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PREMIUMISATION
AND THE BATTLE FOR
CONSUMERS'
HEARTS AND WALLETS

RECKITT BENCKISER
BUILDING ON THE BASICS

L'ORÉAL
BECAUSE
PERSONALISATION
IS WORTH IT

**TAILORED FUND
PORTFOLIOS**
PORTFOLIO MANAGEMENT
FOR THE SUCCESSFUL
PLANNER

**THE PREMIUMISATION
OF A LIFESTYLE**



OLDMUTUAL

WEALTH

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INTRODUCTION

CHRIS POTGIETER, HEAD OF PRIVATE CLIENT SECURITIES

Premiumisation is arguably one of the most significant trends influencing global consumers as businesses are increasingly competing on levels of quality and experience, as opposed to price. While premiumisation is certainly not new, the motivations behind consumers' purchasing decisions have changed.

In developing markets such as China, premiumisation has largely been fuelled by the emergence of an aspirational middle class seeking to assert their status. On the other hand, in more developed markets, premiumisation has gained traction among engaged consumers who want to explore unique and interesting products that cater to their needs. Our feature piece unpacks this megatrend in more detail and makes the point that at its core, premiumisation is about consumers' priorities, and businesses that understand these priorities can capitalise on the difference between commanding a premium and becoming a commodity.

From an investment perspective, we believe that premiumisation offers the best of both worlds - defensive qualities underpinned by middle-class demand and growth as new markets, new products and new consumers are capitalised.

Our two company stories provide practical examples of how two key holdings within our Global Equity Portfolio (which recently achieved a commendable five-year performance track record) are investing in premiumisation to achieve a richer, more meaningful and enduring relationship with their consumers.

The global consumer staples sector has experienced a significant deceleration in revenue growth over the last few years as dynamics have shifted. In response, Reckitt Benckiser made a strategic decision to change its product mix, innovate and premiumise its offering. This has allowed the company to clearly differentiate itself and thrive in a highly competitive sector.

The beauty and personal care industry is an equally complex, multifaceted and fiercely competitive market. Yet L'Oréal has managed to consistently grow profits since its inception over a century ago and, more importantly, this company is not showing any signs of fatigue. With China being the second largest and fastest growing beauty market in the world, L'Oréal has transformed its marketing strategy, product development and corporate culture to meet the demands of Chinese consumers who are

seeking premium products and premium experiences. Their efforts have paid off as they now have nearly 10% of the Chinese beauty market, making them the leading beauty and personal care brand in China.

Closer to home, we delve into how Old Mutual Wealth provides financial planners with a premium offering through its Discretionary Fund Management service, which enables planners to create unique strategies, manage costs and customise branding and reporting. This is but one example of how our business is geared towards meeting the evolving needs of financial planners and investors. We then end off this edition with an interesting short article on the most common ways that businesses premiumise their products and services.

To conclude, I'd like to take this opportunity to wish you and your loved ones well over the holiday season and trust that 2020 will be rewarding and prosperous.

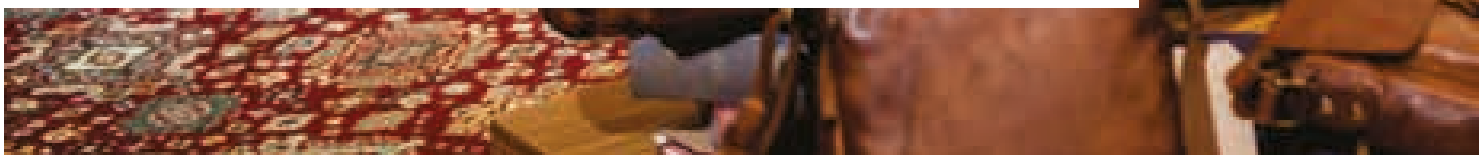
All the best,
Chris



PREMIUMISATION

AND THE BATTLE FOR CONSUMERS' HEARTS AND WALLETS

ANDREW DITTBERNER, CHIEF INVESTMENT OFFICER & **SAMEER SINGH**,
RESEARCH ANALYST AT PRIVATE CLIENT SECURITIES





Premiumisation continues to gather momentum across a variety of sectors and industries as consumers' priorities and spending patterns continue to evolve. Much of what previous generations placed value on has now become commoditised across much of the world.

During the early and mid-20th century, ownership of items such as stoves, refrigerators, radios and TVs were seen as a form of status signalling. Due to technological advances, manufacturing ingenuity and globalisation, these items have become ubiquitous and are impotent as sources of envy in modern times. Essentially, the process of commoditisation has lowered the prices of such goods to the point where the level of quality is standard and so price becomes the key differentiator. Premiumisation lies at the other end of the spectrum and while it may not be new, what has changed is the motivation behind consumers' purchasing decisions.

With its beginnings traced back to alcoholic drinks in the 1970s, premiumisation would historically be referred to as "trading-up", or otherwise classified, and seen, as luxury. However, following a multitude of supply-side advancements, we can now refer to terms such as "masstige" (i.e. mass market prestige or mass personalisation), the exact opposite of commoditisation. Premiumisation though is not restricted to personalisation alone, as other types of premiumisation include a focus on a product's rarity, its ingredients, the level of service associated with the product, its reliability and durability, etc.

Importantly, the shift to premiumisation is not all supply-side driven, as consumers (or the demand side) and their preferences are playing a vital role too. From a desire for status, quality, brand affinity, environmental consciousness and superior style, to the subtleties of the demographic shifts from Baby Boomers to Gen-X to Millennials to Gen-Z and their respective purchasing habits, consumers are driving premiumisation. Those who can afford better, want better, and if they cannot afford better, then they will prioritise for better.

From an investment perspective, understanding the underlying drivers of premiumisation from both the demand and the supply side is critical in identifying and exploiting the potential investment opportunities.

MIDDLE CLASS RISING

Arguably, the greatest tailwind for growth is changing population dynamics. Not only has global population growth increased exponentially over the last century, but poverty has also declined substantially. In fact, as recently as 2018, we reached the tipping point where, for the first time, over half of the world's population were estimated to have enough discretionary expenditure to be considered middle class¹. This is noteworthy as the middle class essentially drives demand in the global economy, accounting for two-thirds of global household consumption.

¹<https://www.brookings.edu/blog/future-development/2018/09/27/a-global-tipping-point-half-the-world-is-now-middle-class-or-wealthier/>

According to the Organisation for Economic Cooperation and Development (OECD), the middle class is expected to grow to 5.3 billion by 2030, accounting for 63.5% of the world population. Based on this estimate, the middle class will be the fastest growing segment of the global population, accumulating an estimated 1.7 billion additional people, while the wealthy will increase by just 100 million people. It is therefore abundantly clear why businesses are making it a key priority to capture the middle-class segment of the global population.

AGE IS MORE THAN JUST A NUMBER

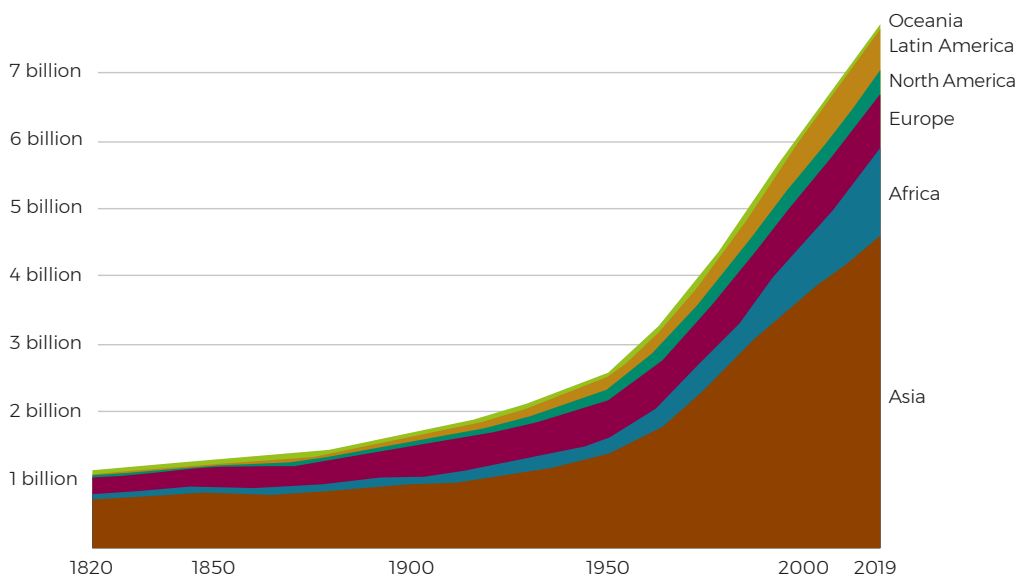
Intuitively, the bulk of the middle-class growth is expected to come from the youngest (by population age) and fastest growing economies. Unsurprisingly, these economies are found across emerging markets. China - with its 1.4 billion population with an average age of 37 years, a fast-evolving services sector, and a 420 million-strong middle class - is

currently the most meaningful of the emerging markets. The country is closely followed by India and Indonesia, whose populations of 1.3 billion and 270 million are on average 27.1 and 30.2 years old, respectively. As these large and young populations age, their personal expenditures ultimately change, causing major shifts in global consumer spending patterns.

Older populations tend to spend more on healthcare and related services and less on entertainment and apparel. This is positive for companies such as Medtronic, Johnson & Johnson, Proctor & Gamble and Reckitt Benckiser. The attractiveness of these businesses, which are either pure healthcare or healthcare-adjacent consumer staple companies, is that they have a steady demand for their products, which are supported by strong brands and brand loyalty, particularly in ageing populated economies. This is not to say that younger generations (Gen-X and

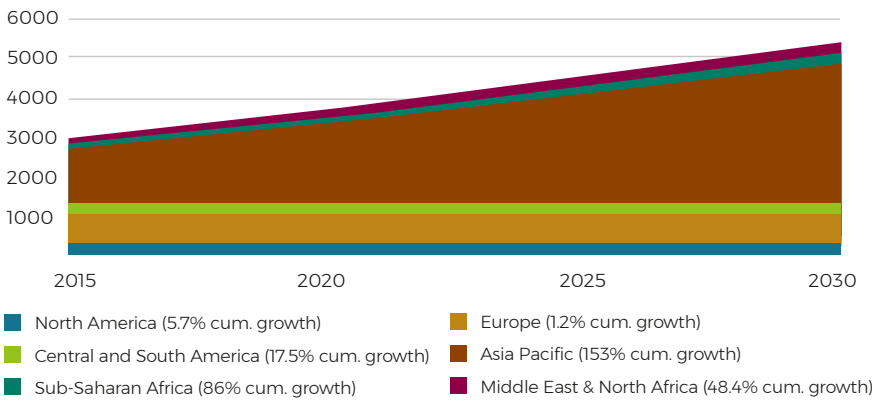
According to the Organisation for Economic Cooperation and Development (OECD), the middle class is expected to grow to 5.3 billion by 2030, accounting for 63.5% of the world population.

Graph 1: World population by region



Source: HYDE (2016) & UN (2019)

Graph 2: Growth in global middle class



Millennials) do not spend on such items; the reality is that their spending priorities are different. So while household and personal care items are important, younger generations tend to prioritise day care and education for their children.

Against this backdrop of evolving consumer spending patterns, it is evident that the opportunity to premiumise products sits across a spectrum of industries and sectors ranging from consumer staple companies to discretionary-spending favouring companies such as Disney, Netflix, Nike and Starbucks. Globalisation has been a key driver of spending across these categories as consumers can easily access a wide range of products that just a few decades ago were only available in certain parts of the world.

PAYING UP FOR PREMIUM

Recent US data shows that premium products account for one-quarter of US dollar sales in personal and home-care categories, while growth in the premium segment outpaced total category growth in recent years. This begs the question, what are consumers willing to pay up for, and vice versa?

According to the 2019 Changing Consumer Prosperity Report by Nielsen, items within the personal electronics, apparel/shoes and cosmetics categories are able to command and achieve premiums. With the exception of personal electronics, which largely speak to media consumption devices such as tablets and smartphones, other categories can also benefit from local insight where manufacturers focus on premium attributes that are more greatly appreciated in specific countries and regions. An example of this is Kwaliti Wall's Kulfi ice cream. Kwaliti Wall's, a frozen desserts brand and division of Unilever since the mid-1990s, has a deep history in India dating back over 50 years. Kulfi is a traditional Indian ice cream featuring rich flavours such as rose, cardamom, saffron and pistachio, Understanding the cultural and historic significance Kulfi holds in the minds of Indian consumers, Kwaliti Wall's market their Kulfi with the tag line, "Indulge in something desi" – desi being a sanskrit word meaning "one from our country".

At the other end of the spectrum, two categories that are least able to command premiums are carbonated drinks and tobacco.

Typically, consumers view these categories as value purchases that are not sufficiently distinct to warrant a higher price.

CORE PREMIUM ATTRIBUTES

Essentially, when consumers make a premium purchase, they are prioritising some aspect of the item over the price. While value is certainly important, it is not measured in pure monetary terms. More specifically, attributes that are worth paying up for, and which manufacturers should focus on, tend to be more experiential in nature:

- High quality/safety standards
- Superior function and performance
- Organic and/or all natural ingredients
- Environmentally friendly/sustainable materials
- Unique feature (often intellectually protected)
- Socially responsible
- Single source of origin

While high quality, superior performance and unique features are well-known premium attributes, the increased significance of organic/natural, environmentally aware and socially responsible attributes differentiate the current generation of consumers from previous ones. In short, today's consumers are increasingly purchasing for both rational and emotional reasons. We view Amazon's 2017 purchase of upmarket grocer WholeFoods for US\$13.7 billion and, more recently, the over 100% price appreciation (and mass media attention) of listed plant-based meat manufacturer Beyond Meat as major signals of this continuing shift.

Although "green" attributes are gaining traction globally, they arguably find the greatest support

in developed markets. Emerging market consumers, especially the new middle class, tend to be more nuanced in what they “trade up” for. Chinese millennials are a significant target market for large multinationals as brand affinity and ownership enhance these consumers’ social capital. Purchasing decisions are therefore about much more than just items, they are lifestyle choices that represent distinction and exclusivity. For context, more than 50% of the global growth in luxury spending between 2012 and 2018 was driven by China and this number is expected to increase to above 66% going forward.

A final but important consideration is that the majority of emerging market consumers are the first in their families to enter into the middle class. As such, they represent untapped markets to manufacturers and their brands. These consumers are less tied to preconceived notions of what represents premium or luxury and they do not easily buy into the legacy often associated with premium brands. Instead, they are more contemporary in their thinking and highly perceptive of current developments. And this has substantially shifted the playing field for supply-side incumbents, both large and small, established and new.

LEVELLING UP

Publicly traded companies are perishing faster than ever. According to the Boston Consulting Group, almost 10% of publicly traded companies fail every year, a fourfold increase since 1965. Failure to adapt to a constantly changing world is a key catalyst for this rapid rise in business failures. It is therefore essential for businesses to identify the forces shaping the global

consumer landscape and then strategically position themselves to benefit from them.

As discussed, products are either being commoditised (resulting in a push to lower prices with very little to differentiate between products), or premiumised. The net result is a rise in the phenomenon known as “death in the middle”. And so to avoid this space, companies are increasingly having to choose between commoditising and competing on price, or premiumising and competing on quality or a similar defining characteristic.

Nielsen’s Innovation Practice has identified six guidelines for successfully developing and deploying premium products; each is briefly discussed below.

1. Product differentiation

Product differentiation is as much about a marketing strategy as it is about ensuring that a product is actually differentiated. With so many choices facing consumers, it is imperative that a company demonstrates how its product is better or unique. Doing this well could result in brand loyalty and competitive advantages.

2. Sustainable support

Linked very closely to differentiation through a marketing strategy is the need to provide long-term support for the product. Most new products see their sales growth declining in year two. What distinguishes those who manage to buck this trend is the amount spent on advertising in year two. Given that adoption of premium products is typically slower than more mainstream products given the higher price point, they do require greater marketing support over longer periods.

It is therefore essential for businesses to identify the forces shaping the global consumer landscape and then strategically position themselves to benefit from them.

3. Distribution

The next piece of the puzzle is how to distribute the premium product. The onset of online retailers such as Amazon and Alibaba was initially thought to potentially commoditise goods through making most products easily available to consumers at lower prices. But while online is becoming increasingly important for premium products, brands today are trying to reclaim their products, selling them through their own channels or speciality channels. Although limiting distribution to speciality channels may enhance premium perceptions, businesses need to weigh this up against the reduction in volumes associated with a mono-distribution strategy. The likes of Disney, Nike and Richemont are a few examples of brands that are currently reclaiming their products' distribution.

An additional consideration in the distribution of premium products is how brands approach promotional activity around their products. Discounting heavily or frequently can erode the premium perception. An interesting example of this is how Richemont destroyed nearly €500 million worth of its watches in 2016 and 2017 due to increased inventory build-up in retailers as China cracked down on corruption and bribery. Richemont was concerned that the retailers would discount the items in order to reduce the inventory build-up and, as such, erode their premium image. Richemont chose to rather destroy their watches than destroy their premium brand reputation.

4. Packaging

Drawing attention through **enhanced packaging** is also important to elevate perceptions about a product. Whether it is about

making the packaging simpler through uncluttered designs and modern graphics, or more functional through lighter weight and easier to carry, or alternatively handcrafted, it is imperative that the product's packaging displays a premium image.

5. Integrity

It goes without saying that premium products need to **live up to their promise**. High prices set a higher bar for product performance.

6. Price

Finally, companies need to ensure that the **price is right**. Prices need to be set according to consumers' value perceptions, as well as the competitive context and retail dynamics. Price alone is not enough to signal premium; the product's price needs to take into account market dynamics and the above-mentioned guidelines.

RIDING THE WAVE

Seen in totality, premiumisation is an investment theme borne and driven by the evolution of a multitude of factors. We live in a more populous, prosperous but flatter and closer world. Consumption patterns are shifting from developed to emerging countries and from physical to digital locations. In addition, our preferences have changed.

As observers, the greatest sources of growth are abundantly clear. However, as investors, we need to be selective about where we allocate capital. Businesses operating in the current environment need to be dynamic and flexible in order to shift with the times. Gone are the days of product differentiation by price alone. A much stronger and closer relationship with the consumer is required, ideally one that is

ongoing, underpinned by product support and evolution. By leveraging technology and digital proliferation, businesses will be able to control their products' narratives while also ensuring they protect their legacies.

Investing in premiumisation offers businesses a richer, more meaningful and enduring relationship with their consumers. For investors, premiumisation offers the best of both worlds – defensive qualities underpinned by middle-class demand and growth as new markets, new products and new consumers are capitalised.





RECKITT BENCKISER

BUILDING ON THE BASICS

VICTOR MUPUNGA, RESEARCH ANALYST AT
PRIVATE CLIENT SECURITIES

Consumer staple companies (those that produce and sell items such as food, beverages and non-durable household and personal products) are mostly known for their defensive qualities. The core investment case for such companies is often that irrespective of the economic cycle (downturn or boom), consumers still require products that are essential for basic living. In previous decades, consumers' low price elasticity resulted in companies within the consumer staples sector reporting solid and dependable growth. However, this began to change at the turn of the decade when a confluence of factors eroded the pricing power of most companies in the sector.



A SHIFT IN DYNAMICS

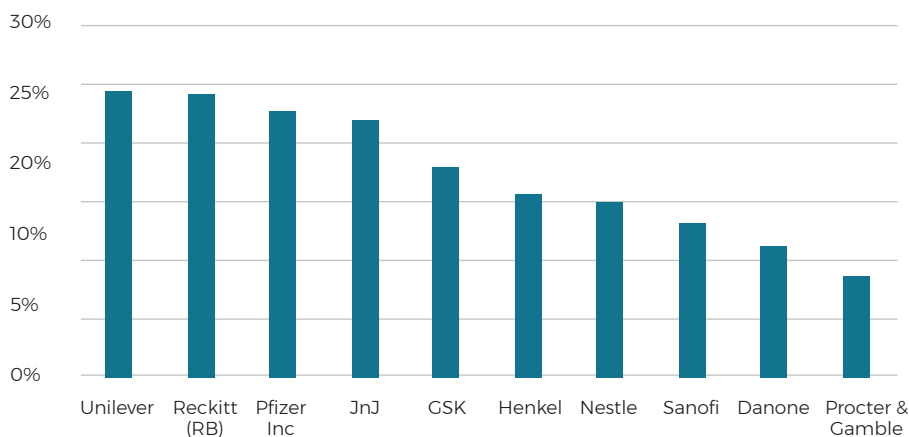
According to global consultants Bain and Company, the average organic revenue growth for the global consumer staples sector was 6% in 2011. Growth has subsequently decelerated to around 2%. There are several reasons for this slowdown, including slowing growth in previously thriving emerging markets; unprecedented levels of disruption within many product categories; loss of market share by large multinational brands to more nimble local incumbents; and the move from on-shelf to online delivery channels.

In response to these changing dynamics, some companies opted to aggressively cut costs to the detriment of their brands – Kraft Heinz being one such example. Others pinned their hopes on mega-deals (ABInBev) while a few have opted to invest in adjacent products, innovate and premiumise their offering. Reckitt Benckiser (RB) is a prime example of the latter, as evidenced by its industry-leading margins, profitability and premium brand portfolio.

Reckitt Benckiser (RB) is a prime example of the latter, as evidenced by its industry-leading margins, profitability and premium brand portfolio.

Graph 1: Superior margins

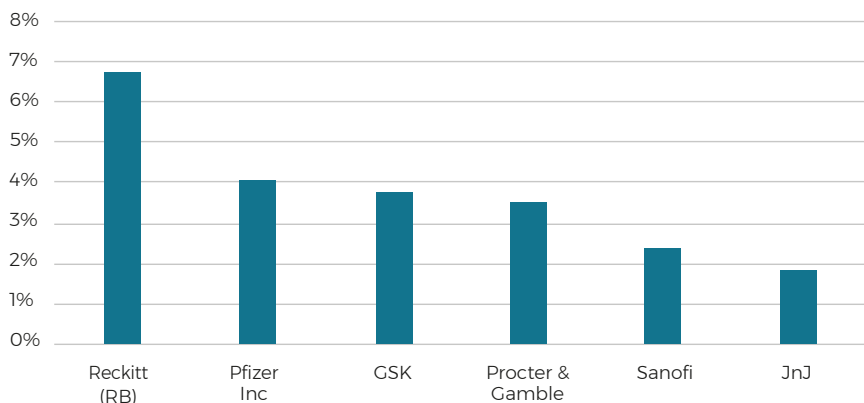
Operating Margin (%), Last reported Fiscal Year



Source: Refinitiv

Graph 2: Rising revenues

Consumer Health, Organic Growth, Average (2011 - 17)



Source: JP Morgan

IT'S ALL IN THE MIX

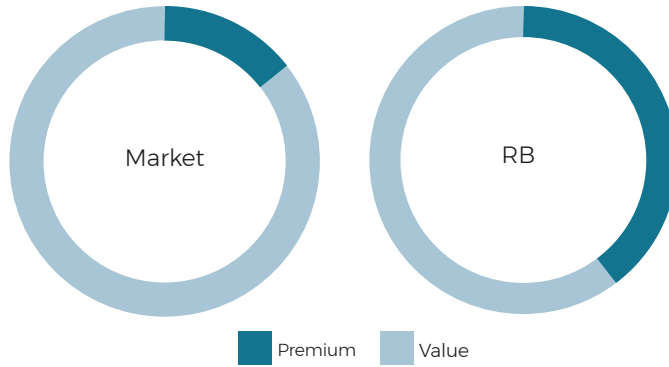
In 2011, when the recently retired CEO of RB took over the reins, the group's exposure to consumer health products was at 21%, with the balance in food, home & hygiene products. Today, RB generates 63% of its revenue from basic consumer health brands such as Gaviscon, Durex and Nurofen. This strategic shift in the group's portfolio mix has resulted in a more premium-weighted and profitable business with gross margins above 60%. Management attribute much of RB's success to its focus on innovation, which is explicitly stated in the group's mission statement and firmly entrenched in its culture.

INNOVATION ENABLING PREMIUMISATION

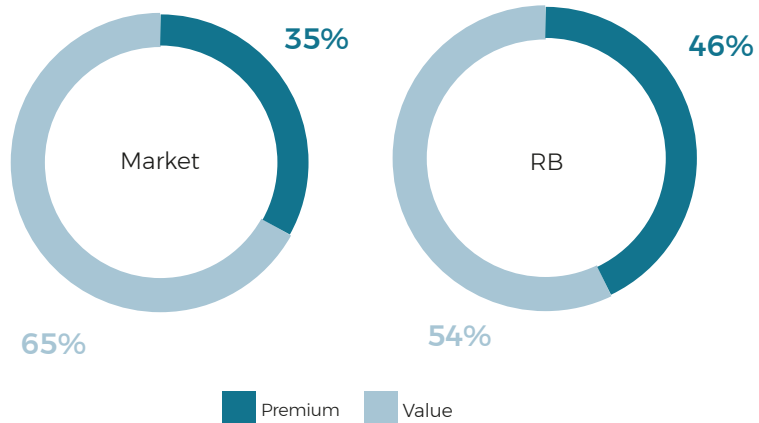
The evolution of RB's Mucinex brand is a good example of how the group has effectively used innovation to enable premiumisation. This over-the-counter (OTC) medication is used to relieve chest congestion and has been around since the 1930s. RB bought the brand in 2008 when it was the seventh largest OTC brand in North America and in the ensuing decade, Mucinex became the top seller in that region. It is important to highlight that no changes were made to the medication's active ingredients and that this growth was achieved solely through innovation and premiumisation. Graph 4 shows how RB upsold variants of the same medication (from capsules and gels to fast-dissolving and liquid formats) at incremental margins – an impressive feat in a competitive and crowded product category.

Graph 3: Creating the right mix

RB Hygiene & Home portfolio

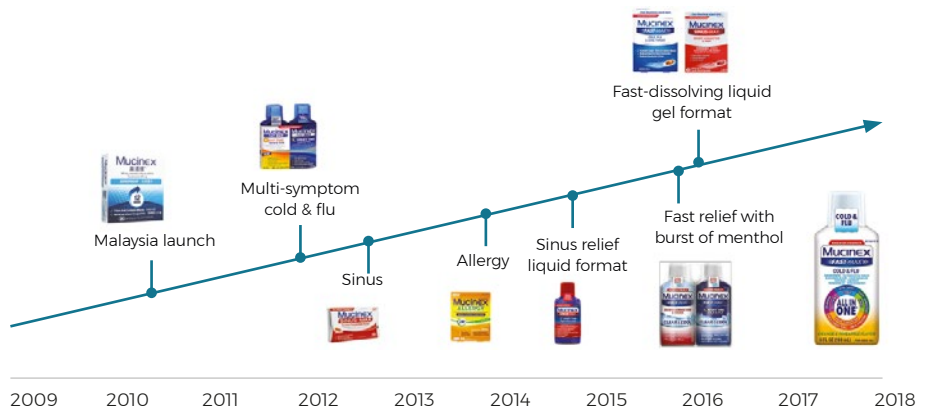


RB Health portfolio



Sources: Euromonitor & Nielsen
 *Premium is defined as >25% of the segment average price

Graph 4: The premiumisation of Mucinex



Source: RB company reports

Dettol and Nurofen provide other case studies of how the group has enhanced everyday basic products and sold them at a premium. In the case of Dettol, the group has ventured into related categories like soaps, hand wash and shower gels. The most recent product launch was a biodegradable multi-surface wipe that, like all Dettol products, kills 99.9% of all germs. Invariably, by attaching the Dettol brand to a generic product such as surface wipes, RB is able to charge a premium relative to competitors and maintain its global share of over 80% in the antiseptic market.

Nurofen, the anti-inflammatory and pain relief medication well known in liquid and capsule form, launched a plaster alternative less than a year ago. At its launch, the ibuprofen-based patch was the world's first clinically proven 24-hour medicated patch delivering the drug at a consistent dose through the skin without the side effects linked to the oral form. Earlier this year, management highlighted

that the plaster variant of Nurofen had exceeded expectations by a magnitude of three times, highlighting the opportunities that exist in premiumising basic products through innovation. Graph 5 shows how the price per dose for Nurofen has increased from £0.17 to £3.23 in the last decade.

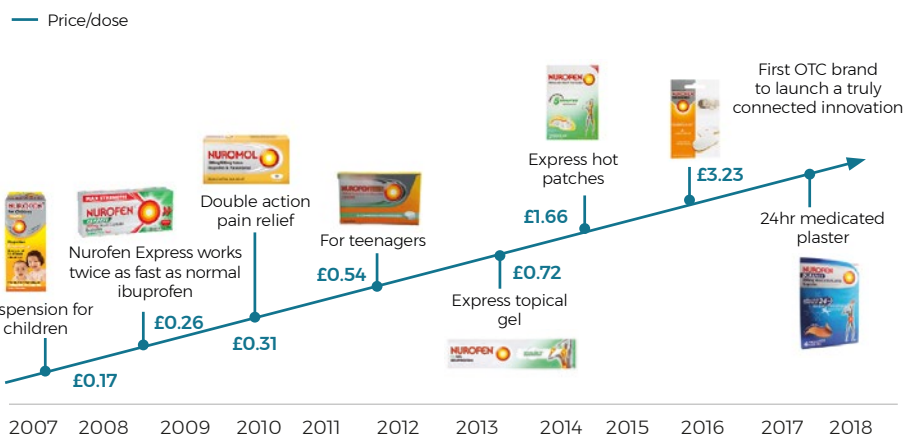
A WINNING FORMULA

The 2017 acquisition of the former Mead Johnson, a global leader in infant formula and child nutrition (IFCN), was a key catalyst for RB's more recent portfolio transformation. The tie-up between the two companies gave RB an 11% market share of the IFCN sector, propelling the group to being the third largest global player behind Nestlé and Danone. IFCN represents almost a quarter of RB's group sales, with the Chinese market alone making up 30% of these sales (7% of total group sales). The disproportionate contribution from China is consistent across IFCN companies, largely because the country represents the largest

Dettol and Nurofen provide other case studies of how the group has enhanced everyday basic products and sold them at a premium.

Graph 5: Increased pricing power

Nurofen innovation



Source: RB company reports

geographic market and opportunity – it represents 46% of the global market by value and two-thirds of industry growth.

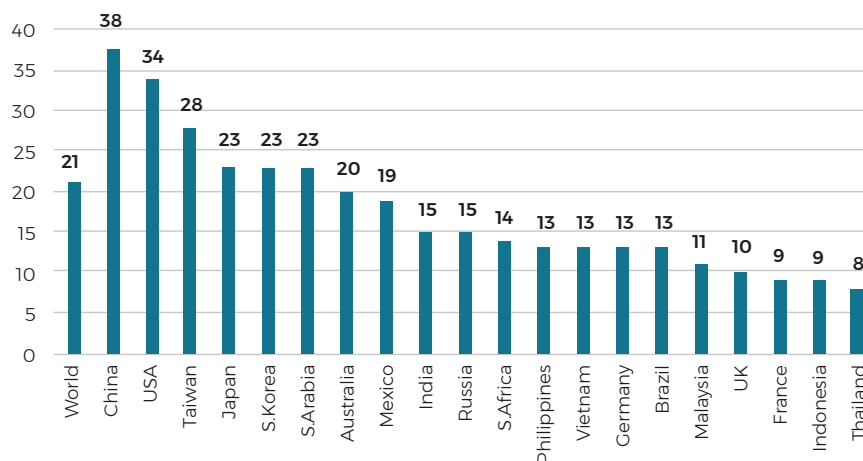
According to Chinese statistics, the number of newborns in the country hit a 15-year low in 2018 at 15.2m, while the quantity of formula consumed per baby has also been plateauing. Theoretically, this combination should point to a weak market for infant formula manufacturers. However, the strong premiumisation trend within the country is expected to result in the total IFCN market growing by just under 8% per annum over the next four years, according to Euromonitor.

There has been a divergence in the market between mainstream infant formula products, which have been experiencing price deflation, and premium products where prices have been increasing. At the very top end of the scale, a kilogram of infant formula in China can sell for up to US\$85, boosting the average selling price of infant milk in China to US\$38 per kg, the highest in the world.

The demand for premium IFCN products (and distrust for lower-end products) can partially be attributed to the multiple Chinese food safety scandals over the years, along with favourable demand and supply factors. Frost and Sullivan, a market research firm, remains optimistic on the outlook and forecasts premium IFCN products to grow by an average rate of 16.6% between 2018 and 2023. In response, RB, along with other market players, have been introducing premium and super-premium products. The range spans from organic to grass-fed, goat or cow variants, soy-based and fortified infant nutrition. The major

Graph 6: Chinese parents pay more for formula

Average US\$ per kg infant formula by market



Source: Euromonitor

global players within the region all have recent product launches and pipelines that they expect to compete within this space. Given the strong competitors vying to win within the fast-growing Chinese IFCN premium segment, this very well may be a case of a rising tide lifting all boats.

STANDING OUT IN A CROWDED FIELD

Given the divergent growth rates between premium and value everyday products, it has become increasingly important to not paint all consumer staple companies with the same brush. The sector has become more competitive and differentiating one's products is key to growing ahead of the market. In our view, innovation and premiumisation are two key ingredients to doing so, and both are areas that set RB apart from its competitors.

L'ORÉAL

BECAUSE PERSONALISATION
IS WORTH IT

TASNEEM SAMODIEN, RESEARCH ANALYST AT
PRIVATE CLIENT SECURITIES



With its humble beginnings in 1909, L'Oréal has become the world's top-selling cosmetics group, employing 86 000 people across 36 brands within 150 countries. Since 1993, barring the 2008 financial crisis, L'Oréal's sales have grown by an average of 10% above the global beauty and personal care market. This consistent performance has solidified the group's market-leading position of about 13% of total global market share, generating US\$29.4 billion in sales in 2018.

ACTIVE ACROSS ALL CATEGORIES

The beauty market is complex and multifaceted, and while the industry has grown steadily, this growth has not necessarily been evenly spread across product categories or geographies.

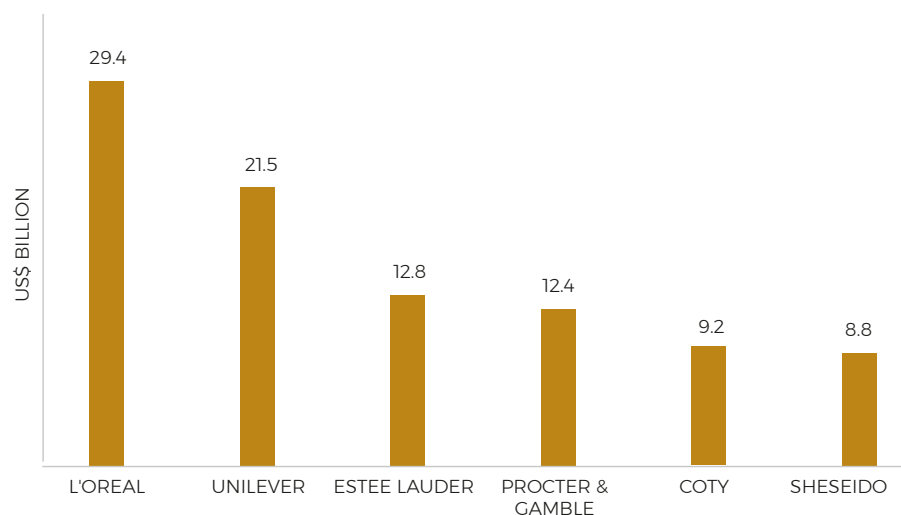
L'Oréal operates across four decentralised divisions (Consumer Products, L'Oréal Luxe, Professional Products and Active Cosmetics) and manufactures products across five categories (see table below) that are distributed globally. This gives L'Oréal a key competitive advantage as it is the only company that is active across all beauty categories.

L'Oréal 2018 sales by product category	Eur' billion	% of sales
Skincare	10.51	39%
Make-up	5.12	19%
Haircare	5.66	21%
Hygiene products	2.69	10%
Fragrances	2.96	11%
Total sales (EUR)	26.94	

Not many companies in any industry can match the consistent profitability and margin expansion that L'Oréal has achieved over

Graph 1: Outselling competitors

Top Global Beauty and Personal Care Companies (Sales)



Source: L'Oréal 2018 annual report

its history. Despite three global recessions between 1988 and 2018, the group grew operating profits by a compound average of 11% per annum. More recently, profitability faltered only during the 2008 Global Financial Crisis, and even then, profitability recovered quickly and strongly in the aftermath. L'Oréal achieves an operating margin above 18% while its closest premium beauty peer, Estée Lauder, trades at an operating margin below 17%.

TESTAMENT OF QUALITY

While L'Oréal operates in a fiercely competitive industry, its unique market positioning sets it apart from competitors. In addition to offering the full range of product categories, the group covers all geographical areas, spans all price ranges and operates in all distribution channels. Furthermore, L'Oréal's strong financial position, evident in its net cash position as opposed to a net debt position, is testament to the superior quality of the business.

Over the past decade, in line with its sustainable and consistent profit growth, L'Oréal has generated fairly stable shareholder returns. Returns on invested capital averaged just below 13% over the same period. L'Oréal's strong cash generation has seen the business sharing its profitability with shareholders through a generous dividend payout policy. Since 1998, the group has grown its dividend by an average of 15% per annum and has generated a total shareholder return of 890%.

More importantly, this century-old company is not showing any signs of fatigue, reporting its highest sales growth (10.6%) in a decade during the first six months of 2019. It is clear that L'Oréal is immensely successful and is said to have mastered the "masstige"¹ category in the beauty and personal care industry.

MARKETING PROWESS

A common thread in L'Oréal's success has been its ability to leverage advertising platforms to drive

¹Masstige: mass-produced, relatively inexpensive goods that are marketed as luxurious or prestigious.

demand for its brands. In 1933, the company commissioned famous artists of the time to design posters and launched its own women's magazine, *Votre Beauté*. The first mass-market shampoo, *Dop*, was promoted through children's hair-lathering competitions at popular French circuses and by 1938 L'Oréal was advertising its hair products with radio jingles. Company founder Eugène Schueller even won an advertising Oscar for his promotional talents.

Recently, the group noted a shift in consumer preferences and behaviour. According to L'Oréal, consumers have changed more in the last three to five years than they have in the previous 30 years combined. This shift is due to a myriad of reasons; however, two closely related factors are having the greatest impact and are the most notable: China and the proliferation of social media.

A SHIFT TOWARDS THE EAST

China is the second largest beauty market in the world (after the US) and is expected to generate US\$51.9 billion in sales in 2019. It

is also the fastest growing beauty market in the world, with an expected compound average growth rate of 7% over the next five years, far outpacing the 2.6% growth expected in the US.

According to a McKinsey luxury market review, in order to be successful in the Chinese beauty market, companies have to cater to young consumers' desire for personalisation and their need to feel different and valued. In the twenty years since L'Oréal has entered the Chinese market, they have transformed their marketing strategy, product development and corporate culture. While L'Oréal was always considered the master of the masstige category, they identified that in China, people are willing to pay more for personalised products that offer good value. In short, Chinese consumers are seeking premium products and premium experiences. L'Oréal's efforts have paid off as they now boast a 9.8% share of the Chinese beauty market, making them the leading beauty and personal care brand in China. The region also represents the largest market for L'Oréal's Luxe brand, Lancôme.

Many continue to ask how a French company has managed to capture the Chinese market, and the answer lies in L'Oréal's successful and ongoing digital transformation.

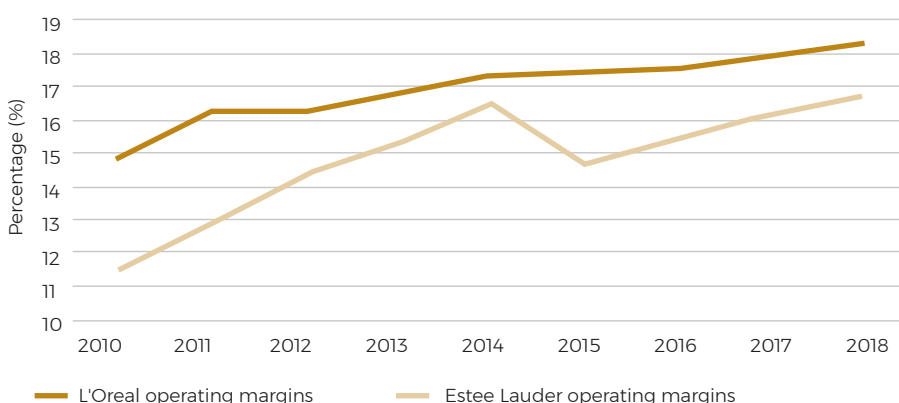
CONNECTED BEAUTY

In addressing the demand for premiumisation in the Chinese market, L'Oréal did not deviate from its key success factor, marketing. Rather, they deviated from their traditional print approach by investing in digital marketing campaigns and leveraging social media platforms to build a closer relationship with their consumers. L'Oréal's social media campaigns attracted over one billion viewers in 2018 and the company customises its digital content based on feedback and data retrieved from their social media sites – a practice they call “social listening”. This helps L'Oréal identify the latest trends, which can then be used for custom or precision marketing campaigns.

DIGITAL LEADER

Beyond marketing, L'Oréal also uses social listening to create relevant editorial content for its brands. They have done this successfully with Maybelline, creating tutorials, how-to videos and YouTube series such as *Glossy Talk*. This helps to build a deeper relationship with consumers and is very different to L'Oréal's traditional, pre-digital marketing campaigns, which were generic advertisements targeted at the mass market. This digital relationship and provision of tailored content makes the consumer feel noticed, important and valued – it is the premium experience. In order to preserve this experience offline, the same products previously sold in traditional department stores in malls, are now sold exclusively in boutique stores, pop-up stores or via digital channels.

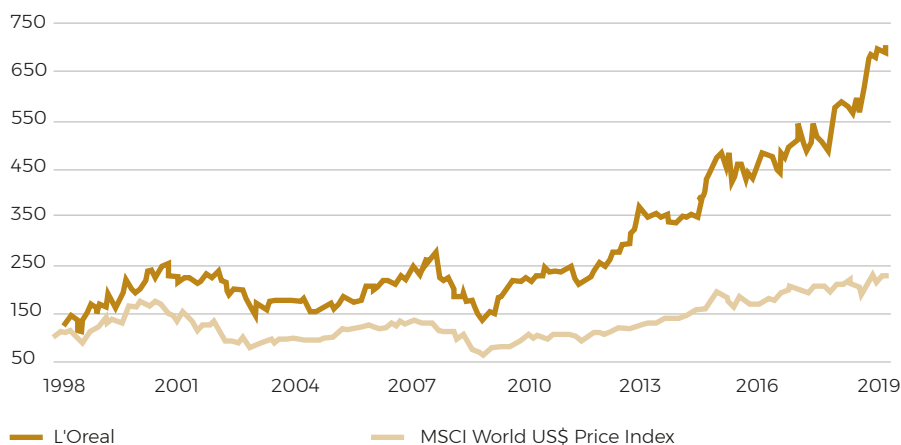
Graph 2: Consistent operating margin expansion



Source: Reuters

Graph 3: Generating strong returns

L'Oreal's relative performance to MSCI World Index since 1998



Source: Reuters

PRODUCT PERSONALISATION

The premium experience is the easier part of L'Oréal's premiumisation strategy. Meeting the demand for personalised products is more challenging. While L'Oréal is only on the cusp of personalisation, they are already making innovative industry breakthroughs.

Leveraging their Luxe database of sixty million qualified contacts, L'Oréal is able to develop customised solutions across its premium brands, which include personalised skincare in-store with Kiehl's apothecary preparations and custom Yves Saint Laurent engraved lipstick. The most popular has been their personalised foundation and facial serum. L'Oréal's makeup brand Lancôme makes a customised shade of its Le Teint Particulier foundation by applying a handheld colour spectrometer to a customer's face to measure the skin's exact tone. This information is fed into a nearby machine that computes the right shade using a special algorithm and

promptly dispenses the product. Then Skinceuticals, L'Oréal's skincare brand, creates a custom facial serum using a series of in-depth questions via a tablet application.

REDEFINING THE BEAUTY EXPERIENCE

The real magic happens when L'Oréal's digital and personalisation strategies are integrated. The group recently launched a brand for at-home hair colouring, Color&Co. Developed in L'Oréal's Technology Incubator, Color&Co gives customers personalised product recommendations through a free video consultation with a certified colourist or an online quiz. After discussing hair type, texture, colouring history and goals with the stylist on a desktop or mobile device, customers can order their customised formula for delivery on a one-time or subscription basis.

Another example is the L'Oréal La Roche Posay "My UV Patch", which is a sticker that can measure UV exposure and connect with a smartphone, to remind users to wear

sunscreen. Levels of UV exposure can be viewed through easy-to-understand charts and graphs. The patch also offers personalised skincare serums and sunscreen recommendations based on skin colour, tone and type.

GLOBAL BEAUTY

L'Oréal has evidently mastered the ability to tailor its marketing campaigns for different cultures and times, and to adjust its brand positioning for different income levels to meet the demands of customers in different markets across the world. Their strategy is broad enough to allow for cross-continent expansion and the result is that L'Oréal has achieved success in almost every country that it has entered. For the group, digital platforms represent a new "territory" with significant potential. Technological progress means that they are able to create a seemingly premium experience for a fraction of the cost and in so doing, L'Oréal is elevating itself from "masstige" to "prestige".

TAILORED FUND PORTFOLIOS

PORTFOLIO MANAGEMENT FOR THE SUCCESSFUL PLANNER

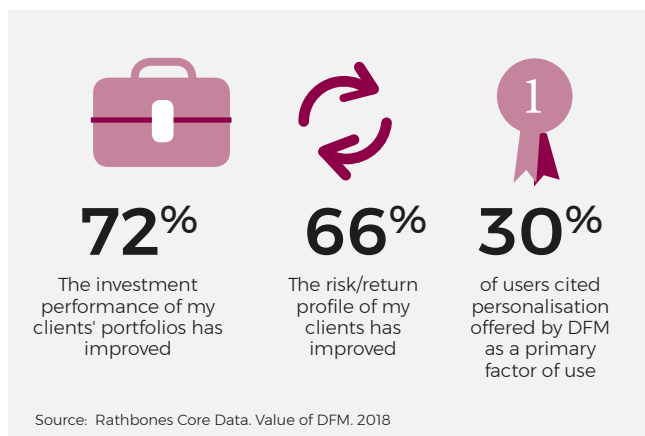
ROLAND GRÄBE, HEAD OF TAILORED FUND PORTFOLIOS

Discretionary Fund Managers (DFMs) offer a premium experience to advisers by tailoring investment solutions to fit their advice process and investment outlook. In addition, they enable planners to create unique strategies, manage costs and customise branding and reporting, including sustainable investment strategies using ESG-driven mandates.

THE IMPACT OF PREMIUMISATION IN THE UK

Before the UK implemented Retail Distribution Review (RDR) at the beginning of 2013, their market was like the current South African investment market. Financial planners had their own investment processes selecting funds. With the introduction of RDR, however, planners were required to constantly understand and interpret investment markets, which meant that they would have to do investment research to make relevant recommendations to clients before they can give investment advice. Even though it was possible to undertake the necessary research, planners found that it took a lot of time (and cost money) to do this, as

Graph 1: Improvements in investment risk and return post adoption



not many planners have the expertise and resources internally to manage client investments efficiently. The industry was forced to focus on what it does best and outsource the rest. With this, the rise of DFMs was unstoppable. However, outsourcing investment management didn't come without apprehension, as planners have a duty of care towards their clients, but the benefits for both clients and planners outweighed the negatives. The outsourcing to DFMs allowed planners to spend time on financial planning, ensuring that the DFM manages the investments to the agreed risk mandate and financial planning requirements. The result was that most saw improvements in investment performance and risk/return for clients.

DFMs also grew their businesses because they spent their time on what they were good at, reducing time spent on administration tremendously.

However, the model has worked where the relationship between client, planner and DFM was clearly stated upfront. The relationships vary from partnership to partnership and there is no blanket approach to this relationship, as the DFM generally offers one or all the following solutions:

Managed Model Portfolios

These are a range of managed multi-asset portfolios that have several objectives, acceptable volatility bands and time horizons, which are available on the Life Company or Nominee platform.

Tailored Model Portfolios

These are customised multi-asset portfolios whose different investment objectives over various time horizons are specifically to meet advisers' structured specifications, and are for their exclusive access. These portfolios are set up on Life Company or Nominee platforms. Where appropriate, an Investment Committee will be established.



Graph 2: Comparison of hourly fees, client numbers and revenues post adoption

Hourly fee

Adopters detailed they were, on average, able to earn an hourly fee of £206 (against £196 for non-adopters).



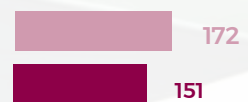
£206



£196

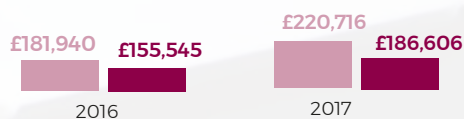
Client numbers

Adopter advisers reported they had, on average, 21 more clients than non-DFM users (172 vs 151).



Client revenues

Time liberated by employing a third-party discretionary fund manager meant that 58% of advisers were able to generate more paid time from existing clients. Users enjoyed annual average revenues of £181,940 vs £155,545 in 2016 and £220,716 vs £186,606 for non-DFM users in 2017, which is 18.3% more.



■ Adopters (n=67) ■ Non-adopters (n=33)

Source: Rathbones Core Data. Value of DFM. 2018

Bespoke Portfolios

These are personalised portfolios, developed for individual high net worth clients according to their specific needs.

AT WHAT COST, PREMIUMISATION?

In the UK, when planners were asked why they didn't use DFMs, the consistent concern for 76% of those who didn't use DFMs was the increased cost. At face value, and to some, it seems that the planner and DFM are overlapping in their responsibilities should both be contracted to the client, and it may look like the client is paying double as opposed to one single fee.

However, as indicated before, the two professionals fulfil different roles for the client. Research showed that the contrary is true, and in fact, the economies of scale generated point to a saving rather than an expense. For most high net worth clients, personalised service is primary and outsourcing enables planners to provide holistic advice and fulfil their clients' financial planning needs, spending more time with the client to get to know them and fully

understand their needs. High net worth clients are time poor and it is key for them to talk to a professional who understands the complexity of their needs. In addition, having a DFM enabled the planner industry to professionalise more, as 10% more planners who had adopted DFMs were able to spend time on training and continuing development, and for those who are non-adopters, it seems this time was spent on marketing their services.

WHAT DOES DFM LOOK LIKE IN SOUTH AFRICA?

Old Mutual Wealth (OMW) has a DFM capability, Tailored Fund Portfolios (TFP). It started partnering with five IFAs in 2017 and has since grown to a substantial capability supported by 75 planners. In addition to the houseview model portfolio range, TFP also manages many bespoke solutions developed around the needs of advisers. Model portfolios can be accessed on the Old Mutual Wealth, Investec, Glacier, Momentum, ABSA and PPS LISP platforms.

With the introduction of RDR, as is currently in the process in SA, the

DFM market has also grown and it is estimated that 25% of wealth managers are using DFMs. Maybe with learnings from the UK market, many local advisers have already realised the benefits of outsourcing their investment proposition. The rise of DFMs has a great advantage in that they are as qualified as asset managers and can have the technical discussions in questioning investment decisions that an average investor would not be able to have. What this is doing for the investment management industry is that DFMs are far more demanding in their research and due diligence than the average adviser or retail investor is, which means that underperforming asset managers and those without a clear value proposition are being found wanting.

For South Africa especially, the requirement for any firm looking to manage funds to also meet far more onerous capital requirements and qualification standards, is leading to consolidation and change.

Financial planners are key to the high net worth client who has many complex requirements beyond just investments, including tax, cash management, fiduciary and estate planning. DFMs focus on the management of investments so that financial planners may focus on helping their clients reach their financial goals. As in the UK, in SA DFMs have grown when markets have been flat. A good DFM can add significant value by implementing astute asset allocation, managing risk and avoiding high fund turnover.

BEYOND FINANCIAL PLANNING

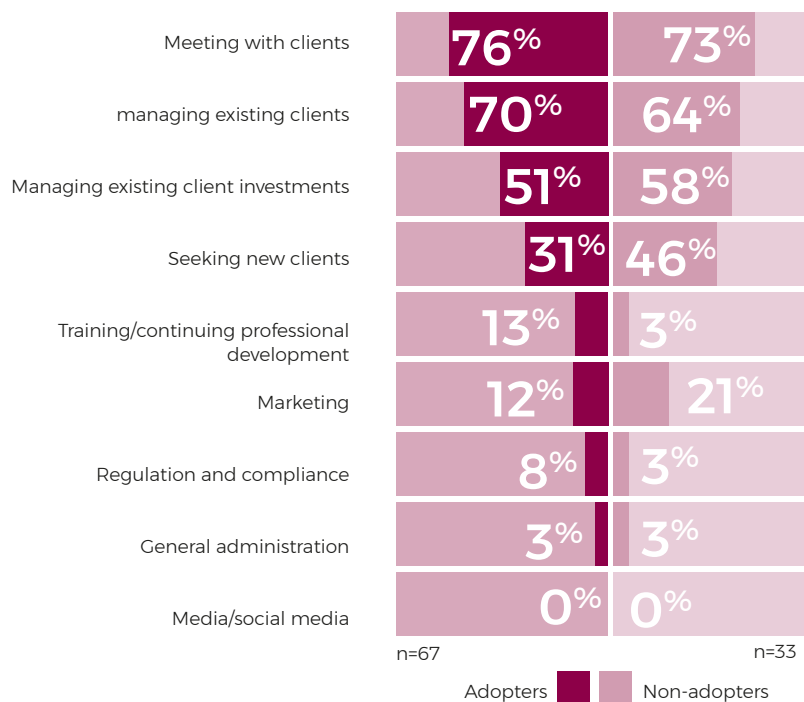
Instead of thousands of planners picking fund managers, it is the DFMs who are doing so currently in the UK. With a few large ones

Graph 3: Primary barriers to use of third-party discretionary managers



Source: Rathbones Core Data. Value of DFM. 2018

Primary activities which resulted in revenue generation for adviser businesses



Source: Rathbones Core Data. Value of DFM. 2018

dominating the market to the extent they do, it means that a much smaller number of funds is being selected for client portfolios, which has serious implications for asset managers. In SA, there are about 40 DFMs managing over R150 billion with 70% of assets managed by only four of them.

WHAT WE BELIEVE IS KEY FOR A DFM

DUTY OF FINANCIAL CARE

As fiduciaries we are entrusted with client investments and we take this very seriously. We want to exemplify excellence in fiduciary care and this duty is the foundation on which we build.

DUTY OF ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) CONSIDERATION

We believe our clients want us to use their money in a way that improves not just their wealth, but also the

world that we live in, in a sustainable and meaningful way. So our approach aims to maximise returns, control risk and create cost leadership whilst supporting responsible investing through careful consideration of ESG factors.

WHAT OMW OFFERS

Access to the best asset managers

Our DFM capability, Tailored Fund Portfolios, leverages the research of Old Mutual Multi-Managers to select the most suitable asset managers within each asset class.

Passive and active investments

We develop an optimal allocation to passive and active management based on the merits of different strategies in each asset class.

The platform of your choice

We have partnered with a wide range of platforms to help you align clients to a defined set of solutions.

Controlled Costs

We manage the overall investment costs through a number of different strategies:

- We use passive investments where appropriate.
- We use our scale to negotiate the best fees with managers.
- We avoid performance-based fees where possible.

First investment manager in South Africa certified for fiduciary excellence

Tailored Fund Portfolios recently underwent a detailed auditing process to receive certification for fiduciary excellence from the Centre for Fiduciary Excellence (CEFEX), becoming the first South African investment manager to receive this certification. This certification is testament to the work TFP does and means that as an investment manager, they strive to achieve global best standards in all processes. The work that CEFEX is doing internationally is adding great value to the financial services industry. By having an accreditation for standardisation for financial services providers, we are moving in the right direction, giving clients peace of mind that their money is being managed in the best possible way to benefit them.

CONCLUSION

In the UK, DFMs are driving down fund manager fees because of the clout their assets under management give them, compared to individual clients. DFMs are improving the reputation of the financial planning industry and promote service excellence to clients, as they are also at the cutting edge of investment industry developments.

THE PREMIUMISATION OF A LIFESTYLE

Premiumisation is a competitive style to offer higher quality items that consumers value. In this way, it contrasts with commoditisation that is defined as competition to lower prices for a standard level of quality. Premiumisation occurs in a product category, market or industry where customers are willing to pay more for higher quality.

Consumers want to buy into products that have a story to tell that creates an identity and a sense of belonging. Premiumisation allows brands to provide a unique and differentiated experience, especially living in a world consumed by globalisation and automation that can breed conformity.

The following are common types of premiumisation:

1 RARITY

Premium brands that release limited edition products are likely to create a scenario where demand exceeds supply. Sneaker brands such as Nike and Adidas have collaborated with Michael Jordan and Kanye West respectively and, together with hyping up their release through their marketing efforts (termed “hype marketing”), usually sell out their limited ranges with some consumers, even reselling these items at a higher price.

2 INGREDIENTS

Consumers are willing to pay more for premium products if these products are made up of quality sourced materials and ingredients. Although premium mountain bikes can cost the same as a car or motorbike, the benefits of having them are due to the materials being used to make them. Consumers want the lightest bike possible that yields the best comforts and results. Components such as carbon-fibre frames and responsive gear systems contribute to a more durable bike built for performance.

3 SENSORY DESIGN

Superior look, feel, taste, smell and sound can play a role in how the quality of the product or service is perceived. An approach that focuses on all five senses not only has an impact on the client’s attention and perception but can also contribute to their overall wellbeing. This is evident in the hospitality industry, where their design concept is consistent throughout the entire sensory experience.

4 EXPERIENCE

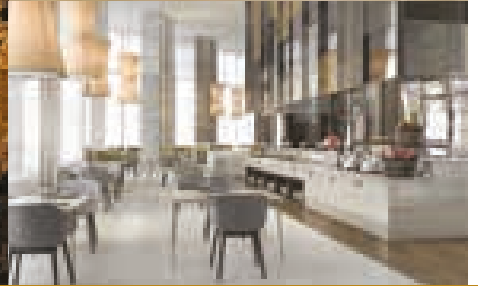
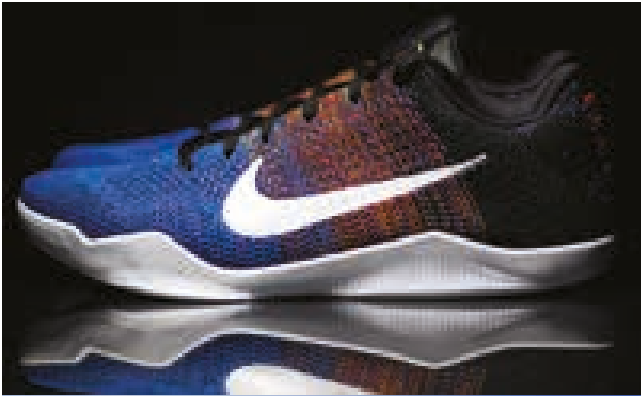
The end-to-end experience of a product or service includes intricate design attractive to the eye, such as the interior design of a restaurant and food photography. Companies such as Amazon have created unique, memorable experiences for their clients through the use of the latest technology and tools, including loyalty programmes, voice-activated purchasing software, transparency, clear and easy return policies, and soon to be released drone-enabled deliveries.

5 STATUS

Premiumisation attaches itself to the costly signalling theory, which states that the cost of these products is a signal of social status and wealth. Fashion brands such as Cartier or Gucci are examples of this, where consumers derive utility from being seen wearing these products.

6 FEATURES

Premium products and services often have a relation to the features they offer to consumers. The advancement of technology has allowed for more features to be standardised. However, premium products will usually offer consumers more cutting-edge features that have not been introduced to the market. Above and beyond that, luxury features can also appeal to a more niche segment. Rolls Royce offers consumers the option to design inner roof lights with fibre optic technology to recreate a night sky.



7 DETAILS

Product packaging plays an important role, as it not only serves a functional role in protecting its contents but also a marketing one. For premium products, carefully designed packaging helps to stir up emotions, create a desire, and indicates quality and prestige in its detail. Premium products focus on creating an aesthetically pleasing design, and over time, growing a sustainable and an environmental consciousness, with brands using more sustainable, recyclable packaging material.

8 CRAFT

The last few years have seen a demand for handcrafted goods, with many consumers seeing the value of buying items that are not mass-produced. Artisanal products bring about a sense of exclusivity – the allure of small businesses who have crafted their art appeals to those who seek customisation and personalisation in the areas they operate in. While quality and uniqueness may play a pivotal role for this desire, consumers are also attracted to the idea of connecting with the craftsman, creating a more authentic experience. Known for its focus on quality, precision and craftsmanship, a handmade Savile Row suit has always been the ultimate display of elegance and style. Trained craftsmen can spend up to 100 man hours to create a suit, which sees customers willing to spend between £3 000 and £10 000 for a bespoke suit.

THE AUTHORS



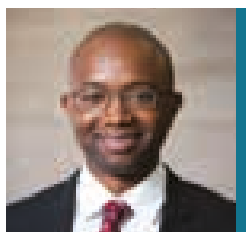
Andrew Dittberner
Chief Investment Officer
Private Client Securities

Andrew joined PCS in 2017 and was previously employed at Cannon Asset Managers. He joined Cannon in 2007 as a Research Analyst and during his tenure, he rose through the ranks to become a Portfolio Manager in 2011 and was then appointed CIO in 2014. Andrew has extensive knowledge and insight into valuing businesses across multiple industries and identifying suitable investment opportunities. He holds a Master's Degree in Economic Science from the University of the Witwatersrand, where he lectured for a while. Last year, Andrew obtained a PhD in Investments and Securities from the University of Pretoria upon completing his thesis titled "Fundamental Momentum: A New Approach to Investment Analysis".



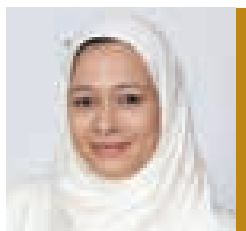
Sameer Singh
Research Analyst
Private Client Securities

Sameer joined PCS in March 2016 and was previously employed as an Investment Analyst at Old Mutual Multi-Managers where he was responsible for absolute return and fixed interest asset class and asset manager research. Prior to that, he was a Trainee Investment Analyst at SYm|mETRY Multi-Managers. Sameer holds a Bachelor of Commerce degree in Business Management from UNISA.



Victor Mupunga
Investment Analyst
Private Client Securities

Victor joined PCS in 2016 and was previously employed as an Investment Analyst at Maestro Investment Management, where in addition to equity research, he was responsible for managing a number of private client equity portfolios on a discretionary basis and managing the client relationships. Prior to that, he was a Fund Accountant at Investment Data Services where he prepared and reviewed valuations and accounting records of hedge funds. Victor graduated from the University of Cape Town with a Bachelor of Business Science (Hons) in Finance in 2007. He is also a CFA Charterholder.



Tasneem Samodien
Research Analyst
Private Client Securities

After graduating with a Postgraduate diploma in Accounting in 2015, Tasneem joined the Old Mutual Chartered Accountant Training Programme in 2016. During the subsequent three years, she worked within various businesses within the Old Mutual Group, gaining valuable experience in functional areas such as internal audit, risk management, finance, group planning and investment analysis. In 2018 she was placed within PCS, first in the Finance team to assist with the annual financial statements and then in the Research and Investment team to assist with investment portfolio reviews. Tasneem successfully completed her articles at the end of 2018 and is a qualified Chartered Accountant (SA).



Roland Gräbe
Head
Tailored Fund Portfolios

Roland has over 15 years' investment experience and earned his CFA charter in 2004. Before heading up Old Mutual Wealth Tailored Fund Portfolios, he was the Chief Investment Officer of SYm|mETRY and Head of Product for Old Mutual Multi-Managers. Prior to joining Old Mutual he fulfilled various roles in the multi-management and investment consulting industries.



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