Evenlode Global Investment View

July 2021 – Consumer Trends Part 2: Alcohol

EVENLODE
GLOBAL INCOME FUND

The commentary below applies to both the Evenlode Global Dividend and Evenlode Global Income portfolios. All market data is from Factset.

Last month in our investment view we examined the move towards plant-based diets and how consumer goods companies are responding to the growing market opportunity. In this investment view we examine how consumer and societal attitudes are evolving to the most ubiquitous social lubricant, alcohol.

At Evenlode we invest in companies that we believe have strong competitive positions, are asset light and experience good free cash flow generation. All of these attributes apply to the alcoholic beverage companies that we have selected for inclusion in our combined 'investable universe' of companies that we may invest in on behalf of our clients. Consumers are often loyal in this sector due to the strength and heritage of the brands.

Take Diageo as an example. Diageo is the world's largest producer of spirits, with a market leading position in the premium sector. Pernod Ricard is a similar example at number two in size behind Diageo, but with a significant presence in emerging markets such as China and India as well as other regions in which consumption of spirits is low compared to the Western world.

However, these companies and other businesses that have revenue exposure to the production and consumption of alcohol are coming under increasing scrutiny in recent years for their impact on the environment and society. Environmentally their use of water and effect on agriculture is high on the list of concerns - a key theme for the likes of brewers Anheuser-Busch InBev and Heineken given the number one ingredient in beer is water (90 – 95%). Socially there is also an increasing awareness of the potential negative social impact that these companies' products can have. For example, Norway's largest pension fund recently pointed to a statistic from the WHO that in Norway, more than 50% of incidents of violence involve alcohol and that alcohol related costs to the nation are estimated at $2bn annually[i].

The shares of companies that operate in certain sectors are often referred to as 'sin stocks', which refer to investments that might be considered by many to be unethical, immoral or unsavoury. The Nordic market is arguably the most advanced in the consideration of environmental, social and governance factors in investing, and as such a list of 'sin industries' that many refer to is known as the 'Nordic 5', consisting of alcohol, tobacco, weapons, oil & gas, and pornography. To take one of the Nordic 5, over several years investors have increasingly excluded investments in tobacco companies from their portfolios, as the tobacco industry is seen as socially disadvantageous. For example, in 2017 the UN Global Compact - the world's largest corporate sustainability initiative - excluded tobacco companies from participating in their initiative in alignment with their ambitions around Sustainable Development Goal 3: '*Ensure healthy lives and promote wellbeing for all at all ages'*. The UN Global Compact quotes Cary Adams, the CEO for Union for International Cancer Control: '*cancer kills more than 7 million people each year and therefore it is entirely appropriate that the industry responsible for this avoidable death toll plays no role in the UN Global Compact'.*[ii]

Society's view on the alcoholic drinks industry is less clear-cut. Alcoholic drinks are for most a treat after work or a beverage best consumed in a sunny garden with friends. Interestingly, the Covid-19 pandemic seems to have highlighted the appeal of relaxing with a drink at home. Even though consumers were locked down for months at a time, it did not stop them buying ready-mixed drinks as well as all the ingredients to make their own cocktails from home. Tequila in particular is one of the fastest growing categories and Diageo continues to grow at a fast rate in the US Tequila market, increasing sales at a compound annual rate of 43% over the past 2 years. However, outside of the pandemic other notable trends are at play. Consumers are making a steady trade up from beer and wine to spirits through time, as well as the continued 'premiumisation' of beverages with consumers wanting to drink better rather than drink more. Additionally, younger generations are proceeding to adulthood drinking less and the number of individuals defining themselves as non-drinkers continues to increase[iii]. There is potentially a significant health benefit from changing ones' drinking habits including a reduction in risk of developing chronic diseases, with the suggestion that young people are becoming more aware of these alcohol-related health risks.

The alcoholic beverage companies' reaction to these emerging trends is to offer low and no alcohol offerings such as Heineken with their Heineken 0.0 product. Interestingly though it is not just the alcoholic content of traditional drinks that is playing on consumers' minds. There is currently a boom in 'hard seltzer', a drink made up of carbonated water, fruit flavouring and a portion of alcohol (alcohol by volume is usually around 5%). Often these drinks are marketed as 'healthier alternatives' or 'low calorie', aiming to attract consumers with these claims, stealing share away from beer towards an array of new alternatives. The increasing popularity of hard seltzers highlights how consumers continue to buy into new health trends, as well as the movement towards low and no alcohol alternatives.

ESG in focus, and in practice

Despite the emerging health trends and the beverage companies' shift towards them, negative environmental and social impacts are still very much in focus. For example, AB InBev in their Sustainable Development Goal framework highlight the importance of water use and reduction, as well as how they treat workers and farmers within their supply chains. This has a knock-on effect for agriculture as a whole and climate change exacerbates the issue given weather scenarios are becoming less and less reliable.

At Evenlode we encompass the risks and opportunities for all businesses we invest in through our risk factor framework. We rank companies on a range of risk factors from A to E, which are then used to define the maximum position we are willing to hold in the company. In the case of alcoholic beverages the risk factor in question here is that of Social Impact, a score that encompasses issues across environmental (E), social (S), and governance (G) matters. For the beverage companies we have within the universes this not only means looking at governance structures, remuneration and board makeup, but also the key environmental and social issues noted above.

A positive point to mention is that companies like AB InBev and Heineken are currently highlighting and stressing the focus they have on issues such as water stewardship and 'smart drinking'. As an example, as part of AB InBev's 2021 sustainability goals the company aims for 100% of their communities in high-stress areas to have measurably improved water availability and quality. Additionally, alongside other alcoholic beverage companies AB InBev has committed to targeting smart or positive drinking through marketing to change social norms. The company aims to do this through investing at least $1bn across its markets in dedicated social marketing campaigns to help influence behaviours and reduce the harmful use and effects of alcohol consumption. As a result, and in recognition of these efforts, our Social Impact score for alcoholic beverage companies tends to be somewhat higher than that of tobacco (as a result, we have no tobacco companies in our investable universes). As an example, for Diageo we score a C, balancing the potential negative effects on public health with their goals around environmental sustainability and positive drinking initiatives.

To sum up, it is vital for food companies to invest behind emerging sustainability trends such as the plant-based diets we discussed last month, and it is just as, if not more, important for alcoholic beverage companies to invest in their product range, production practices and social programmes to ensure that they remain relevant to an increasingly health- and environment-conscious consumer. As investors it is important that we critically assess those efforts. At Evenlode we are enhancing our analyses to better understand how businesses are adapting, for example by identifying measurable key performance indicators that we can track against the UN Sustainable Development Goals over time. With this effort we aim to reduce risk for investors and also improve outcomes, in financial terms of course but also for the broader range of communities touched by the companies that we invest in on behalf of our clients.

Bethan, Ben, Chris and the Evenlode Team
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Please note, these views represent the opinions of the Evenlode Team as of 30th July 2021 and do not constitute investment advice.

Past performance is not a reliable indicator of future results. The value of investments can go down as well as up, and investors may not get back the money they invested. Current forecasts provided for transparency purposes, are subject to change and are not guaranteed.

[i] https://www.ft.com/content/018f1394-8110-11e9-9935-ad75bb96c849
[ii] https://www.uicc.org/news/un-global-compact-exits-tobacco-companies
[iii] https://theconversation.com/why-young-people-are-drinking-less-and-what-older-drinkers-can-learn-from-them-133020