
REUTERS/ NGUYEN HUY KHAM

# COMMODITY COSTS CONSUME CAGNY CONFAB

## Rising prices of oil, wheat and other commodities and shifting coffee alliances were hot topics at Florida meeting.

WITH ALL THE concern consumer products executives and analysts had about raising prices to cover soaring commodities costs, it is amazing anybody had time for a cup of coffee at the Consumer Analyst Group of New York meeting.

But cups of coffee became a hot topic, as companies talked about the shifting alliances in the market for single serving, machine-made coffee at home with the Starbucks-Kraft distribution alliance breaking up.

Some investors, meanwhile, looked for ways to invest in the U.S. consumer without actually investing in the consumer companies that are being hit by those soaring costs for oil, wheat and other commodities.

REUTERS

# BIG COMPANIES EYE ONE-CUP COFFEE MARKET

**COFFEE TALK:** A farmer walks near coffee flowers at a field in Vietnam's central highland Di Linh district February 23, 2011.**REUTERS/NGUYEN HUY KHAM**

**BY MARTINNE GELLER**
BOCA RATON, FLA, FEB 22

BIG FOOD AND beverage makers, including Kraft Foods Inc and Sara Lee Corp, are maneuvering to get more of the small but growing one-cup coffee market in the United States.

The small segment of the high-end coffee market has been getting a lot of attention lately, due in part to the pending dissolution of a deal between Kraft and Starbucks Corp , whereby Starbucks provides coffee for Kraft's Tassimo one-cup brewer.

## *KRAFT AND STARBUCKS ARE DISPUTING THE TERMS OF ENDING THEIR PARTNERSHIP.*

Kraft and Starbucks are disputing the terms of ending their partnership, by which Kraft also distributes bags of Starbucks coffee at supermarkets.

Despite the dent in sales the loss of Starbucks would cause, Kraft Chief Executive Irene Rosenfeld said she was committed to that business.

"Single serve has been an important part

**KRAFTY CEO:** Irene Rosenfeld, Kraft Chairman and Chief Executive speaks to Reuters during a interview in Paris May 21, 2010. **REUTERS/JACKY NAEGELEN**

of our portfolio. It's growing quite nicely around the world and we expect that that will continue to be a key part of our coffee portfolio," Rosenfeld told Reuters at a conference in Boca Raton, Florida.

Kraft also sells the mid-range coffee brands Maxwell House and Yuban. It is unclear what premium brand will replace Starbucks and Kraft has declined to comment on any specifics, given the ongoing fight with Starbucks.

### COFFEE GETS BUZZ

THE DEMISE OF Starbucks' partnership with Kraft has led many to wonder what the world's biggest coffee maker will do next as it seeks growth outside its namesake cafes.

Marcel Smits, chief executive of Sara Lee, which has the Senseo brand one-cup brewer, said the flurry of headlines and focus on the single-serve market are good for the industry and prove coffee is an exciting business.

*"SINGLE SERVE HAS BEEN AN IMPORTANT PART OF OUR PORTFOLIO. IT'S GROWING QUITE NICELY."*

"It adds buzz to the category," said Smits at the same industry conference.

The buzz comes as Sara Lee is planning to split into two companies -- one focused on its North American meat brands such as Jimmy Dean and Hillshire Farm, and one on coffee and tea brands such as Senseo, Douwe Egberts and Pickwick.

Green Mountain also announced a deal on Tuesday with Dunkin' Donuts to bring that company's coffee onto its machines. Analysts said bringing in such a popular brand lessened the potential competitive threat from Starbucks.

### MORE THAN JUST THE COFFEE

WHILE COMPANIES LIKE Sara Lee and Kraft spend a lot to market their coffee brands, their electronics partners spend a lot to market the machines, said Sara Lee Chief Financial Officer Mark Garvey. Since many purchases are driven by hardware, the coffee makers sometimes offer brands for rival machines.

For example, in Europe, Sara Lee sells L'Or espresso capsules for Nestle AG's Nespresso machines and Kraft sells Carte Noir coffee made for Senseo machines.

When asked if Senseo would make coffee for Keurig machines, Smits said it was too early, since the brand has such a little presence in the United States, where Keurig has more than an 80 percent share of the market.

"If we would have a very big brand, I guess we'd start thinking about it putting it into Keurig machines. But we don't have a very big brand here in the U.S.," Smits said.

Of Senseo's total 2010 sales of $536 million, the United States only accounted for $20 million.

Smits, who was named permanent CEO last month after serving on an interim basis since May, said Sara Lee's beverage business will take aggressive steps to compete with Nestle, the world's largest food company.

"In Europe, it's obvious the Nestle people, they have an ambition. There's other people out there who have less of an ambition," Smits said. "We have an ambition. We want to play. We will throw everything we have at that category."

(Editing by Andre Grenon)


**A MUG'S GAME:** Cups are displayed at a Starbucks restaurant in Hong Kong April 15, 2010. **REUTERS/BOBBY YIP**

# INVESTORS LOOK FOR SIN, SIPS AND STUMBLES

**BY JESSICA WOHL**
BOCA RATON, FLA., FEB 25

INVESTORS LOOKING for excitement in the normally bland consumer staples sector should seek out smokes, Coke and trouble.

Top stock picks in the sector among analysts and investors are generally tobacco companies, which have unusual power to raise prices, followed by beverage makers with loyal customers.

Meanwhile, some troubled companies appear ready to face their challenges, and their shares are poised to rise as a result, said investors gathered at the Consumer Analyst Group of New York conference in Florida.

"I always look for companies that have stumbled, that are currently out of favor, that can just get back to normal," said David Kolpak, managing director at Victory Capital Management, which has $16 billion in equity assets under management.

He is "bullish" on Kellogg Co, which has been struggling with its North American cereal business, and said its new chief executive officer, John Bryant, "showed a lot of confidence" during his presentation at the conference.

Church & Dwight Co Inc CEO Jim Craigie pleaded that shares of the Arm & Hammer and Trojan maker are still a good value, even though they soared nearly 25 percent in six months.

He used to say that the company was in the "10 for 10" club, with 10 straight years of at least 10 percent earnings per share growth. He is now adding a decade, calling it the "10 for 20" club, as the company pursues more deals and launches products.

"It's not too late to get on board," he said on Friday. Church & Dwight shares jumped 1.8 percent to an all-time high.

Investors are looking for companies that are best prepared to tackle issues like rising oil prices, which are hitting drivers at the gas pump, and higher costs for ingredients.

"I think all of the investors are saying: 'How do you invest and beat the market in this environment?'" said PepsiCo CEO Indra Nooyi.

When a company says that it must perform

**SMOKE 'EM IF YOU GOT 'EM:** Farm worker, Solomon Motsi, harvests tobacco leaves at Nyamzura Farm in Odzi, about 200km (124 miles) east of the capital Harare February 18, 2011. **REUTERS/PHILIMON BULAWAYO**

differently because of such headwinds, "a buyside person sits back and says 'Oh my God, now I have to think about this whole business even more differently than I did before ... I have to create a portfolio that hedges all these positions,'" Nooyi said.

Even if their fundamentals are good, most companies have not laid out major plans that would drive up their shares.

"Some of these staples stocks are very high-quality companies that are trading at multiyear lows in valuation," Kolpak said. "A lot of investors like to go where there's action, and there just hasn't been much action in this space."

Many other companies have already seen strong gains.

"These companies have solid balance sheets, they pay decent dividends and return cash to shareholders, they're not overly risky," said Morningstar analyst Erin Lash. "In general, it tends to be a more consistent category, but in our opinion, most of the names in the area are more fairly valued."

**HAVE A COKE AND SMILE:** Bottles of Coca-Cola are seen on the production line at their bottling plant in Clamart near Paris June 10, 2010. **REUTERS/JACKY NAEGELEN**

## ONES TO WATCH

COMPANIES WITH high brand loyalty are the ones to watch, such as Marlboro cigarette maker Philip Morris International Inc, whose stock hit an all-time high on Thursday.

Kolpak and Janney Capital Markets analyst Jonathan Feeney both said they liked Hershey Co as it has little private-label competition in the U.S. chocolate market.

Lash likes packaged food and household and personal care companies with strong brands, such as HJ Heinz Co and General Mills Inc, as they can raise prices without a significant impact.

Others, such as ConAgra Foods Inc and Sara Lee Corp, may be less attractive, as they operate in businesses where shoppers often choose products based on price, she said.

"Sysco is probably one of the more attractive names on my list," Lash said, as it should be able to pass price increases through to its restaurant customers and it has large scale and strong operating margins.

Kolpak also favors companies that, like Sysco, are a step away from consumers on the food chain. He notes agribusiness giant Archer Daniels Midland as a favorite.


**PEPSI CHALLENGE:** Bottles of Pepsi cola are seen in a display at PepsiCo's 2010 Investor Meeting event in New York, March 22, 2010. **REUTERS/MIKE SEGAR**

## BUY BEVERAGES

PEPSICO INC, which recently cut its profit forecast, has "buy" ratings from 13 analysts and continues to trade at a discount to soft drink leader Coca-Cola Co.

Still, Coca-Cola is the large-cap name preferred by analysts, including Stifel Nicolaus' Mark Swartzberg, who also likes Anheuser-Busch InBev.

Coke trades at about 15 times expected earnings, while Pepsi, which has larger exposure to commodities through its food business, trades around 12.9 times.

Despite the higher multiple, Coke shares have more potential upside than Pepsi, Swartzberg said.

"There's a school of thought out there that Pepsi is a better stock because the gap has increased," he said. "Our view is that Pepsi is a good stock, because it is undervalued. But that doesn't mean Coke is overvalued."

He said Coke's North American business keeps improving.

"Some have described buying a multinational as 'you buy it and you hold your nose for the U.S. business,'" Swartzberg said. "We think for Coke, you buy Coke for its international, but you don't have to hold your nose any longer for North America. That's an investment merit."

(Reporting by Jessica Wohl and Martinne Geller; Editing by Lisa Von Ahn and Matthew Lewis)

**IT'S A GAS GAS GAS:** An oil export terminal is seen in the town of Brega, February 25, 2011. **REUTERS/GORAN TOMASEVIC**

# HIGH OIL PRICE MAKES FOR SLIPPERY SLOPE

**BY MARTINNE GELLER**
BOCA RATON, FLA., FEB 25

THE UPHILL climb for retailers and consumer goods makers to improve sales and profits is getting more slippery, as higher oil prices add to costs and also cut into budgets people have for shopping.

Consumer products executives gathered at this week's Consumer Analyst Group of New York meeting in Boca Raton, Florida, said that so far, the higher oil price has not had a huge impact on their businesses, which are already pinched by soaring ingredient costs and weak consumer spending.

Through Thursday, the price of oil traded on the NYMEX was up about 11 percent from Jan. 27, the day Procter & Gamble Co posted quarterly earnings. The price eased a bit on Friday as Saudi Arabia was reported to have increased output.

"We've had, even since our earnings release, a pretty significant run-up in commodities, some of which have an immediate impact on the bottom line, things like diesel," said P&G Chief Financial Officer Jon Moeller.

*"WE'VE HAD... A PRETTY SIGNIFICANT RUN-UP IN COMMODITIES."*

He said on Thursday that the maker of Tide detergent and Pampers diapers would therefore see its margins increase by less than forecast over the next few months.

Church & Dwight Co Inc CEO Jim Craigie also said that slides he assembled 10 days ago of the company's prospective 2011 business environment were more optimistic than he feels now, given the rising oil price and unrest in the Middle East.

Plastic bottles made partially from petroleum account for about 40 percent of the drinks sold by Coca-Cola Enterprises Inc, but PET resin is still less than 5 percent of the Coca-Cola Co bottler's total cost of goods.

Chief Financial Officer Bill Douglas said the price of resin was being driven up more by the fact that more petrochemicals were being used to make polyester after a weak cotton crop.

"The oil price is not helping, but it's not the primary factor," Douglas said.

## RISK TO CONSUMER SPENDING

DIAGEO'S CHIEF executive, Paul Walsh, said the world's largest spirits company was more concerned about whether a spike in oil would slow consumer spending, which could then frustrate job creation and cause a further economic slowdown.

"I would hope that the spike in the oil price is temporary, and if it is temporary, I don't think we've got anything to worry about," he told Reuters, noting that oil prices were still much lower than the highs reached a few years ago. "If it is sustained, and continues to march toward $140, then I think there are natural concerns that should be had."

Brent crude closed at $111.36 on Thursday, after rising to a 2-1/2 year high of $119.79 on the revolt in Libya causing large disruptions in the OPEC nation's oil supplies. U.S. crude futures, which are more insulated from international geopolitical risk due to a domestic stockpile, closed at $97.44.

PepsiCo Inc, maker of Frito-Lay snacks and Tropicana orange juice, has said it expected $1.4 billion to $1.6 billion in additional costs this year, an increase of 8 percent to 9.5 percent, due to higher costs for commodities.

Pepsi CFO Hugh Johnston said he did not expect to have to alter that forecast.

"We feel like we've got our arms reasonably well-wrapped around, short of some major event where perhaps in the fourth quarter if we're not covered, there might be a significant change in cost," Johnston said.

*"IF GASOLINE PRICES HOLD, I DON'T ANTICIPATE ANY CHANGE IN TRENDS. BUT GASOLINE PRICES ARE AN OPEN QUESTION. THEY MOVE PRETTY RAPIDLY."*

"In terms of the consumer, it's a much trickier equation," he said, noting that higher gasoline prices often lead to less spending at gas stations on drinks and snacks.

So far, gas station and convenience store business is "still pretty good," he said. "If gasoline prices hold, I don't anticipate any change in trends. But gasoline prices are an open question, they move pretty rapidly."

The average price for a gallon of gasoline in the United States was $3.18 in the latest Lundberg Survey of some 2,500 gas stations nationwide, up 5 cents from two weeks earlier.

Ken Perkins, president of tracking firm Retail Metrics, said higher gas prices often make people do more shopping at stores that are closer to home, a shift that stands to hurt big-box retailers like Wal-Mart Stores Inc and Target Corp and help smaller discount stores, which include Family Dollar and Dollar Tree, that are in neighborhoods. He also said that when gas creeps up toward $4 per gallon, it impacts consumers' spending more broadly.

"It is affecting the amount of disposable income, because they are putting more money in their tank as opposed to into retailers' cash registers," Perkins said.

The biggest threat could be to companies whose products are not necessities.

"Our target is a middle income consumer," Kohl's Corp CEO Kevin Mansell said in an interview. "Higher fuel prices at the pump -- that impacts them, that's less money in their pocket for things that are more discretionary, which is pretty much everything we sell."

(Additional reporting by Phil Wahba and Dhanya Skariachan in New York and Jessica Wohl in Boca Raton; Editing by Dave Zimmerman and Matthew Lewis)


**JOHNNIE WALKER:** A man walks past barrels outside the Diageo Shieldhall facility near Glasgow, Scotland August 26, 2010. **REUTERS/DAVID MOIR**

# VICTORY CAPITAL'S KOLPAK LOOKS BEYOND CONSUMER

BY JESSICA WOHL
BOCA RATON, FLA., FEB 25

FOR DAVID KOLPAK, each February brings a chance to get away from the frigid winters in Cleveland and head to the big consumer analyst conference in Florida.

This year, Kolpak is also trying to get away from the consumer, at least in some respects.

Aside from companies you would expect a consumer stock analyst to look at -- names like Kellogg Co and Dr Pepper Snapple Group Inc -- Kolpak, a managing director at Cleveland-based Victory Capital Management, likes companies like grain processor Archer Daniels Midland Co.

ADM is a step away from the consumer, providing ingredients rather than duking it out on the store shelf for consumers who are still hesitant to spend much on everyday goods, and can get a boost from its international reach in transporting grains.

"ADM has a lot more opportunities to benefit from these global dislocations that we're seeing right now between where the food is and where it needs to be," Kolpak said.

When there are droughts, flooding, dry seasons or other issues countries can get shipments of wheat from the United States or Canada "that will run through ADM terminals, and be carried on ADM rail cars and on ADM ships to feed those people."

He is also intrigued by International Flavors & Fragrances Inc, whose shares soared 38 percent in the last year.

"It's one I'm looking for a pullback on ... looking out a year or two, I think the story is fantastic," Kolpak said.

## FUN IN THE SUN?

KOLPAK AND ANOTHER 500 or so analysts and investors were in Boca Raton, Florida, for the annual Consumer Analyst Group of New York conference this week to hear from companies such as Coca-Cola Co and Colgate-Palmolive Co

This event gives Kolpak a chance to hear companies' strategies and see how executives posture against each other, since they can sit in on their rivals' presentations.

This year watching that action was exciting after "an unusually brutal year for price discounting and competition," along with "crazy levels of promotion that really didn't have a return," he said this week.

"I think it's a lot of companies, frankly, trying to signal each other, 'Hey, we'd like to take pricing up and we hope you will too,'" he said of the presentations.

At Victory, a subsidiary of KeyCorp with $16 billion in equity assets under management, Kolpak follows food and beverage makers, household products, tobacco, restaurants, lodging, gaming and cruise lines.

Discretionary stocks have appreciated


**OPEN WIDE:** People pass the entrance of Colgate-Palmolive World headquaters in New York City, August 31, 2003.


**OH WHAT A DREAM:** 'Carnival Dream' sails down the Hudson River and past midtown Manhattan as she leaves on her maiden voyage from New York November 13, 2009. **REUTERS/RAY STUBBLEBINE**

more than staples since the March 2009 market bottom, leading Kolpak to lean more toward the staples area at this point.

Kolpak's favorite large-cap food company is Kellogg Co. He also likes Dr Pepper Snapple Group Inc.

Kolpak, a Milwaukee native, started his career in 1992 at Principal Financial in Des Moines, Iowa.

Now, he navigates consumer staples and discretionary stocks for three of Victory's products: the Victory Diversified Fund, its flagship fund, as well as a large cap value fund and a mid-cap value fund that are also based in Cleveland.

He works alone tracking a wide swath of companies.

"I haven't slept in 15 years, so I drink a lot of this," Kolpak joked as he sipped a bottle of Pepsi MAX, a soft drink with almost twice as much caffeine as regular or Diet Pepsi.

His favorite discretionary stock in the short term is Penn National Gaming, which is building casinos in places such as Ohio and has the financial flexibility to bid on properties.

He also likes Carnival Corp, which he said has a good balance sheet and a lot of free cash flow and could raise its dividend and buy back a lot of stock.

Still, while he follows the sector, Kolpak has yet to find the time to take a cruise.

When he does take his first one, he may try to go to Alaska. Quite a change from the warmth in Boca Raton this week.

(Editing by Matthew Lewis)

**COVER PHOTO:** A worker sifts coffee beans at a processing factory of the coffee trader Atlantic Commodities (Acom) in Bao Loc city, near Vietnam's southern commercial hub Ho Chi Minh city February 22, 2011. **REUTERS/NGUYEN HUY KHAM**

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