ltd., Ajinomoto Co. Inc., and Midea Group Co. Ltd., will maintain their ongoing financial policies with spending targeting their focus areas such as shareholder remunerations, brand investments, and growth initiatives including acquisitions. We believe these companies will likely continue generating stable cash flows aided by their solid brand equity and diversified portfolios, enabling them to sustain their financial policies.

One risk factor is weak consumer confidence in China. Falling real estate prices and the weaker macroenvironment could sap consumers' spending appetite. Asia-Pacific discretionary goods companies operating in China, especially those with weaker brand equity, could face severe pricing pressure and hence lower profitability than others.

Most rated Chinese consumer product firms have sound finances for our ratings on them. However, smaller issuers or those with a higher financial leverage could see credit headroom compression given shrinking household wealth and tepid consumer sentiment amid property sector woes. We assume China's property crisis will not greatly affect the credit quality of rated Japanese consumer companies because of limited exposure to the Chinese market.

Key risks or opportunities around the baseline

1. Robust labor market continues to underpin consumers' confidence to spend

We expect household purchasing power will increase as a result of disinflation and wage growth. In the eurozone, inflation will likely ease to an average 2.9%, wages will rise by 4%. In the U.S., households have not yet run down their excess savings balances from COVID-relief policies, but real wage growth is slowing.

2. Leveraged issuers may struggle with tight financing conditions and the high cost of debt service.

We expect further credit deterioration in 2024, continuing the diverging trends of resilience at the investment-grade level and downgrades largely at the lower end of the ratings scale. Many lower-rated borrowers will be forced to refinance at much higher rates. Across all the corporate ratings, the consumer products sector has the highest negative bias, with negative outlooks or ratings on CreditWatch with negative implications on 23% of issuers.

3. Increased digitization can generate greater operating efficiencies and cost savings, but cyberattacks are becoming more widespread.

Branded consumer goods companies are investing in a wide assortment of technology to improve efficiency and accelerate growth. However, given the scale and scope of business disruption arising from recent cyber events, the financial impact of cyberattacks is growing, along with its potential to erode credit quality, accentuate credit risks, and strain ratings over time.

Robust labor market continues to underpin consumers' confidence to spend. The labor market is critical to consumer spending. While there are uncertainties about the lagged transmission of cumulative rate hikes, if workers keep their jobs--or expect to keep their jobs--then spending is likely to be maintained. Labor markets remain tight across many economies and wage growth prospects may continue to spur consumers to spend. We also expect household purchasing power will increase as a result of disinflation and wage growth.

In our soft-landing scenario for the eurozone, inflation will likely ease to an average 2.9%, wages will rise by 4%, and employment will stagnate. In the U.S., households have not yet run down their excess savings balances from COVID-relief policies, but real wage growth is slowing. We expect unemployment to peak in 2025 at 4.6%, only slightly above the long-run steady state unemployment.

Leveraged issuers may struggle with tight financing conditions and the high cost of debt service. On the back of a slowing economy and the high cost of debt, we expect further credit deterioration in 2024, continuing the diverging trends of resilience at the investment-grade level and downgrades largely at the lower end of the ratings scale. Many lower-rated borrowers will be forced to refinance at much higher rates than they enjoyed over the past years, and this would further strain cash flows, given many of the rated companies in the consumer product sector are highly sensitive to a drop in growth.

Across all the corporate ratings, the consumer products sector has the highest negative bias, with negative outlooks or ratings on CreditWatch with negative implications on 23% of issuers.

Increased digitization can generate greater operating efficiencies and cost savings, but cyberattacks are becoming more widespread. Branded consumer goods companies are investing in wide-ranging technology solutions to improve their efficiency across the supply chain and accelerate growth in e-commerce and direct-to-consumer operations. Digitization and advanced technologies can help consumer goods companies gain competitive advantage through innovation, process and cost efficiencies across production, supply chain, marketing, and distribution.

However, amid increasing technological dependency and global interconnectedness, cyberattacks pose a potential systemic threat and significant single-entity event risk. Given the scale and extent of business disruption arising from some recent cyber events in the consumer products sector, the financial impact is becoming more substantial and they increasingly have the potential to erode credit quality, accentuate other credit risks, and strain credit ratings over time. U.S.-based Clorox Co., for example, significantly lowered fiscal 2024 (June 30) guidance primarily due to temporary out-of-stock and some lost distribution on account of cyberattack-driven operational disruptions. We revised our outlook to negative from stable, reflecting the potential for a lower rating if Clorox does not demonstrate material sequential recovery in 2024 from the recent cyberattack.

Related Research

- European Retailers' Margins Are Unlikely To Regain Their Pre-Pandemic Strength, Nov. 7, 2023
- Corporates Up Their Cyber Preparedness As Cyber Attacks Become More Widespread, Oct. 25, 2023
- Industry Credit Outlook: A Second Half Rebound May Be Tall Order For U.S. Consumer Products Companies, Aug. 21, 2023
- Peer Comparison: A Cocktail Of Growth And Financial Discipline Will Keep Most Alcoholic Beverage Sector Ratings Steady, June 21,2023
- Slides: EMEA Consumer Goods Overview, Credit Trends, And Outlook, May 16, 2023
- 2023 CAGNY Presentations Highlight The Long Road To Recovery For Consumer Products Companies, March 15, 2023
- Personal Luxury Goods' Allure Endures As New Challenges Beckon, March 2, 2023
- Why One In Four U.S. Consumer Products 'BBB' Category Issuers Have Lowered Leverage Targets Significantly, Feb. 16, 2023

Industry Forecasts: Consumer Products

Chart 10

Revenue growth (local currency)

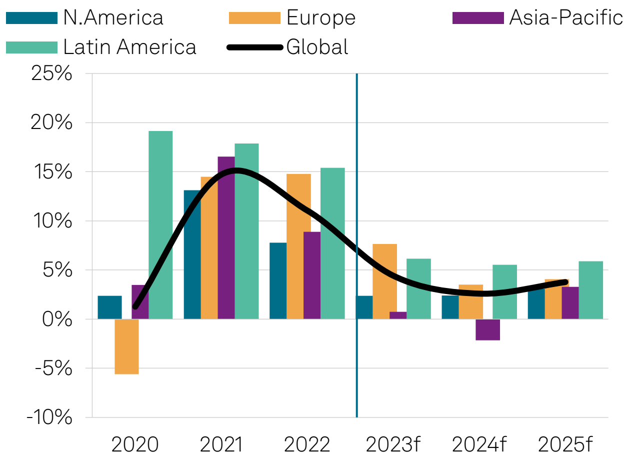


Chart 11

EBITDA margin (adjusted)

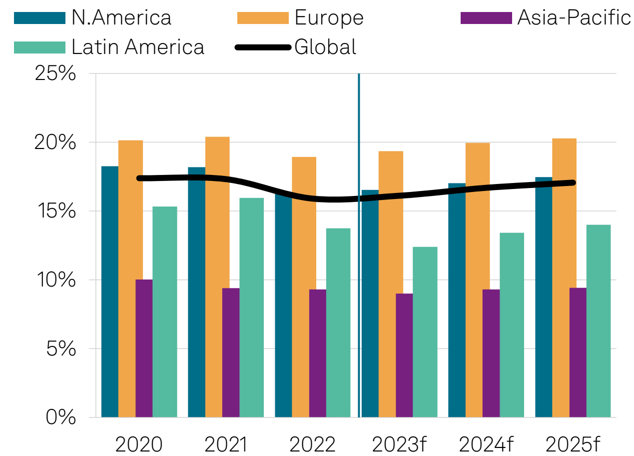


Chart 12

Debt / EBITDA (median, adjusted)

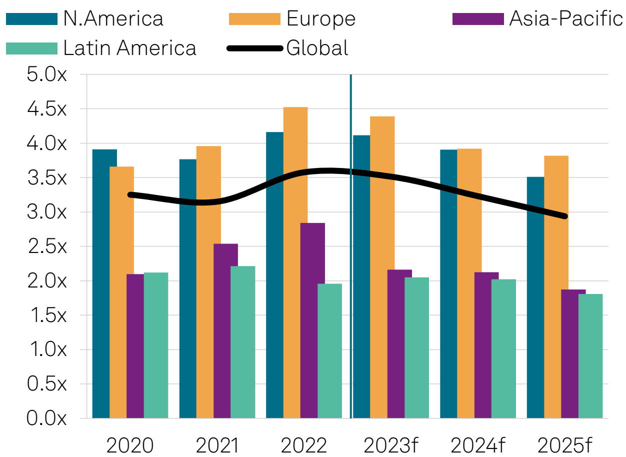
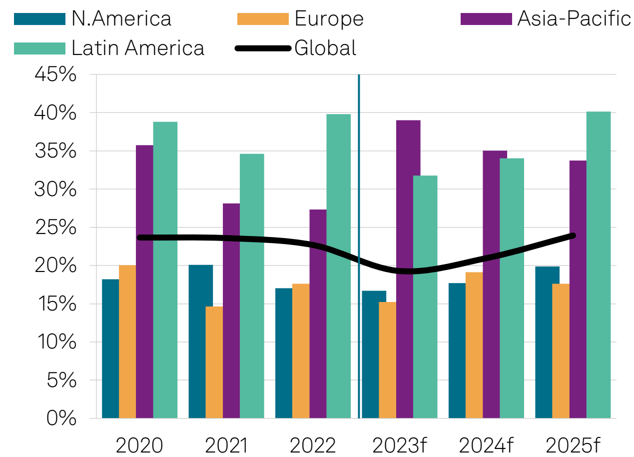


Chart 13

FFO / Debt (median, adjusted)



Source: S&P Global Ratings. f = forecast.
Revenue growth shows local currency growth weighted by prior-year common-currency revenue share. All other figures are converted into U.S. dollars using historic exchange rates. Forecasts are converted at the last financial year-end spot rate. FFO—Funds from operations.

Cash, Debt, And Returns: Consumer Products

Chart 14

Cash flow and primary uses

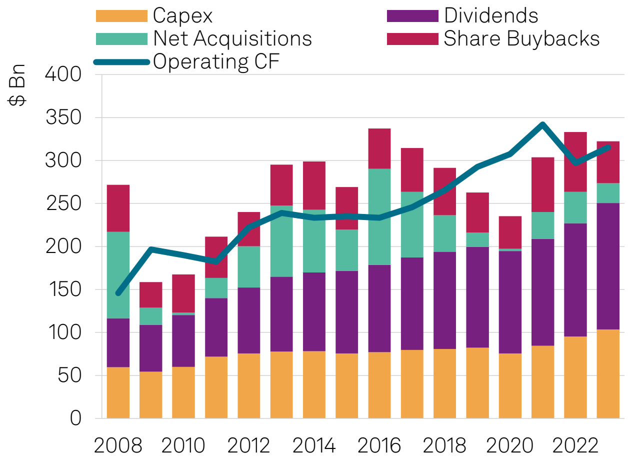


Chart 15

Return on capital employed

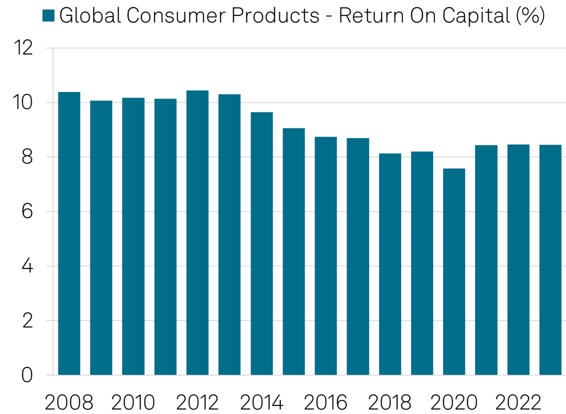


Chart 16

Fixed- versus variable-rate exposure

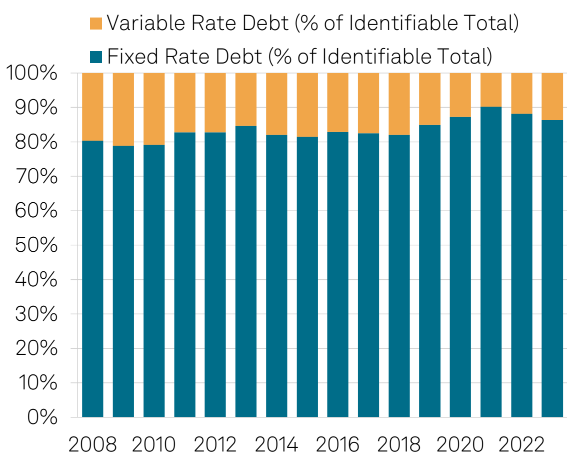


Chart 17

Long-term debt term structure

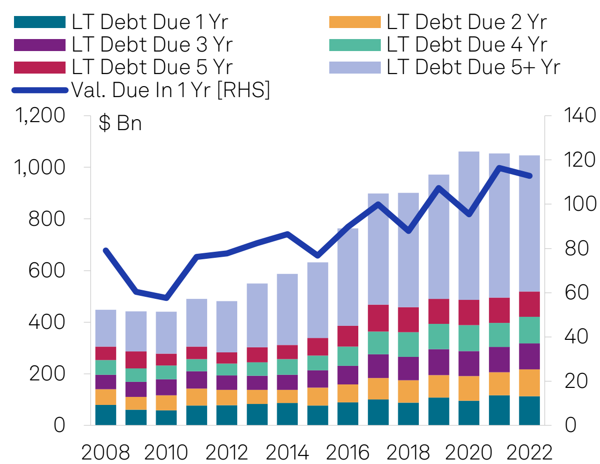


Chart 18

Cash and equivalents / Total assets

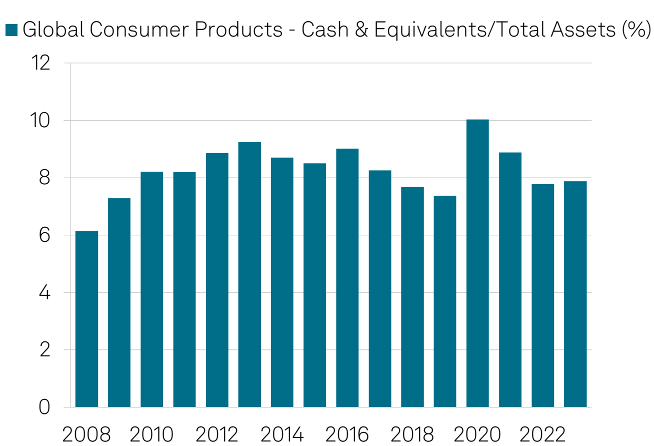
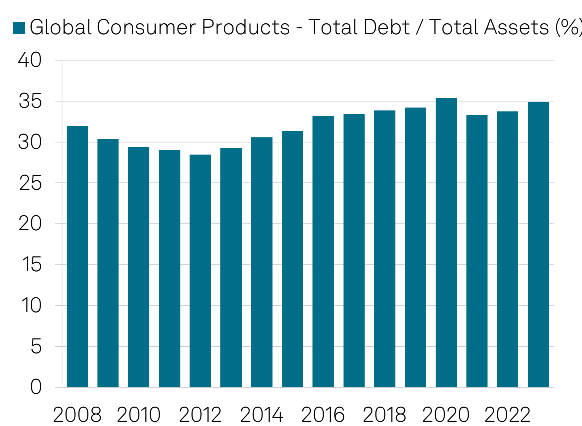


Chart 19

Total debt / Total assets



Source: S&P Capital IQ, S&P Global Ratings calculations. Most recent (2023) figures use the last 12 months' data.