



C&R portfolios 2023: Business cycle implications



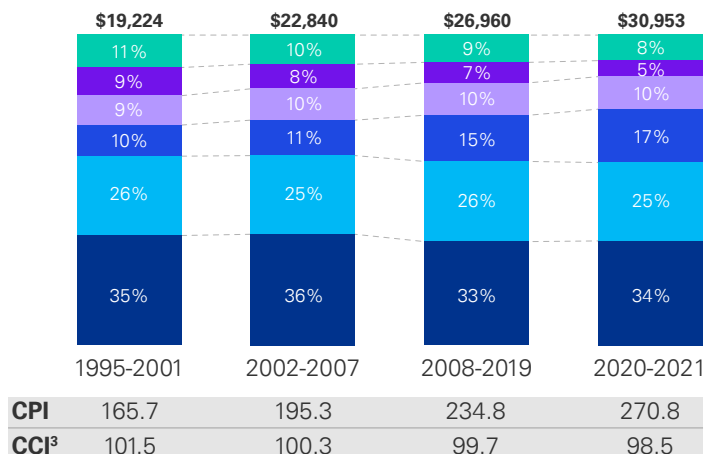
Business cycles can result in significant shifts in investment returns in the consumer & retail (C&R) sector. As 2023 begins with widespread concerns about a possible economic downturn, we look at how various C&R subsectors fared in previous downturns. What kind of companies lost the most value? Which ones did better in recoveries? Who was able to preserve margins when sales dipped? As we enter a new business cycle, C&R companies should consider optimizing their asset portfolios to best position themselves to generate sustainable total shareholder return (TSR) in this business cycle. Based on our analysis, here are six observations that may help to explain drivers of sustainable TSR in the C&R sector. We believe these observations can help C&R executives make portfolio decisions in 2023.

Observation 1:

From 1995 to 2021, the distribution of consumer spending shifted

Healthcare and entertainment spending accounted for a larger share of wallet while apparel, transportation, and food account for a smaller share of wallet.

Distribution of average consumer spend¹ by consumer unit by business cycle



	1995 to 2021 $\Delta\%^2$	CAGR 1995 to 2021
Total spend	–	1.8%
Apparel	-4.0%	-0.3%
Entertainment	1.1%	2.2%
Healthcare	7.2%	3.8%
Food	-0.3%	1.7%
Transportation	-1.7%	1.6%
Other ⁴	-2.2%	0.9%

Commentary:

- Aside from Healthcare spend increase, Entertainment increased as a share of wallet by 1.1 percent for the average consumer.
- Conversely, Apparel (-4.0 percent) and Transportation (-1.7 percent) experienced the largest discrete share of wallet declines.

Notes: (1) Proportion of sub-sector expenditures calculated as an average of total sub-sector expenditures for each period adjusted by CPI; (2) Sub-sector revenue share of wallet change from 1995-2021; (3) Consumer Confidence Index; (4) Includes Misc., Personal Care, Alcohol, Tobacco, Reading

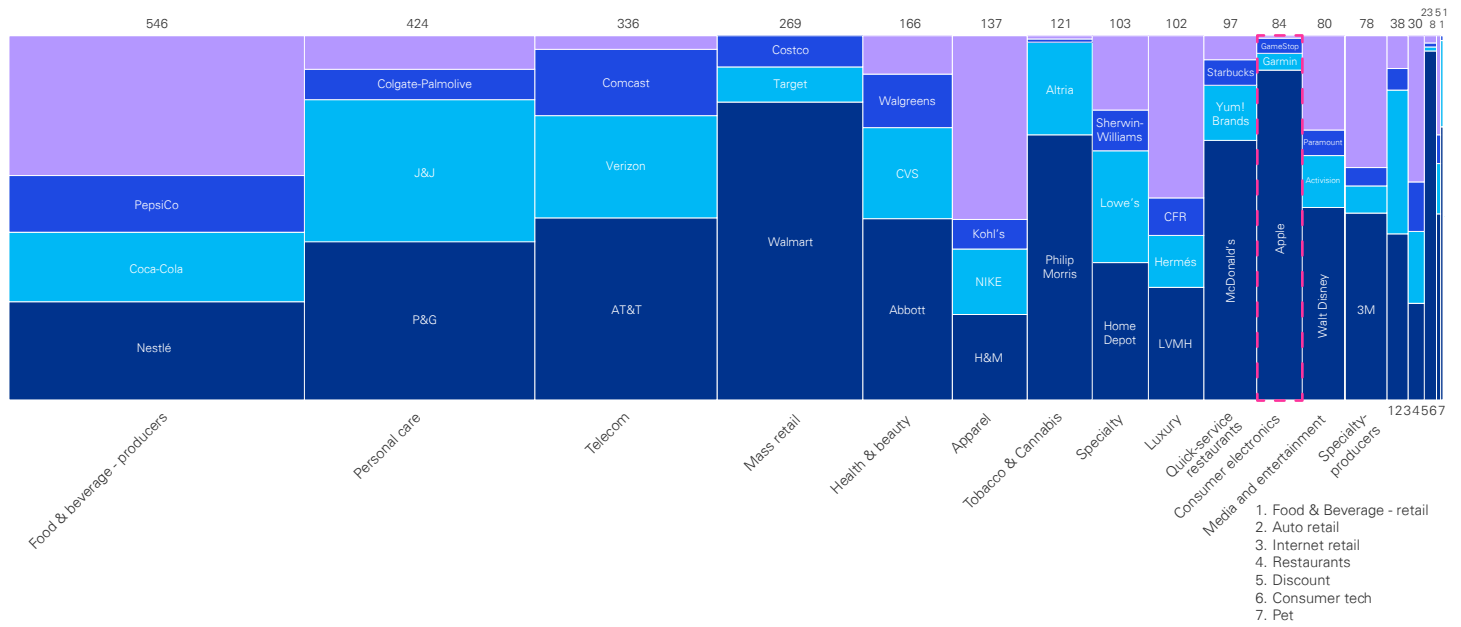
Source: US Census Bureau consumer spending data

Methodology: We examined the TSRs of 21 consumer-facing subsectors from 1995 through Q2'22 to understand the drivers of sustained TSR growth. This period captures four business cycles (as defined by the National Bureau of Economic Research), and as such, significant events such as 9/11 and COVID-19 are covered. KPMG examined data on 589 public companies that traded during the time span. Acknowledging that survivorship bias impacts this analysis, we still believe this study is germane to 2023 portfolio positioning.

2008 Consumer Electronics outpaced all other sub-sectors from 2002 to 2008 with an 8.2x growth in market cap.

Market cap by sub-sector

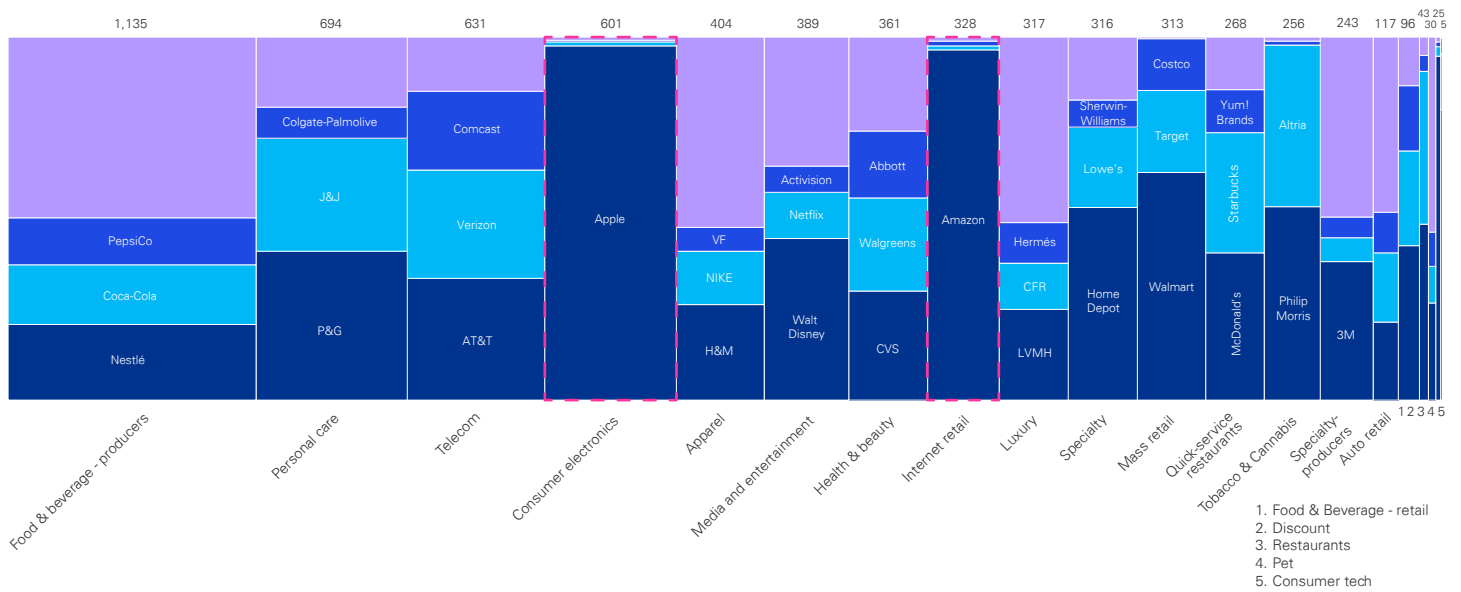
2008, \$2.6t, n=311



2015 By 2015, continued growth in both the consumer electronics and internet retail sub-sectors began altering the overall landscape of C&R.

Market cap by sub-sector

2015, \$6.6t, n=392

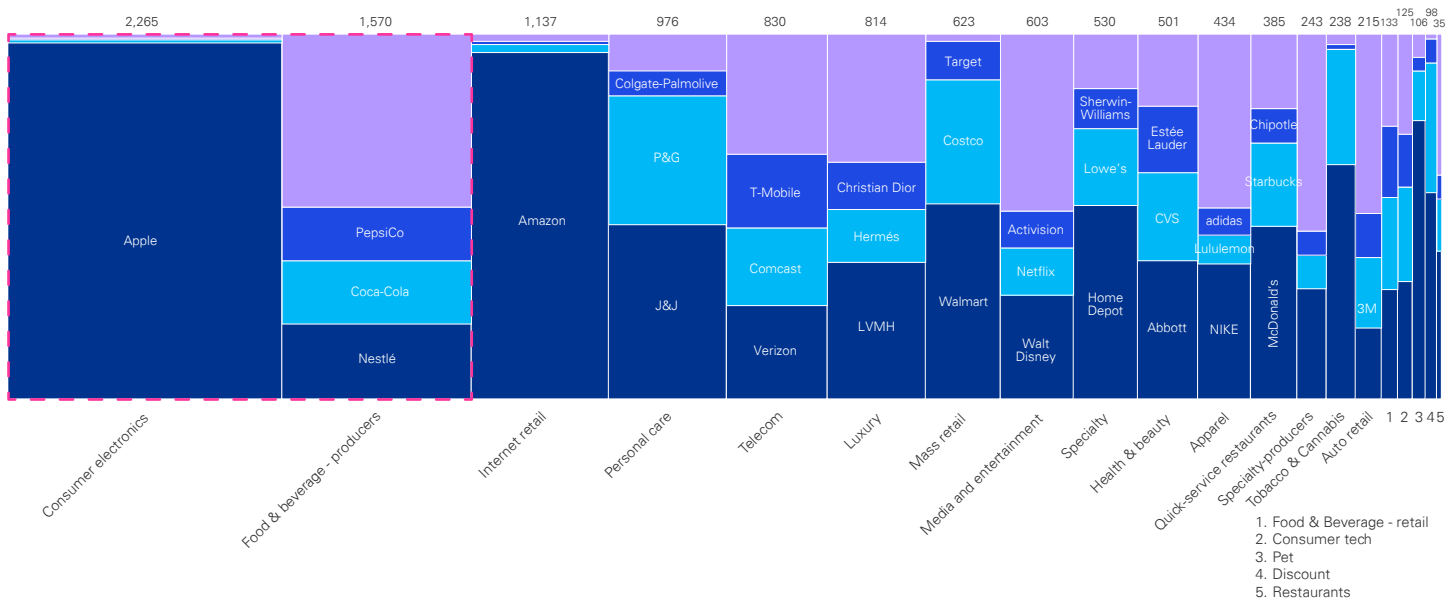


Source: S&P Capital IQ, accessed 10/21/22

2022 In Q2 2022, consumer electronics and food and beverages made up nearly a third of the total C&R market cap.

Market cap by sub-sector

2022, \$11.9t, n=589



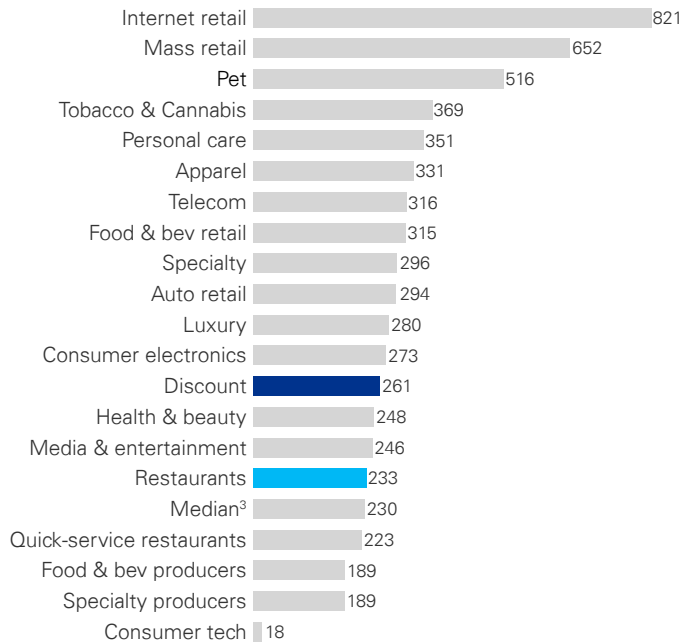
Source: S&P Capital IQ, accessed 10/21/22

Observation 3:

Across all four business cycles, a different sub-sector had led in median TSR; some sub-sectors are more volatile while others demonstrate consistent performance.

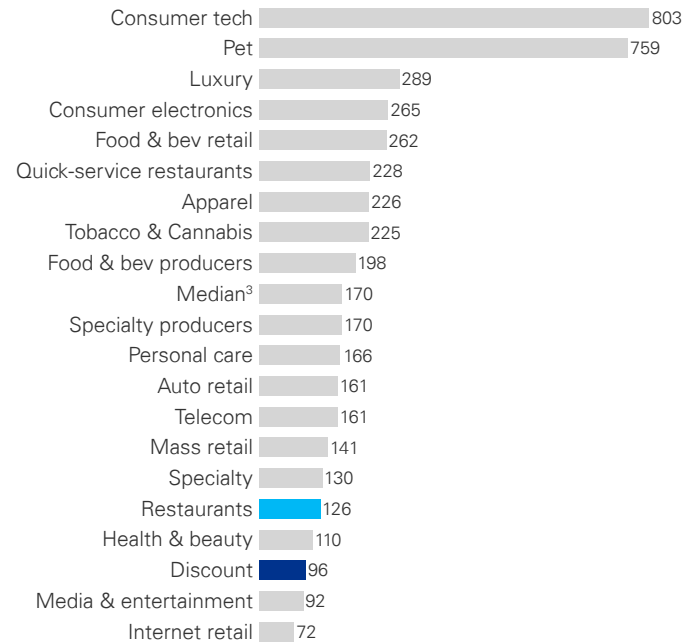
Median company TSR by sub-sector¹

\$, 1995 to 2001, n=255²



Median company TSR by sub-sector¹

\$, 2002 to 2007, n=306²

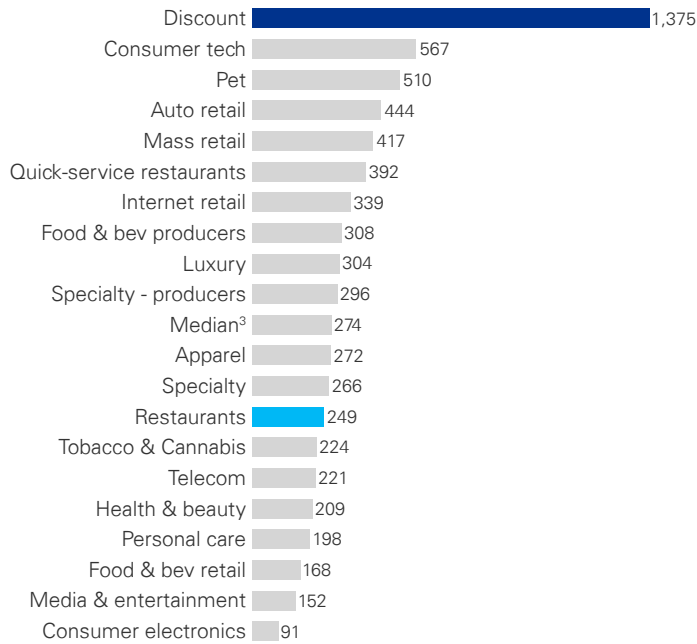


Note: (1) Determined as-if \$100 invested in each sub-sector's median TSR performer company at the beginning of each respective business cycle; (2) Company counts as of last year identified in business cycle; (3) Median \$TSR of entire sample (n=255, 306, 467, 589) for respective business cycle

Source: S&P Capital IQ, accessed 10/21/22

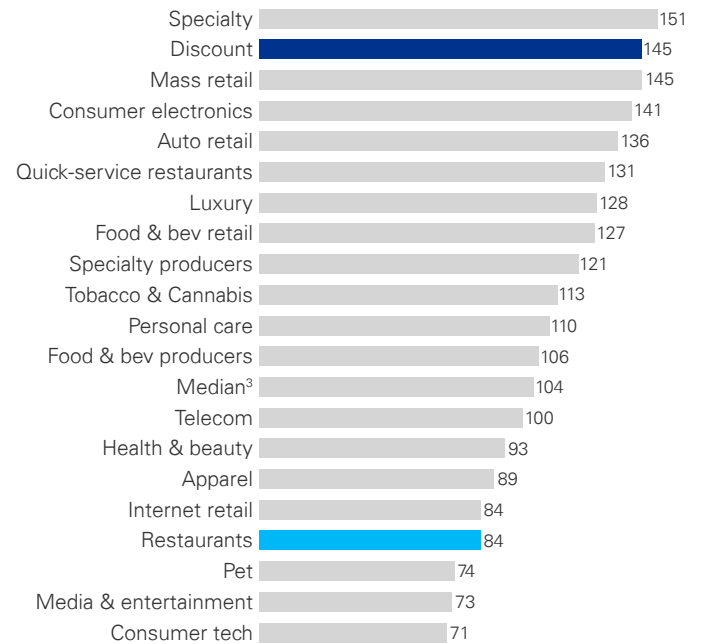
Median company TSR by sub-sector¹

\$, 2008 to 2019 , n=467²



Median company TSR by sub-sector¹

\$, 2020 to Q2 2022 , n=589²



Note: (1) Determined as-if \$100 invested in each sub-sector's median TSR performer company at the beginning of each respective business cycle; (2) Company counts as of last year identified in business cycle; (3) Median \$TSR of entire sample (n=255, 306, 467, 589) for respective business cycle

Source: S&P Capital IQ, accessed 10/21/22



Observation 4:

TSR dispersion exists, both between sub-sectors and within sub-sectors

Distribution of median TSR CAGR(1) (%) by sub-sector 1995 to Q2 2022

Sub-sectors	N count ²	Median TSR CAGR	Mean TSR CAGR	25th percentile	75th percentile	25% to 75% range
Discount	5	11.7%	10.4%	10.4%	13.0%	2.6%
Mass Retail	6	10.8%	-2.2%	8.7%	12.9%	4.2%
Tobacco and Cannabis	10	9.8%	1.9%	5.2%	10.5%	5.3%
Telecom	13	8.6%	5.2%	0.2%	12.2%	12.0%
Auto Retail	28	8.5%	-4.3%	-9.8%	15.2%	25.0%
Luxury	23	8.1%	0.3%	0.0%	13.5%	13.5%
Food and Beverage - Producers	77	6.9%	0.4%	-7.1%	11.1%	18.2%
Restaurants	26	5.7%	3.8%	-3.1%	10.4%	13.5%
Quick-Service Restaurants	18	5.0%	-7.4%	-8.4%	10.6%	18.9%
Consumer Electronics	19	4.8%	-10.0%	-29.0%	13.2%	42.1%
Specialty	33	4.6%	-3.4%	-7.6%	11.9%	19.5%
Specialty - Producers	63	4.6%	-3.4%	-5.2%	8.3%	13.5%
Apparel	71	4.2%	-2.4%	-5.9%	8.9%	14.8%
Food and Beverage - Retail	14	4.0%	0.8%	-6.9%	9.6%	16.5%
Personal Care	21	-1.0%	-14.4%	-37.2%	7.0%	44.2%
Media and Entertainment	64	-1.5%	-7.9%	-15.0%	3.7%	18.7%
Health and Beauty	37	-8.6%	-15.6%	-34.4%	6.3%	40.7%
Internet Retail	28	-17.1%	-26.2%	-47.1%	-0.9%	46.2%
Consumer Tech	21	-21.5%	-24.8%	-39.9%	-12.9%	27.0%
Pet	12	-23.7%	-18.6%	-41.3%	6.8%	48.1%
Sector	589	3.3%	-6.0%	-14.4%	9.6%	24.1%

Commentary:

- 1 The middle 50 percent of TSR CAGRs are most clustered for the Discount and Mass Retail sub-sectors, indicating a decreased likelihood of return dispersion
- 2 Conversely, the middle 50 percent of TSR CAGRs are least clustered for the personal care and pet sub-sectors, indicating an increased likelihood of return dispersion
- 3 Consumer Technology's 25th and 75th percentile TSR CAGR are -39.9 percent and -12.9 percent, respectively, indicating that the majority of sub-sector returns are negative



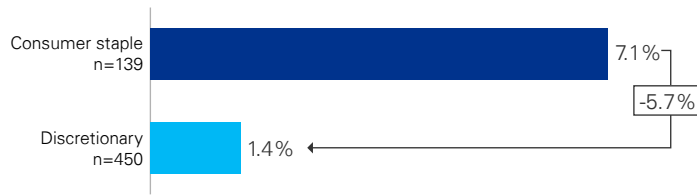
Note: (1) Determined by indexing \$100 in period 1 of TSR being calculated and taking the CAGR from initial to Q2 2022; (2) N count as-of Q2 2022

Source: S&P Capital IQ, accessed 10/21/22

Observation 5:

Certain qualitative factors may play a role in TSR dispersion among consumer and retail companies

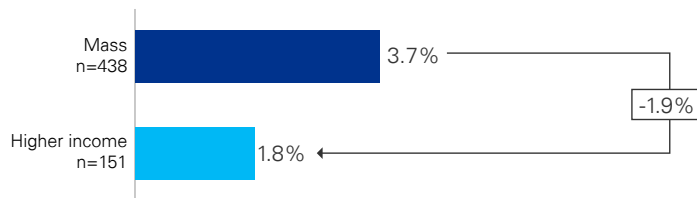
**Median company TSR CAGR¹,
Consumer staple vs. Discretionary Q2 2022, %**



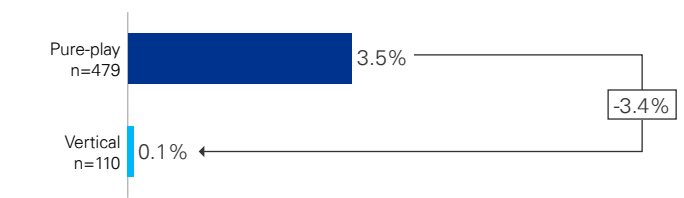
**Median company TSR CAGR¹,
Single brand vs. Multi-brand Q2 2022, %**



**Median company TSR CAGR¹
Mass v. higher-income target consumer Q2 2022, %**



**Median company TSR CAGR¹
Vertically integrated vs. pure-play Q2 2022, %**



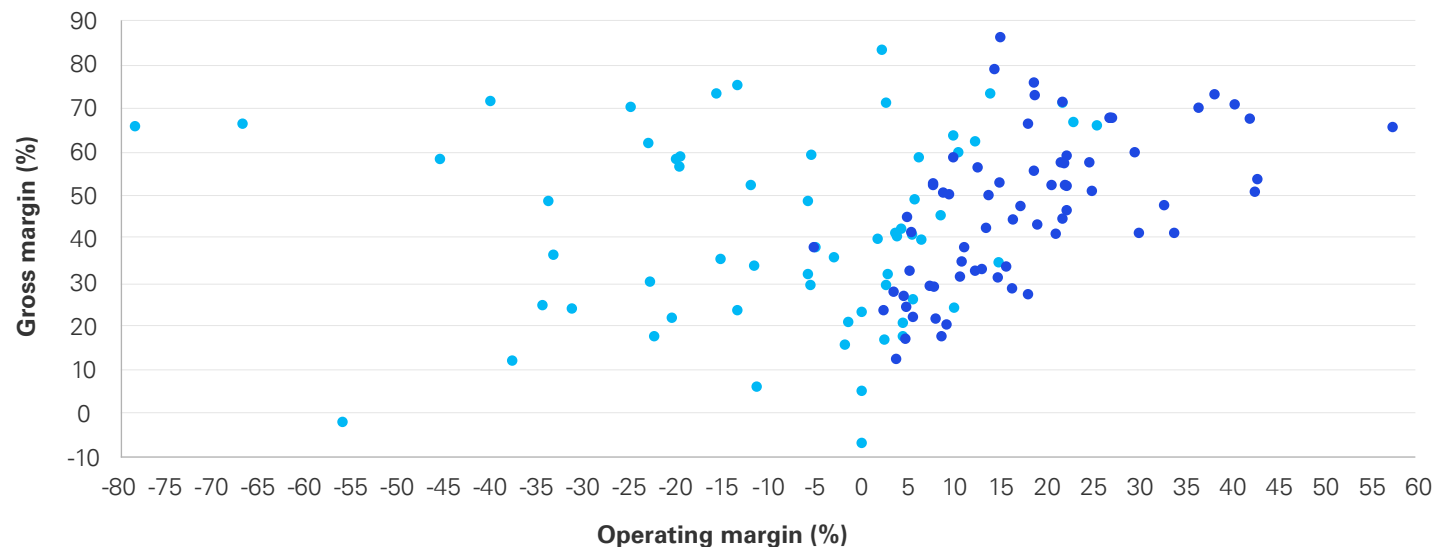
Note: (1) Determined by indexing \$100 in period 1 of TSR being calculated and taking the CAGR from initial to Q2 2022
Source: S&P Capital IQ, accessed 10/21/22

Observation 6:

For each sub-industry, the overwhelming majority of winners had a stronger operating margin profile, but gross margin profile results are mixed.

Gross margin vs. operating margin of winners and laggards %, FY 2021, n=131

	Median gross margin	Median operating margin
● Winner	48.1%	16.2%
● Laggard	40.7%	-2.4%



Source: S&P Capital IQ, accessed 10/21/22

Conclusion

Business leaders in the consumer and retail sectors should consider the implications of these six observations on their respective companies' asset portfolios, asking themselves a fundamental question:

Does our current asset portfolio position us to generate sustainable, above-average total shareholder return during the next business cycle, and what actions—acquisitions and/or divestitures—should be considered for optimal and sustainable TSR this year?



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DASD-2023-11494