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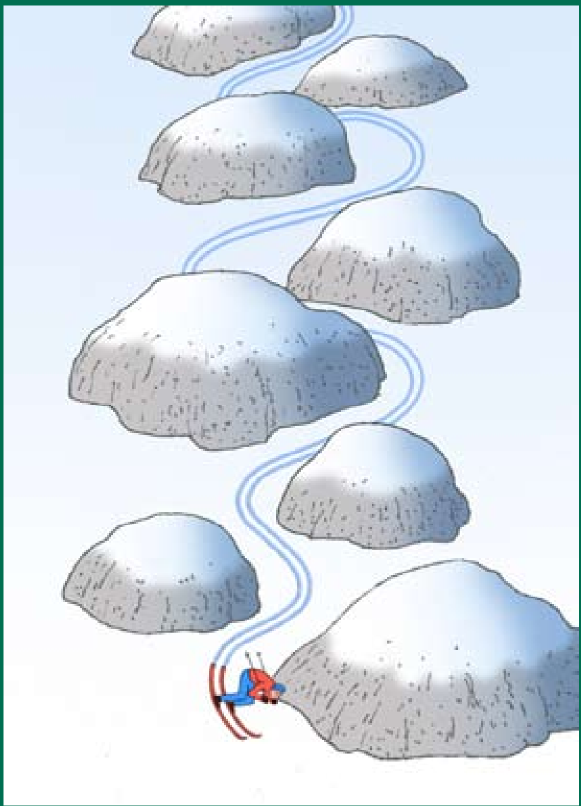
Report

The 2012 Consumer Value Creators Report

Creating Superior Value in Challenging Times



The Boston Consulting Group

THE 2012 CONSUMER VALUE CREATORS REPORT

CREATING SUPERIOR VALUE IN CHALLENGING TIMES

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EXECUTIVE SUMMARY

The 2012 Consumer Value Creators Report: Creating Superior Value in Challenging Times, *examines the total shareholder return (TSR) of more than 200 major consumer companies for the period 2007 through 2011.*[1] *The report covers four sectors in the consumer industry—fast-moving consumer goods (FMCG), consumer durables and apparel, retail, and travel and tourism. The analysis is based on empirical data from The Boston Consulting Group's fourteenth annual report in the Value Creators series,* Improving the Odds: Strategies for Superior Value Creation *(September 2012), which is a broader review of 1,003 companies across 21 industry sectors.*

The 2012 Consumer Value Creators Report *draws lessons for generating superior returns from the top performers in each consumer sector. The results of our analysis provide guidance and encouragement for consumer companies in today's below-average-growth environment. They also illustrate some surprising winners and losers.*

Consumer companies are at the rockface of a sluggish global economy that could potentially slow even further. Yet despite this challenging environment, some companies continue to generate high shareholder returns.

- We have entered a period of extended below-average economic growth, and the future does not look much brighter for the medium term. Emerging markets, hailed as the engines of global economic growth, are losing some of their luster, and the recovery of the U.S. economy remains uncertain.
- Consequently, eight out of ten investors expect TSRs across markets and industries to be substantially below long-term averages for the next five years.
- The TSR from 2007 through 2011 for all 208 consumer companies analyzed in our study averaged 5.4 percent, echoing these difficult

times.[2] The rate is significantly below the industry's long-term average of approximately 10 percent.

- However, the shareholder returns of the leading value creators in the four consumer sectors analyzed—FMCG, consumer durables and apparel, retail, and travel and tourism—were substantially higher. The average TSRs for the top ten performers in each of these sectors ranged from 15 to 26 percent per year.

The top performers took many different paths to create value, indicating that superior shareholder returns are not confined to a particular model or sector. There are a lot of individual value-creation stories, but three common themes emerge when looking at successful companies across the four consumer sectors:

- *Cash machines* are companies that create shareholder value by consistently generating strong cash flows. Their paths tend to emphasize modest growth combined with healthy and steady cash flow generation. They typically enjoy stable competitive advantages and realize high margins as a result of their powerful brands and go-to-market systems. And they continually reinvest in their core businesses to maintain these advantages. Examples in our 2012 study include McDonald's (number nine in retail) and Lorillard (number ten in FMCG).

- *Global challengers* are growth engine companies that serve high-growth emerging markets. These companies have used their positions in markets that are experiencing rapid expansion in consumer demand to grow their revenues sustainably and profitably. But position in a high-growth market alone does not guarantee superior TSR—global challengers have established advantaged, winning models in these markets. Good examples of such companies are Hengan International (number one in FMCG) and Titan Industries (number two in consumer durables and apparel).

- *Growth platforms* are companies that also create value through growth, but they do not necessarily serve high consumer-demand growth markets. Rather, these companies drive top-line growth via category, product, and brand innovation. They establish their competitive edge in many ways. They often create completely new consumer spaces with their offerings, tapping into unmet consumer needs and demand, as Chipotle Mexican Grill (number two in retail) did. Their strategies are usually well aligned with a prevailing megatrend, as illustrated by Dollar Tree (number four in retail), which successfully tapped into the growth of the value arena. Growth platforms also sometimes leverage changes in technology, product design, and business model to deliver breakthrough innovation, as illustrated by Priceline.com (number one in travel and tourism).

FMCG companies produced the highest TSR over the period of our study, using high-margin branded products and services to generate positive cash flow and growth, especially in emerging markets.

- FMCG companies' weighted-average TSR (8.6 percent) was the highest of any sector, including all sectors outside the consumer industry. The returns of the top ten value creators were nearly three times as high, averaging 24 percent. Several of those top players were repeat performers from *The 2011 Consumer Value Creators Report: Gaining a Value Creation Advantage in Volatile Times* (a report by The Boston Consulting Group, November 2011), demonstrating that it is possible to sustain outperformance.

- One common theme among the winners in this sector is that they generate more cash than needed to sustain growth, and they deploy that surplus in a smart and disciplined manner.

- The biggest winners—seven out of ten of the top performers—came from emerging markets. These global challengers rode to success on the back of strong, sometimes exceptionally high, growth.

- In developed markets, the top value creators deliver strong TSR through either a combination of cash yield and growth or through transformative M&A.

The TSR for the consumer durables and apparel sector fell far below its long-term average. But the top ten value creators in this sector produced impressive results by sharpening their business models and building new growth platforms.

- Despite negative shareholder returns for the sector as a whole (–1.3 percent), the top ten companies produced an annual average TSR of 19 percent.

- In consumer durables, the outperformers in developed markets concentrated on becoming efficient cash machines by removing costs, improving margins, and allocating capital to the highest-value operations while strengthening their balance sheets.

- As a result, capital returns to shareholders have become a more important part of the TSR mix for consumer durables companies. Their emerging-market peers, meanwhile, rely on growth to lift their returns.

- In apparel, the most successful companies have generally been able to develop sustainable growth platforms built on three key ingredients: brands that resonate with consumers, designs creating or reflecting trends that cannot be matched by competitors, and continuous innovation. Consequently, sales growth has been the biggest driver of TSR for the top performers, and it is likely to remain so.

The top retailers outperformed their sector by a substantial margin, despite being heavily exposed to the economically troubled developed markets. The winners drove shareholder returns through sales growth, notably by attracting consumers with innovative value propositions and using advantaged eco-

nomic models (such as smaller store footprints and online transactions).

- The weighted-average annual TSR for the leading retailers was 26 percent—more than four times higher than the sector average of 6.1 percent.

- Despite fierce competition from online rivals and increasingly picky, value-hungry consumers, six of the top ten retailers delivered double-digit sales growth.

- To appeal to consumers' quest for value, successful TSR performers establish growth platforms via new approaches that combine affordably priced products and services with higher-margin, yet still attainable, value-added options.

- Companies that are able to deliver growth are rewarded with significant expansions in their multiples—the second biggest driver of superior shareholder returns for nine of the top ten players, after sales growth.

Travel and tourism's leading performers pursue three routes to success. They either leverage emerging markets, use assets and market consolidation to fuel margin and cash flow growth, or implement technology to spearhead new business models.

- Of all the consumer sectors, travel and tourism suffered the most: the weighted-average TSR for the sector as a whole declined by 3.4 percent. Nevertheless, the top ten value creators produced 15 percent TSR on average.

- Several of the leaders are global challengers that grew by leveraging the increased spending power and mobility of consumers in emerging markets, especially in Asia.

- Airlines drove margins and cash growth upward through more effective use of their assets and market consolidation, including improved utilization of their fixed-asset bases and smart partnerships supported by effective postmerger integration.

- New economy growth-platform models also proved effective for rapid growth and margin improvements: Priceline.com produced the highest TSR (60.7 percent) of all the companies in our study.

With few signs of global economic growth rebounding sustainably in the near future, cash payouts are likely to play an increasingly important role in superior shareholder returns. But for smart consumer companies, growth is still attainable.

- Most senior executives have never encountered an economic environment like the one that exists today.

- Nevertheless, there are many routes to achieving above-average TSR. In fact, despite the gloomy economic outlook, most of the top performers in our study were able to drive significant top-line growth by using several different levers.

- Ultimately, the best path for any individual company will depend on its starting point, as determined by the economics of its business and its current valuation in the equity markets. The top performers show how to accelerate along these four routes to superior value creation.

NOTES

1. For a discussion of how we define total shareholder return, including its key drivers, see "The Components of TSR" section of the Appendix.
2. See the "Study Methodology" section of the Appendix for details of our sample size and selection criteria.

CONTEXT

A FUNDAMENTALLY DIFFERENT ENVIRONMENT

In recent Value Creators reports, we have argued that the global economy faces an extended period of below-average growth.[1] The outlook for growth has, if anything, become more pessimistic over the course of 2012. The ongoing fiscal crisis in the Eurozone has continued to create a challenging environment, with ripple effects felt the world over. As of the third quarter of 2012, the Eurozone had officially slipped back into recession, according to Eurostat, the statistical office of the European Union.[2]

To be sure, growth rates in emerging markets significantly outpace those in the developed world and will continue to do so. And yet signs indicate that those rates are slowing in many leading emerging markets. For example, Brazil's Central Bank lowered its GDP growth forecast to only 1.6 percent for full-year 2012, its slowest pace since 2009.[3] India's full-year GDP growth is forecast by the International Monetary Fund to be only 4.9 percent, its lowest since 2008.[4] In October 2012, China's official purchasing managers' index reached 50.2, returning to positive territory after spending several months below 50 earlier in the year.[5] (Anything below 50 indicates a contraction.)

In the early part of 2012, the United States was the sole bright spot in the global economy, showing modest but genuine improvements in growth. This modest growth has slowed, however, in part due to the fallout from the euro crisis, which caused the IMF to lower its estimates of U.S. growth to 2.2 percent in 2012 and to 2.1 percent in 2013.[6] As of this writing, it is not entirely clear whether the U.S. recovery will be sustainable, particularly given the looming fiscal cliff that a newly elected, but still divided, government faces.

Growth rates in emerging markets continue to outpace those in the developed world.

How have these trends affected global equity markets? For one thing, they have contributed to reduced expectations on the part of investors. In the BCG 2012 Investor Survey, published in April, 57 percent of respondents who focused on non-U.S. (primarily European) equities and 32 percent of those who focused on U.S. equities believed that there was either a "highly likely" or a "somewhat likely" possibility of a double-dip recession in 2012—about twice the percentage of those who thought so in 2011.[7] While such a recession is now unlikely to occur in the balance of 2012, investors remain concerned that it is a realistic possibility for 2013. The survey also showed that increased investor pessimism extended to expectations for the likely average total shareholder return (TSR) over the next few years—with 40 percent of respondents estimating that it will be in the range of 6 to 8 percent (below the long-term historical average of 9.3 percent) and another 40 percent estimating that it will be even less. (See Exhibit 1.) Despite investor skepticism, many markets have seen share prices rise solidly year to date through late November: the S&P 500 is up 12 percent, the CAC-40 up 11.7 percent, the Nikkei 225 up 10.8 percent, and the FTSE 100 up 4.4 percent. Neverthless, investors remain cautious—the S&P 500, for example, posted several significant corrections during the course of the year.

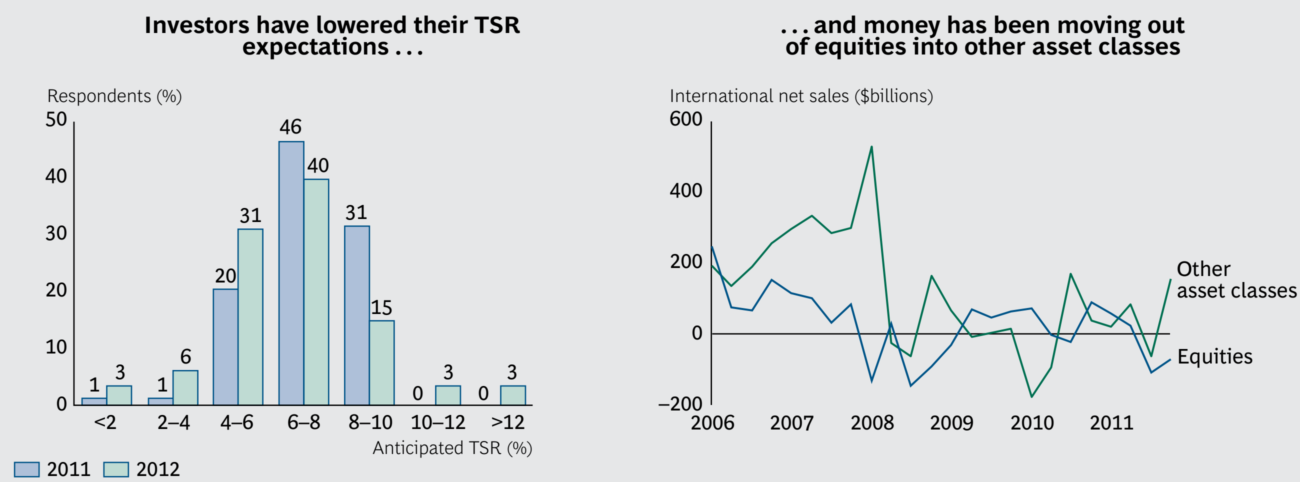
The pessimism about future equity returns is further illustrated by recent movements of investors out of equities and into other asset classes. Investments in equities are at their lowest levels since the 2008 financial crisis. In today's volatile and low-return world, many investors are clearly putting safety and yield ahead of growth prospects when they evaluate their investment alternatives.

Even when investors keep their money in the equity markets, they are putting much more emphasis on the free-cash-flow component of TSR. (For the multiple factors that play a role in determining TSR, see "The Components of TSR" section of the Appendix.) Contributing to this trend is the somewhat paradoxical fact that, during a period of limited growth prospects, companies have been enjoying record-high profitability and liquidity. Since 2000, companies have experienced a dramatic widening of profit margins. In the U.S., for example, median operating profits as a percentage of revenues have increased by 27 percent (from 12.8 percent of sales in 2000 to 16.2 percent in 2011). Over the same period, corporate cash balances and liquidity have more than doubled, as cash per dollar of assets increased from 4 percent to 9 percent. This improvement was not a function of top-line growth, which is still stalled for many companies, but rather of a relentless focus on costs.

Superior Returns with Modest Growth

This combination of below-average growth, pessimism about future equity returns, and the increasing importance of the cash flow contribution to TSR sets the context for our discussion of value-creation strategy. According to analysts' estimates, fewer than half of U.S. companies are expected to grow revenues more than 6 percent over the next three to five years. For the many companies that are poorly positioned to deliver above-average growth, the name of the game in today's environment is judicious capital deployment. Those companies need to

Exhibit 1 | Investors Are Expressing Pessimism About Future Equity Returns



Sources: The BCG 2012 Investor Survey; European Fund and Asset Management Association; BCG analysis.
Note: Survey responses were to the following question: "Once the economy settles to its new normal, what do you think the average annual total shareholder return will be, assuming normal levels of inflation?"

thoughtfully allocate the vast quantities of cash that they generate and continue to accumulate on their balance sheets. They should avoid unrealistic growth targets and the temptation to use excess capital to purchase one-time or low-quality revenue growth. Rather, they should focus on keeping their margins strong, take advantage of currently robust free cash flows to increase cash payout, and skew the payout mix toward dividends, because dividends tend to put a floor under a company's stock price in a way that share repurchases do not.

> A more yield-oriented strategy should help companies beat the TSR market average.

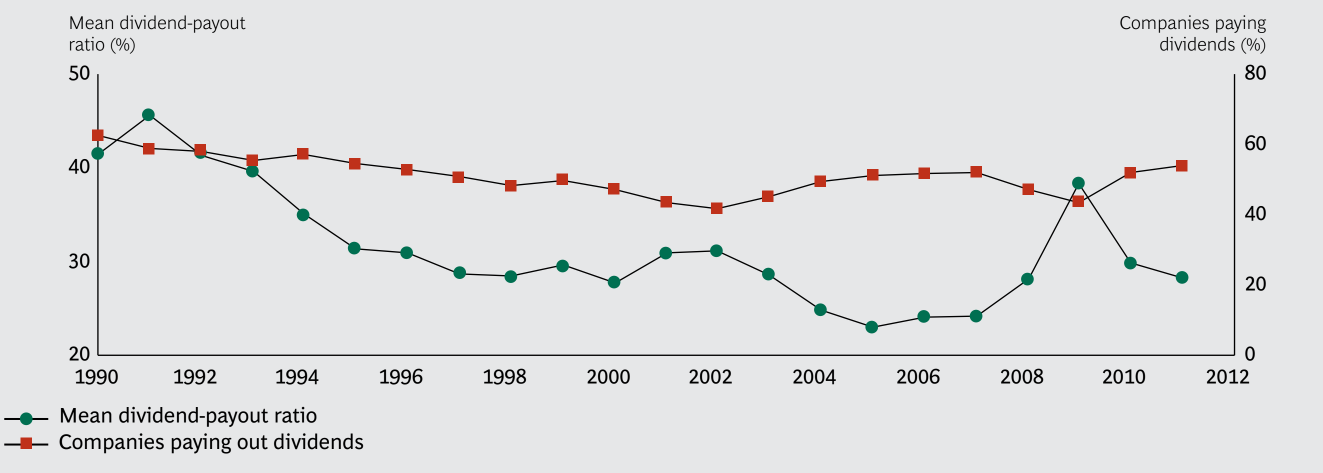
There are signs that dividends are indeed becoming a more important component of companies' financial policies. According to one estimate, 429 nonfinancial companies in the U.S. increased their common dividend in fiscal 2011 by a market-cap-weighted average of 21.5 percent.[8] And investors have rewarded them: valuation premiums for healthy companies with a meaningful dividend have expanded in the neighborhood of 15 to 20 percent over the past year compared with their nondividend-paying peers. For companies with excess distributable cash, dividends should continue to remain an attractive path to supporting valuations and creating value for owners over time.[9] Despite the recent increases, dividend payout ratios among the S&P 1500 companies in 2011 were still 17 percentage points lower than they were as recently as 20 years ago. And nearly half of the S&P 1500 companies did not pay any dividends at all. (See Exhibit 2.)

A more yield-oriented strategy should help companies beat the TSR market average—keeping in mind that that average will likely be lower than it was in the precrisis environment and that, in a world in which capital appreciation is modest, yield will become a relatively more important contributor to overall TSR. But will that strategy generate enough TSR to enable companies to earn a place in our Value Creators rankings? The evidence suggests that, at least in some cases, the answer is yes.

Three Routes to Value Creation

In looking across the four consumer sectors covered in our study—fast-moving consumer goods (FMCG), consumer durables and apparel, retail, and travel and tourism—it is apparent that there are many different paths to creating value in the consumer space. But three common themes emerge when looking at the top consumer value creators.

Exhibit 2 | Dividend Payouts Have Yet to Return to Earlier Levels



Sources: Bloomberg; BCG analysis.
Note: The sample is the S&P 1500.

In recent Value Creators reports, we identified a set of companies we call *cash machines,* which combine superior TSR with relatively modest growth.[10] One can find a number of these companies in the current report. Examples include British American Tobacco (number five in the FMCG sector) and McDonald's (number nine in the retail top ten). Even some companies in faster-growing, developing-world markets have delivered superior TSR, in part, through above-average cash payouts. Nike is a case in point.

Growth platforms drive top-line growth via category, product, and brand innovation.

These top performers tend to enjoy stable competitive advantages, high margins, and strong free cash flows. What's more, they continually reinvest in their core businesses to maintain those advantages and to sustain—or even improve—their already high margins. When they do so, they are able to deliver superior returns over an extended period of time despite relatively modest growth.

For a select group of companies, however, it is still possible to create superior value through growth—even in today's low-growth environment.

Some of these successful growth companies we call *global challengers*—market leaders serving high-growth emerging markets. Such companies have been able to grow sustainably and profitably in part because they are well positioned to capture rapid end-demand growth in their markets. And they are growing not only because they happen to be in high-growth markets: they are growing and winning in the context of very competitive market dynamics. Good examples of these companies are Hengan International (number one in FMCG) and Titan Industries (number two in consumer durables and apparel).

The final, and perhaps the most interesting, thematic set of companies comprises *growth platforms*. These companies have been successful at creating value via top-line performance despite not having much of a tailwind for growth. These companies do not necessarily serve high-growth end markets, but they drive top-line growth via category, product, and brand innovation. They establish their edge in many ways. They often create whole new consumer spaces with their offerings, tapping into unmet consumer needs and demand, as Chipotle Mexican Grill (number two in retail) did. Their strategies are usually well aligned with a prevailing megatrend, as illustrated by Dollar Tree (number four in retail), which successfully tapped into the growth of the value arena. Growth platforms also sometimes leverage changes in technology, product design, and business model to deliver breakthrough innovation, as illustrated by Priceline.com (number one in travel and tourism).

NOTES

1. See, for example, *Threading the Needle: Value Creation in a Low-Growth Economy,* The 2010 Value Creators Report, September 2010.
2. See "GDP Down by 0.1% in Euro Area," *Eurostat News Releases,* November 15, 2012.
3. See "Brazil Central Bank Lowers GDP Forecast to 1.6%," *Folha De S. Paolo,* September 28, 2012.
4. See "IMF Cuts GDP Forecast to 4.9%," *Business Standard (India)*, October 10, 2012.
5. See "China PMI Factory Data Hints at Upturn," *The Guardian,* November 1, 2012.
6. See "IMF World Economic Outlook Database," October 2012 edition, http://www.imf.org/external/pubs/ft/weo/2012/02/weodata/index.aspx, retrieved from the Web on November 25, 2012.
7. See "Back to the Future: Investors Refocus on Yield," BCG article, April 2012.
8. See "Dividends Rising," *CFO* magazine, April 2012.
9. See "Expect No Let-Up in Dash for Equity Yield," *Financial Times,* July 29, 2012.
10. See *Searching for Sustainability: Value Creation in an Era of Diminished Expectations,* The 2009 Value Creators Report, October 2009; and "The Rise of the Cash Machine," BCG article, February 2012.

FINDINGS

TOP 2012 CONSUMER VALUE CREATORS

LIKE MOST INDUSTRIES, THE consumer industry has been strongly affected by the economic slowdown: the weighted-average annual TSR for the period 2007 through 2011, 5.4 percent, is significantly below the industry's long-term annual average of about 10 percent. However, averages can be deceptive. Many of the top ten TSR performers in the four consumer sectors analyzed in our study—fast-moving consumer goods (FMCG), consumer durables and apparel, retail, and travel and tourism—produced significantly better returns. For example, the top ten performers across all four sectors achieved shareholder returns ranging from 7 to 61 percent during the five-year period from 2007 to 2011, and the averages for each sector's top ten companies ranged from 15 to 26 percent.

All businesses can potentially produce above-average TSR.

When we analyzed the top ten value creators' shareholder returns against three main dimensions of TSR—sales growth, margin change, and changes in valuation multiples—we found a wide spread around the average on each specific dimension. We also found that the top performers took many different routes to value creation. Some were substantially below average while others were significantly above average. (See Exhibit 3.)

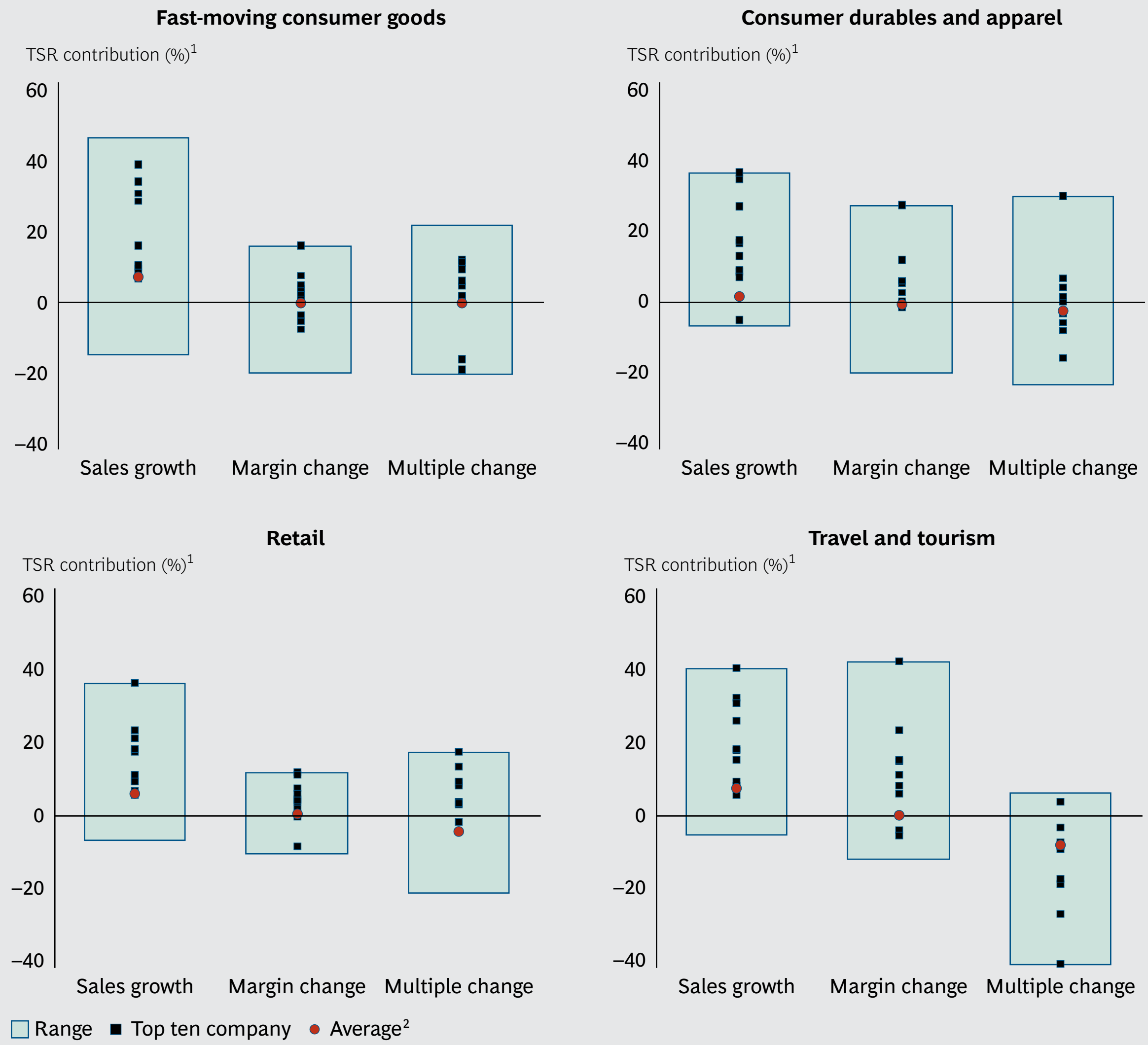
For senior executives, such wide variations can be frustrating because there does not appear to be a clear path to superior value creation. But the encouraging takeaway from our analysis is that the path to above-average TSR is not a fixed route available to only a few, select companies: all businesses can potentially produce above-average TSR. The best path for any individual company will depend on that company's starting point, as defined by the economics of its business and its current valuation in the equity markets. In the end, each company has to chart its own course and develop its own value-creation strategy.

Fast-Moving Consumer Goods: Leading the Field with High-Margin Brands

FMCG was the highest-performing sector in the consumer space: it outpaced every other sector, from chemicals to telecommunications, achieving a weighted-average annual TSR of 8.6 percent.

The top ten companies produced dramatically better results (24 percent on average), outstripping the sector average by a factor of nearly three. High-margin, distinctive brands lie at the heart of this success, generating the

Exhibit 3 | There Are Diverse Pathways to Value Creation in Different Sectors



Source: Thomson Reuters Datastream; Thomson Reuters Worldscope; Bloomberg; annual reports; BCG analysis.
[1]The contribution of each factor is shown in percentage points of five-year average annual TSR.
[2]The weighted average is based on 2011 year-end market capitalization.

returns and cash flow needed to boost TSR through cash payouts or by reinvesting in sales growth. Different companies took different routes. The full list of top ten value creators in the FMCG sector is shown in the rankings titled "Fast-Moving Consumer Goods," on page 18.

Cash machines continue to deliver results. One recurring theme across the FMCG companies is their ability to generate more cash than they need to grow. In developed markets, where economic growth is sluggish and could slow even further, the top TSR performers used their surplus cash smartly to fuel superior returns in conjunction with modest sales growth. This cash machine approach was illustrated by companies such as British American Tobacco and Lorillard. Even in high-growth emerging markets, robust cash flows and increased payouts can be powerful levers, as demonstrated by AmBev.

These outperformers struck the right balance between growth and throwing off cash, either through above-average cash payouts or by using the cash to fund M&A. For example, Brasil Foods (BRF) carried out a transformational M&A that helped the company achieve the sixth-highest TSR in the FMCG space. BRF accomplished this through a mix of growth and improved margins despite multiple compression.

Growth engines reap the benefits of emerging markets. Unlike their developed-world peers, companies in emerging markets have enjoyed—and capitalized on—a relatively high-growth environment, particularly in the brand-conscious Asian markets. In fact, seven out of ten of the top TSR performers in FMCG are from emerging markets, highlighting the importance of growth for superior returns; for the sector as a whole, sales growth accounted for 60 percent of TSR. Some companies, such as Hengan International, Tingyi, and Kweichow Moutai, produced and sustained spectacular growth from 2007 through 2011. As a general rule, companies that are structurally more profitable are able to grow more rapidly than the average company in this sector.

Effective utilization of assets and strong free-cash-flow generation are essential.

The power of multiples. In both developing and industrialized markets, some companies earned superior shareholder returns through a combination of growth, cash generation, and expanding multiples, reflecting heightened expectations from investors. For example, higher multiples contributed significantly to the TSR of Femsa and Estée Lauder, among others.

Potential pitfalls for the unwary. While many companies produced impressive TSR performances given the circumstances, others lost their way. Companies that fail to grow, especially if they concede market share, are often severely punished by investors. In a branded market, any move toward lower-margin commoditization is also likely to produce a backlash. Another common problem is a "leaky" capital-allocation strategy, including poorly timed share buybacks, one-off dividends that are capitalized by shareholders, and M&A deals that fail to deliver on their promise, often due to weak postmerger integration.

Going forward. Maintaining and cultivating brands with consumer pull will continue to be crucial for success and to enable both growth and margin expansion, when done correctly. Emerging markets will also be important for growth. For multinationals, M&A will offer opportunities to access these markets, including new distribution channels, while local businesses will have to professionalize further to compete with these growth-hungry "outsiders." In all cases, effective utilization of assets and strong free-cash-flow generation will be essential, especially if economic growth continues to slow down.

Consumer Durables and Apparel: Sharpening Business Models and Building Growth Platforms

Consumer durables and apparel companies saw their weighted-average shareholder returns fall by 1.3 percent for the period 2007 through 2011. Nevertheless, the top ten players showed that above-average returns can be achieved, producing a weighted average annual TSR of 19 percent. Of course, the two types of business that make up this group—consumer durables and apparel—are quite different, and thus the challenges they face and the value-creation paths they have created are different as well. The full list of top ten value creators in the consumer durables and apparel sector is shown in the rankings titled "Consumer Durables and Apparel," on page 19.

Consumer durables become more efficient cash machines. Following the financial crisis, many top TSR companies in the consumer durables space introduced cathartic cost takeouts and margin improvements, striving to allocate capital to highest-value operations while bolstering the balance sheet and balancing a meaningful capital return to shareholders. Those companies, mainly in developed markets, have been confident in their ability to consistently deliver free cash flows, regardless of where in the cycle they are, and to use them to invest in new opportunities, including M&A. Tempur-Pedic

International is a case in point. The company strengthened its core business and focused on innovation, a strategy that was enhanced through its acquisition of Sealy.

Generally, capital returns to shareholders are an important part of the TSR mix for developed-market outperformers. This strategy is likely to become even more important in the near to medium term because a low-growth environment will not hide inefficient or decretive capital deployment back into R&D or operations.

In emerging markets, growth-oriented approaches may not be a sustainable source of TSR.

In emerging markets, companies such as the Indian watchmaker Titan Industries generally relied on growth to lift their TSR, while others, such as China's white-goods giant Haier, combined growth and margin improvements. Whether or not the growth-oriented approaches are a sustainable source of TSR will depend on the economic outlook of these markets; current indicators suggest that they may not be.

Apparel establishes brand-focused growth platforms. The most successful apparel companies have generally been able to develop sustainable growth platforms that are built on three key ingredients: brands that resonate with consumers, designs creating or reflecting trends that cannot be matched by competitors, and continuous innovation.

Consequently, sales growth has contributed far more to TSR for the top performers than dividend yield. For example, both Burberry and Deckers Outdoor have continued their growth trajectory with five-year average annual sales growth of 17 percent and 35 percent, respectively. Nike also relied on growth, although multiple expansion played a nearly equal role in producing the company's TSR. Dividends and share redemptions were also more influential with regard to Nike's final TSR than they were with regard to Burberry or Deckers. Fossil, in turn, grew both its sales and margins simultaneously to achieve superior TSR, delivering double-digit improvements in both measures year on year.

Going forward. Growth is likely to remain a major driver of above-average TSR in the near term. Successful companies will capitalize on the growth of increasingly affluent populations in emerging markets (assuming that income growth materializes). In addition, durable-goods companies that continue to identify attractive adjacencies for growth, while effectively managing their core asset-base and margin structures, will outperform. Success for apparel makers, on the other hand, will continue to depend on their ability to commercialize break-out brands and products that both reflect current trends and cultivate an emotional connection with consumers.

Retail: Attracting Consumers with Innovative Value Propositions

Retailers are fighting major battles on two fronts. On one side, traditional models, such as big-box stores—and especially consumer electronics retailers and department stores—are increasingly being challenged by more-specialized competitors and nimble online rivals. On the other side, consumers, who have developed a keen eye for value and are becoming pickier about how and where they shop, are forsaking middle-market retailers in favor of trading down to value-focused stores or trading up to high-end retailers—a trend foretold in a 2008 BCG publication. (See "Trading Up and Down Around the World," BCG Perspectives, September 2008.)

Yet despite these turbulent challenges, the weighted-average annual TSR for the retail sector was 6.1 percent. In contrast, the returns of the top ten TSR performers were more than four times higher on average, at 26 percent. More impressively, given the frosty economic climate, six of these outperformers generated double-digit sales growth. In fact, growth was the biggest contributor to shareholder value for the sector as a whole. The full list of top ten value creators in the retail sector is shown in the rankings titled "Retail," on page 20.

Significantly, companies that were able to deliver credibly sustainable growth were rewarded by investors with improved multiples—the second biggest contributor to TSR for the sector as a whole. Multiples for nine of the top ten retailers moved up. Conversely, many companies that lost investors' confidence in their growth potential are trading at substantially lower multiples than in the past.

Innovation is key for attracting consumers in developed economies.

The Continuing Importance of Developed Markets. The TSR winners have a disproportionately high exposure to economically beleaguered developed markets, especially the U.S., underlining the importance of these markets for superior shareholder value. Six of the top ten retailers derive more than 50 percent of their sales from the U.S. (Note, however, that some effective companies may not appear in our sample only because they did not meet the criteria for ownership structure and size of retailers in developing markets.) While developing markets still have substantial potential, as consumers urbanize and disposable income grows, one of the key lessons from developed economies is the importance of innovation, particularly given consumers' pursuit of value for money.

Enticing Consumers with Valued Innovations. Consumers continue to be focused on finding the goods they want at attractive prices. This is one explanation for the success of online retailers such as Amazon.com, which offers products more cheaply than brick-and-mortar rivals. But to attract and keep consumers, companies need to use innovative approaches. And the top TSR performers do this in different ways. For example, AutoZone delivers both affordable parts and value-add services to grow DIY auto repair, while Chipotle is changing expectations of what fast, casual dining can deliver, promoting new occasions to produce rapid sales growth. McDonald's, in turn, is taking a two-pronged approach to value through a combination of Dollar Menu offerings and trade-up items using higher quality ingredients at relatively affordable price points relative to competitors.

Going Forward. While some innovative retailers will continue to generate strong growth in their respective markets and categories, a greater focus on improving margins and free cash flow is forecast to be required for achieving top-quartile TSR. The sluggish economic outlook, the growing share of online transactions, and a higher proportion of consumers seeking a distinct value or service offering will all drive the trend.

Travel and Tourism: Delivering Value via Targeted Growth and Effective Asset Utilization

Of the four consumer sectors analyzed, travel and tourism produced the least impressive TSR results, with average shareholder returns falling by 3.4 percent over the five-year period. Impressively, however, the top ten value creators in travel and tourism averaged 15 percent TSR. Three main value-creation themes emerge from this sector. The full list of top ten value creators in the travel and tourism sector is shown in the rankings titled "Travel and Tourism," on page 21.

Leveraging Emerging Markets to Drive Growth. Asia has become a major source of revenue growth for many companies as consumers in the region become more mobile and have greater disposable income. Companies that have capitalized on Asia's increasing appetite for travel include AirAsia, China Southern Airlines, and China Eastern Airlines. At the same time, businesses are seizing the commercial opportunities offered by more relaxed gaming regulations. Companies that have aggressively invested in local options for gaming include Genting, Kangwon Land, and Wynn Resorts.

Strengthening Asset Productivity and Market Consolidation to Improve Margins. In developed markets, the top TSR airlines are increasing their utilization of assets while optimizing networks and allocating existing aircraft to the routes with the highest yields. For example, Alaska Airlines drove margin improvements and increased revenues through smart selection of routes and improved utilization of its fixed-asset base. Although no U.S.-network airlines have yet become top ten TSR performers, that situation could soon change. Most have made major strides through consolidation-oriented M&A, effective postmerger integration, and smart partnerships that enable them to compete and grow on the global playing field while generating improved returns.

U.S.-network airlines have made major strides and could become top ten TSR performers.

Creating New Business Models with Technology. A new breed of companies is disrupting traditional distribution channels through scalable, IT-driven models that offer consumers better value and service while allowing providers to capture an attractive share of the revenue pool. For example, Priceline.com delivered the highest TSR of all 208 consumer companies studied—an impressive 60.7 percent—through a combination of rapid growth and margin expansion, a pattern it sustained during the five-year period. At the same time, Expedia followed a more measured path to TSR with moderate sales growth and effective use of buybacks, which led to an improved multiple that contributed to its 8.5 percent TSR.

Going Forward. Emerging markets are likely to continue to drive growth and enable TSR as long as consumer incomes keep growing. In addition, liberalized regulation of gaming companies may provide an additional boost in emerging markets. In developed markets, market consolidation and improved utilization of assets will remain key drivers of value creation. Airlines are also likely to continue to leverage partnerships to augment their global reach and realize growth from the increasing connections between developed and developing markets. Finally, new economy models will likely create fewer TSR opportunities as the evolution of digital travel distribution enters its mature stage.

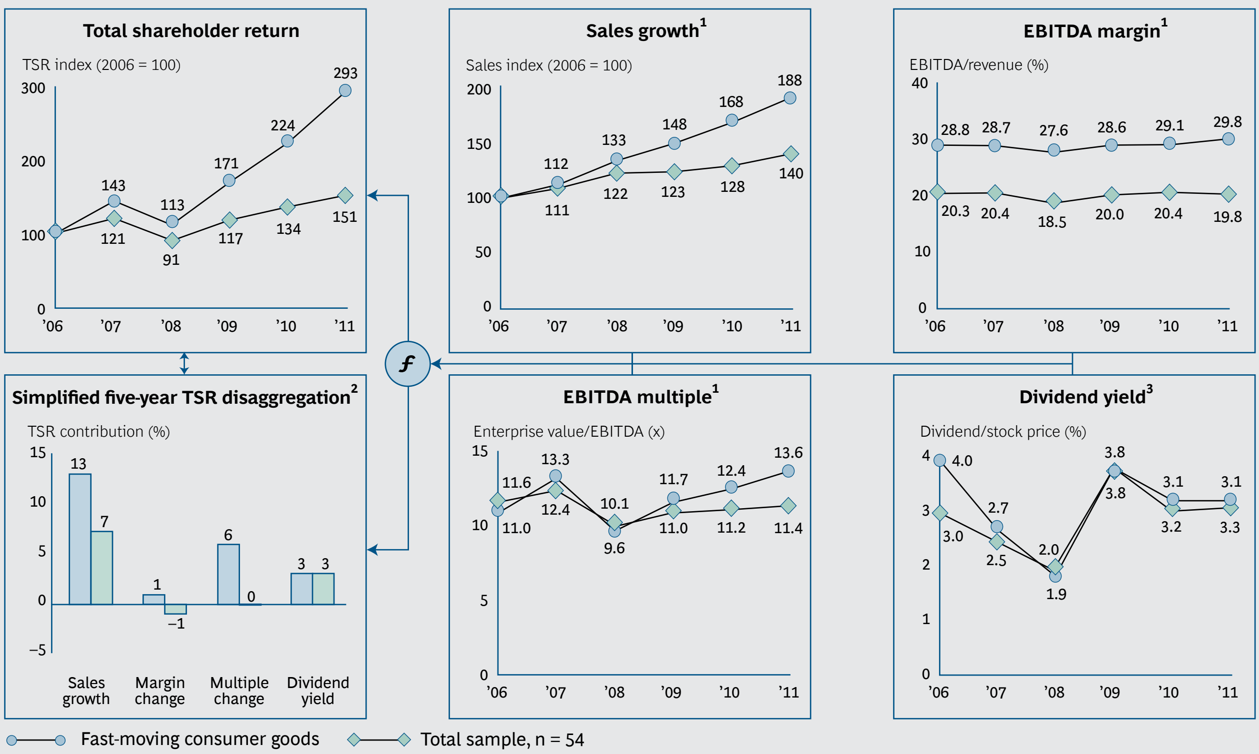
FAST-MOVING CONSUMER GOODS

The Fast-Moving Consumer Goods Top Ten, 2007–2011

#	Company	Location	TSR[2] (%)	Market value[3] ($billions)	TSR Disaggregation[1]: Sales growth (%)	Margin change (%)	Multiple change[4] (%)	Dividend yield (%)	Share change[5] (%)	Net debt change (%)	2012 TSR[6] (%)
1	Hengan International	Hong Kong	33.1	11.5	33	–5	4	3	–3	1	4
2	AmBev	Brazil	31.1	119.8	9	2	11	5	1	3	17
3	Tingyi	Hong Kong	27.6	17.0	28	–7	6	2	0	0	–15
4	Estée Lauder	United States	24.0	22.2	6	4	11	2	1	0	–4
5	British American Tobacco	United Kingdom	21.6	96.4	10	5	1	5	0	1	9
6	BRF	Brazil	21.1	18.1	38	15	–16	2	–18	0	–16
7	ITC Ltd.	India	20.8	31.4	15	2	2	3	–1	0	31
8	Kweichow Moutai	China	20.3	31.7	30	7	–19	1	0	1	24
9	Femsa	Mexico	19.8	26.4	10	–4	9	1	0	3	24
10	Lorillard	United States	17.2	15.0	8	1	2	5	6	–4	19

Sources: Thomson Reuters Datastream; Thomson Reuters Worldscope; Bloomberg; annual reports; BCG analysis.
Note: n = 54 global companies with a market valuation of at least $9 billion.
[1]Contribution of each factor shown in percentage points of five-year average annual TSR; any apparent discrepancies in TSR totals are due to rounding.
[2]Average annual TSR, 2007–2011.
[3]As of December 31, 2011.
[4]Change in EBITDA multiple.
[5]"Share change" refers to the change in the number of shares outstanding, not to the change in share price.
[6]As of June 30, 2012.

Value Creation at the Fast-Moving Consumer Goods Top Ten Versus Industry Sample, 2007–2011



Sources: Thomson Reuters Datastream; Thomson Reuters Worldscope; Bloomberg; annual reports; BCG analysis.
[1]Industry calculation based on aggregate of entire sample.
[2]Share change and net debt change not shown.
[3]Industry calculation based on sample average.

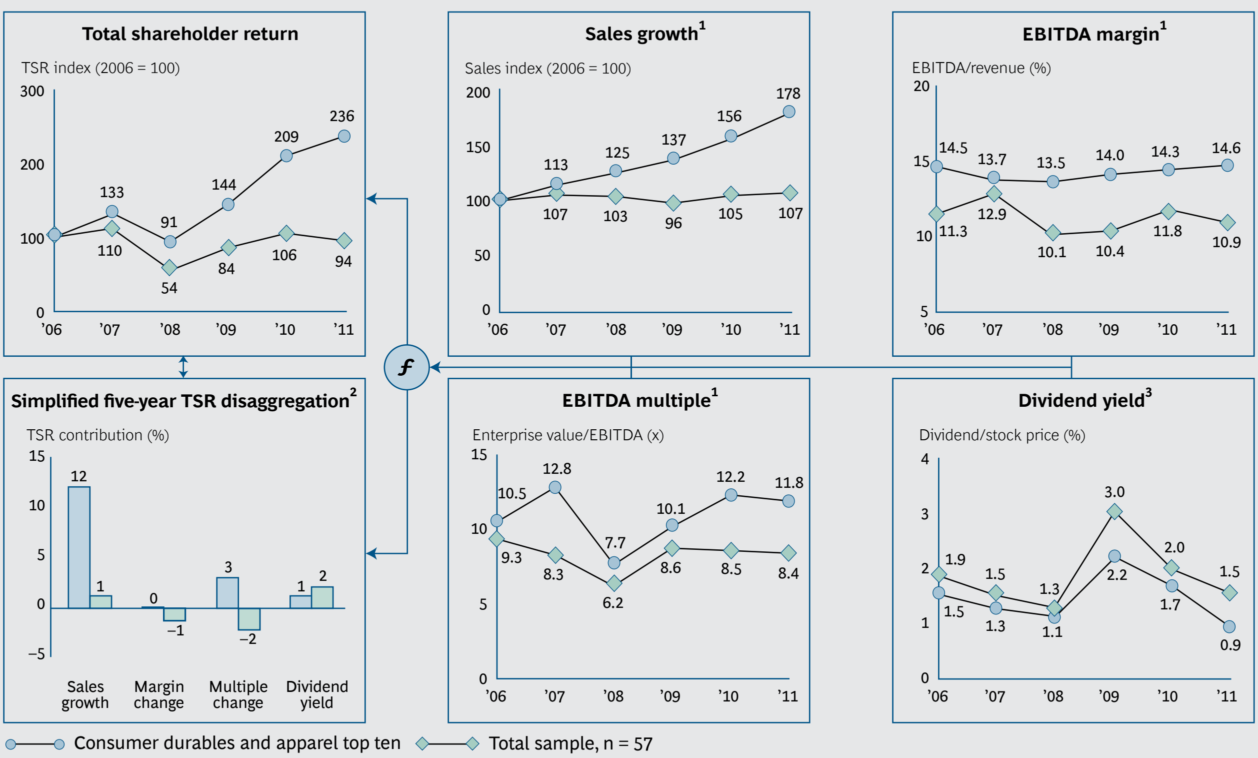
CONSUMER DURABLES AND APPAREL

The Consumer Durables and Apparel Top Ten, 2007–2011

#	Company	Location	TSR[2] (%)	Market value[3] ($billions)	TSR Disaggregation[1]: Sales growth (%)	Margin change (%)	Multiple change[4] (%)	Dividend yield (%)	Share change[5] (%)	Net debt change (%)	2012 TSR[6] (%)
1	NCsoft	South Korea	43.1	5.4	12	5	29	1	0	–5	–11
2	Titan Industries	India	32.6	3.0	33	–1	–3	1	0	2	31
3	Deckers Outdoor	United States	30.5	2.9	35	0	–3	0	0	–1	–42
4	Fossil	United States	28.6	4.9	16	11	0	0	2	–1	–4
5	Tupperware Brands	United States	23.3	3.6	8	6	2	4	–1	5	–1
6	Tempur-Pedic International	United States	21.5	3.3	8	2	4	0	5	1	–55
7	Sanrio	Japan	18.5	4.5	–5	26	–8	2	0	3	–26
8	Nike	United States	16.1	45.1	7	–1	6	2	2	0	–8
9	Burberry	United Kingdom	15.6	8.1	17	0	–6	3	0	1	12
10	Haier	China	15.5	3.8	26	6	–15	2	–2	0	33

Sources: Thomson Reuters Datastream; Thomson Reuters Worldscope; Bloomberg; annual reports; BCG analysis.
Note: n = 57 global companies with a market valuation of at least $2.5 billion.
[1]Contribution of each factor shown in percentage points of five-year average annual TSR; any apparent discrepancies in TSR totals are due to rounding.
[2]Average annual TSR, 2007–2011.
[3]As of December 31, 2011.
[4]Change in EBITDA multiple.
[5]"Share change" refers to the change in the number of shares outstanding, not to the change in share price.
[6]As of June 30, 2012.

Value Creation at the Consumer Durables and Apparel Top Ten Versus Industry Sample, 2007–2011



Sources: Thomson Reuters Datastream; Thomson Reuters Worldscope; Bloomberg; annual reports; BCG analysis.
[1]Industry calculation based on aggregate of entire sample.
[2]Share change and net debt change not shown.
[3]Industry calculation based on sample average.

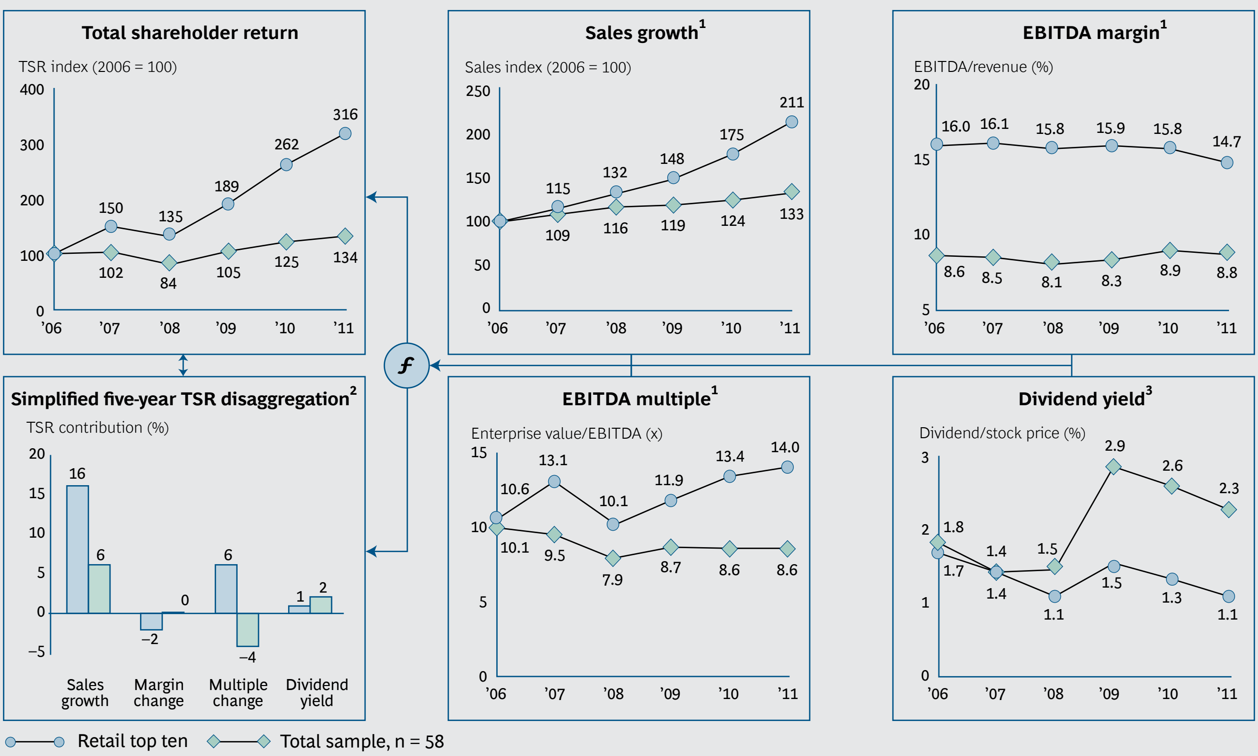
RETAIL

The Retail Top Ten, 2007–2011

					TSR Disaggregation[1]						
#	Company	Location	TSR[2] (%)	Market value[3] ($billions)	Sales growth (%)	Margin change (%)	Multiple change[4] (%)	Dividend yield (%)	Share change[5] (%)	Net debt change (%)	2012 TSR[6] (%)
1	Shoprite	South Africa	44.0	9.3	17	7	17	4	0	–1	11
2	Chipotle Mexican Grill	United States	42.7	10.6	22	11	9	0	1	–1	12
3	Amazon.com	United States	34.4	78.8	35	–8	8	0	–2	1	32
4	Dollar Tree	United States	32.9	9.6	11	4	13	0	5	0	29
5	Jerónimo Martins	Portugal	32.6	10.5	17	0	8	2	0	5	5
6	Ross Stores	United States	28.0	10.8	9	11	3	1	4	0	32
7	AutoZone	United States	23.0	13.0	6	2	3	0	12	–1	13
8	El Puerto de Liverpool	Mexico	22.8	10.7	9	4	9	1	0	0	6
9	McDonald's	United States	21.4	102.5	5	6	3	4	3	0	–10
10	O'Reilly Automotive	United States	20.1	10.2	20	4	–2	0	–2	0	5

Sources: Thomson Reuters Datastream; Thomson Reuters Worldscope; Bloomberg; annual reports; BCG analysis.
Note: n = 58 global companies with a market valuation of at least $8 billion.
[1]Contribution of each factor shown in percentage points of five-year average annual TSR; any apparent discrepancies in TSR totals are due to rounding.
[2]Average annual TSR, 2007–2011.
[3]As of December 31, 2011.
[4]Change in EBITDA multiple.
[5]"Share change" refers to the change in the number of shares outstanding, not to the change in share price.
[6]As of June 30, 2012.

Value Creation at the Retail Top Ten Versus Industry Sample, 2007–2011



Sources: Thomson Reuters Datastream; Thomson Reuters Worldscope; Bloomberg; annual reports; BCG analysis.
[1]Industry calculation based on aggregate of entire sample.
[2]Share change and net debt change not shown.
[3]Industry calculation based on sample average.

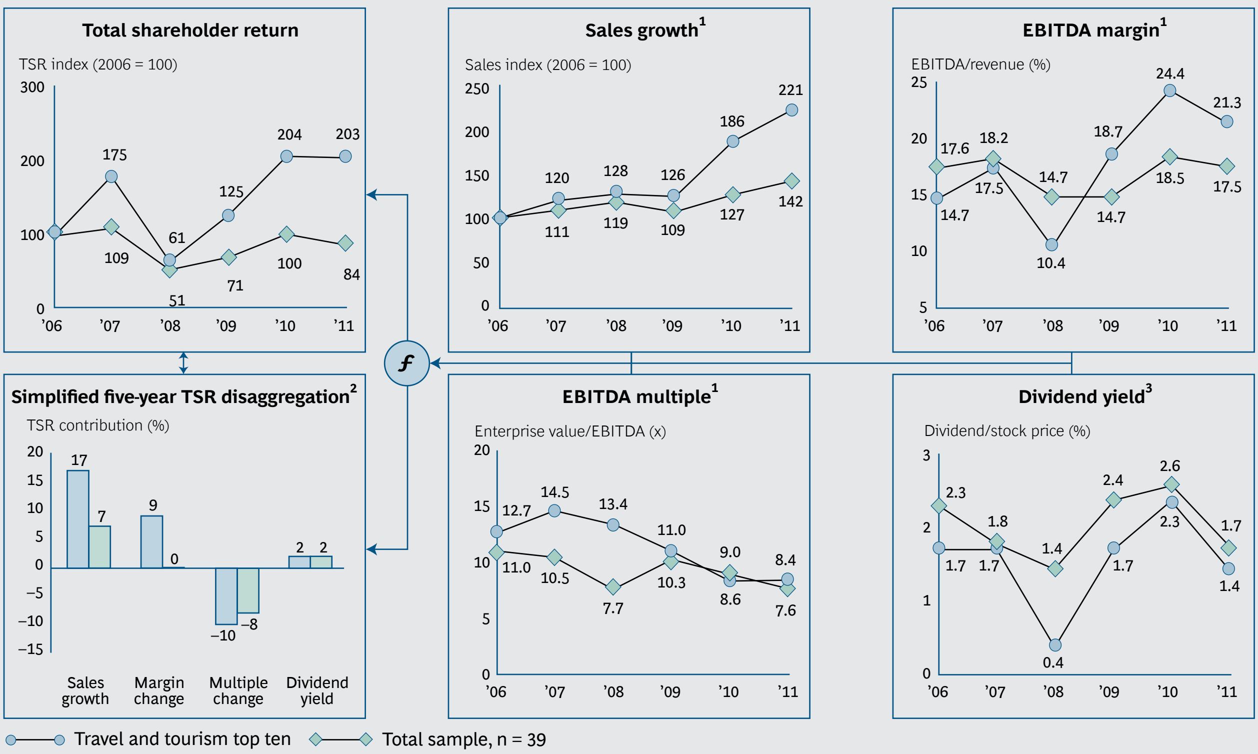
TRAVEL AND TOURISM

The Travel and Tourism Top Ten, 2007–2011

#	Company	Location	TSR[2] (%)	Market value[3] ($billions)	TSR Disaggregation[1]: Sales growth (%)	Margin change (%)	Multiple change[4] (%)	Dividend yield (%)	Share change[5] (%)	Net debt change (%)	2012 TSR[6] (%)
1	Priceline.com	United States	60.7	23.3	31	41	–9	0	–6	4	42
2	AirAsia	Malaysia	20.3	3.4	39	8	–18	0	–3	–5	–4
3	Alaska Air Group	United States	13.7	2.7	5	14	–8	0	3	0	–4
4	China Southern Airlines	China	13.3	5.0	14	6	–7	0	–8	8	–7
5	Genting	Malaysia	12.7	13.1	25	–4	–8	2	0	–2	–14
6	Kangwon Land	South Korea	10.4	5.1	8	0	–3	4	0	1	–10
7	China Eastern Airlines	China	10.2	4.0	17	22	–26	0	–15	12	–11
8	Expedia	United States	8.5	3.9	9	–5	4	1	3	–2	66
9	Wynn Resorts	United States	8.3	13.8	30	15	–39	7	–4	0	–5
10	Air China	China	7.2	9.5	18	11	–17	1	–1	–4	–18

Sources: Thomson Reuters Datastream; Thomson Reuters Worldscope; Bloomberg; annual reports; BCG analysis.
Note: n = 39 global companies with a market valuation of at least $2.5 billion.
[1]Contribution of each factor shown in percentage points of five-year average annual TSR; any apparent discrepancies in TSR totals are due to rounding.
[2]Average annual TSR, 2007–2011.
[3]As of December 31, 2011.
[4]Change in EBITDA multiple.
[5]"Share change" refers to the change in the number of shares outstanding, not to the change in share price.
[6]As of June 30, 2012.

Value Creation at the Travel and Tourism Top Ten Versus Industry Sample, 2007–2011



Sources: Thomson Reuters Datastream; Thomson Reuters Worldscope; Bloomberg; annual reports; BCG analysis.
[1]Industry calculation based on aggregate of entire sample.
[2]Share change and net debt change not shown.
[3]Industry calculation based on sample average.

CASE STUDY

CHURCH & DWIGHT—KEEPING A FOOT ON THE GAS

One company that has delivered a truly stellar TSR performance in recent years is the U.S. consumer-packaged-goods company Church & Dwight. With a 2011 year-end market capitalization of $6.5 billion, the company was too small to be included in this year's Value Creators consumer nondurables sample (which has a market cap hurdle of $9 billion). But the company's five-year average annual TSR of 17.6 percent puts it at the same level of performance as our top ten companies in the consumer nondurables ranking. What's more, compared with its much larger packaged-goods peers—such as Procter & Gamble, Unilever, Colgate-Palmolive, and Clorox—Church & Dwight has been the top value creator in its peer group for the past three, five, and ten years.

Church & Dwight dates back to 1846, when founders Austin Church and John Dwight developed bicarbonate of soda (more commonly known as baking soda). Today, the company's diverse portfolio includes some 80 global brands and products, such as its venerable Arm & Hammer brand, Nair depilatories, the prewash laundry additive OxiClean, Trojan condoms, and First Response home pregnancy and ovulation test kits. The brands are market-share leaders in many of the segments in which the company competes.

What explains the consistent superior performance of this mid-cap company? According to CEO James Craigie, one important factor is his use of TSR as an overarching framework for managing the company. "A lot of companies give lip service to the idea of managing for TSR," explains Craigie, "but they don't really believe that what they do affects their stock price. They don't think they can manage it. At Church & Dwight, being TSR-oriented is a mindset that is woven into our culture—a mindset that is shared by me, my entire executive team, and, indeed, by every employee in the company. We are deeply committed to delivering attractive and sustainable TSR over the medium to long term."

A Healthy Business with Hidden Challenges

When Craigie joined Church & Dwight as CEO in July 2004, the company was financially healthy and already boasted a strong value-creation track record. But after a long period of delivering top-quartile TSR, it was unclear how the company could sustain that value-creation performance into the future.

In the latter half of the 1990s, Church & Dwight had delivered an average annual TSR of 21.1 percent through organic growth of its main Arm & Hammer brand and through margin improvement due to cost reductions. But a few years later, organic growth had slowed significantly. And, in order to boost the company's revenue and earnings growth, the previous management had taken on debt to fund new growth through acquisitions.

In the first few years of the twenty-first century, the majority of Church & Dwight's growth in revenue came from acquisitions, which helped the company produce a TSR of 14.9 percent from 2000 through 2004. But despite delivering a one-time boost to earnings per share (EPS), they didn't help raise the company's organic-growth rate—and the availability of acquisition targets large enough to really move the company's growth needle declined. With its valuation hovering at 22 times earnings, the company needed to find a new way to meet those high expectations and continue to deliver superior TSR.

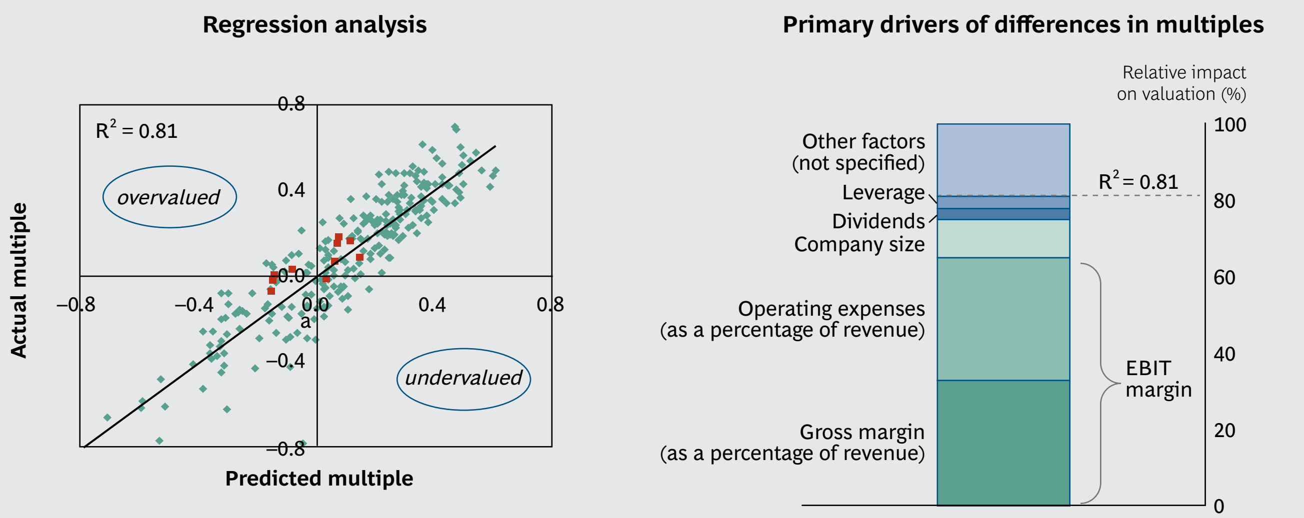
"The Gas in the Engine"

Clearly, increasing organic growth had to be part of the company's new value-creation strategy. But in early 2006, BCG's analysis of what was driving differences in company valuations among Church & Dwight's packaged-goods peer group helped Craigie realize that the appropriate path forward might be more complicated than he had initially thought.

In previous Value Creators reports, we described BCG's use of statistical regressions to identify correlations between the range of valuation multiples in a group of competing companies and a comprehensive set of financial and operational variables—including growth, margin, profitability, risk, sustainability, and uses of free cash flow.[1] The approach allows a company's executives to develop a statistical model that explains differences in valuation multiples in their industry and to take action to earn an improved valuation multiple relative to the company's peers.

Exhibit 4 shows the results of this analysis for Church & Dwight and its peer group in the period 1996 through 2005. The scatter plot on the left shows that the model BCG developed, based on statistical regressions of financial data from Church & Dwight and its peer group companies, predicted valuations that were a close fit with the actual valuations in the group, with an R2 of 0.81: 81 percent of the differences in valuation multiples in the group are explained by the model. The bar graph on the right shows that the most influential driver of differences in multiples in this group was the size of a company's gross margin as a percentage of revenue (responsible for 33 percent of the difference in multiples), followed closely by operating expenses as a percentage of revenue. In other words, all other things being equal, the higher a compa-

Exhibit 4 | A Focus on Gross Margins Was Key to Protecting Church & Dwight's Multiple



Sources: Compustat; BCG analysis.
Note: The scatter plot charts actual multiples for Church & Dwight and its peer group over the ten-year period from 1996 through 2005 against the predicted multiples derived from the regression analysis. The red squares indicate Church & Dwight's multiple for each of the ten years; the green diamonds indicate peer-group multiples during the same time period. R^2 stands for the coefficient of correlation between predicted and actual multiples.

ny's margins and the lower its operating expenses as a percentage of revenue, the higher its valuation multiple compared with those of its peers. Together, these two factors make up a company's EBIT (earnings before interest and taxes) margin.

Interestingly, this analysis suggests that in the fast-moving consumer goods sector, revenue growth is *not* a key driver of differences in valuation multiples, though it is an important contributor to TSR. Indeed, to the degree that growth comes at the price of eroding margins and increasing operating expenditures, it could actually cause a company's multiple to decline. Thus, if Church & Dwight chose to maximize its organic revenue growth without paying close attention to the impact of that growth on the company's gross margins, then the impact could be the *opposite* of what Craigie intended. Instead of sustaining the company's multiple, the changes could weaken it, and the company might lose more TSR in the decline of its valuation multiple than it would gain from the increased revenue growth.

Gross margin is a key driver of Church & Dwight's value-creation strategy.

The insights from the statistical regression analysis had a big impact on how Craigie and his management team thought about the path forward. It wasn't as if the Church & Dwight executives didn't understand that gross margins were important. But up until then, they had treated them as just one factor among many affecting the company's stock price and ability to deliver TSR. "The key insight was that gross margins are 'the gas in the engine,'" says Craigie. "They drive everything—revenue, profits, share-price appreciation, our valuation multiple, and TSR."

Of course, increasing organic growth remained important for Church & Dwight. When it came to value creation, however, not every dollar of earnings was created equal. The impact of each dollar on the company's valuation depended on how that dollar was generated—that is, whether it came from a business in which growth sustained high margins or from one in which growth came at the expense of eroding margins. "Before, most people at Church & Dwight thought of gross margin as the responsibility of operations," says Craigie. "Now, we see that growing gross margin is everyone's responsibility."

The Elements of a Comprehensive Strategy

The valuation multiple analysis led Craigie and his senior team to develop a more multifaceted and comprehensive value-creation strategy. It had four key components.

Transform the portfolio. Church & Dwight in 2005 was in a starting position very similar to that of the high-value-brand value pattern described in the 2012 Value Creators report. The company didn't just need more growth; it needed more high-quality growth. And to achieve it, the leadership team would have to transform the portfolio.

To do so meant investing in innovation to boost high-quality organic growth. Craigie created a dedicated new-product-development team to focus on value-added ways to grow the company's core businesses. This innovation effort extended the Arm & Hammer brand to more categories than any other brand in the U.S. and increased its annual revenue growth from 1 percent to 10 percent.

Additional acquisitions remained a key part of the company's transformation agenda, but only if they contributed to organic growth over the long term and to improvement in gross margins. It was no longer enough for an acquisition to be accretive to near-term EPS; the new business had to be accretive to TSR by delivering ongoing high-margin growth that would sustain the company's strong multiple. So the company's acquisition screen focused more on healthy businesses with good margins and strong long-term growth potential. In 2005, the company acquired the Spinbrush battery-operated toothbrush business from Procter & Gamble; in 2006, it bought Orange Glo International, the maker of OxiClean; and in 2008, it purchased Del Pharmaceuticals, maker of the oral pain reliever Orajel. Although more expensive, on average, than its previous round of acquisitions, these higher-margin businesses delivered not only attractive cost synergies but also a much bigger footprint in growing categories.

Finally, the weaker brands in Church & Dwight's portfolio had to become long-term contributors to TSR or else they would be sold or closed down. Craigie created what he called a "tiger team" to deal with the minor brands that were in decline and diluting earnings. Among the businesses the company has divested since 2004 are a small pet-products business and the Brillo brand.

As a result of this combination of initiatives, the Church & Dwight portfolio looks very different today than it did eight years ago. The strength of the portfolio is much more concentrated, with eight "power brands"—including Arm & Hammer, Trojan, OxiClean, Spinbrush, Nair, and Orajel—delivering 80 percent of the company's revenue and profits. The company's marketing spend is also much more focused on the company's 8 to 12 top brands, with the lion's share going to the power brands. In the process, gross margins—the gas in the engine—have increased from 39.1 percent in 2006 to 44.2 percent in 2011, and operating margins have grown from 13 percent to 18.1 percent.

Redraw financial policies. A second component of Church & Dwight's new value-creation strategy has been changes in the company's financial policies. Take, for example, dividends. At 13 cents per share in 2006, Church & Dwight had the lowest dividend yield (0.6 percent) among those of its peers that paid a dividend. Indeed, at the time, the company could have *tripled* its dividend and still only reached the median level of the S&P. And some competitors had yields of as much as 4.5 percent.

As Church & Dwight improved its margins and grew its most profitable brands, it began to generate the cash flow that allowed the company to raise its dividend substantially. In addition to representing a direct contribution to TSR, any increases in dividend payout also had the virtuous side effect of putting a floor under the company's market valuation. In February 2011, Church & Dwight dramatically doubled its dividend payout from 15 percent of net income to 30 percent, and in February 2012, increased it again to 40 percent.

Craigie trained his top managers in the logic and principles of TSR.

Institutionalize a TSR culture. At the same time that he was transforming the Church & Dwight portfolio and redrawing the company's financial policies, Craigie was also working hard to embed an understanding of, and orientation toward, TSR in the Church & Dwight culture. As in many other companies, managers at Church & Dwight had traditionally focused on delivering growth in operating income and EPS. But not all EPS growth necessarily contributes to TSR. A company can improve its EPS by chasing lower-margin, or even unprofitable, growth by engaging in share wars that erode margins and profitability or by making acquisitions that may be EPS-accretive but are TSR-dilutive.

To help them understand this distinction, Craigie trained his top 100 managers in the logic, principles, and analysis of TSR. He also redesigned the Church & Dwight incentive system to include criteria linked directly to a model of how a business unit's operational improvements actually contribute to TSR.

"My employees know that their efforts can directly affect our stock price," says Craigie. "The people who run my businesses have become millionaires—and they never expected it." The payoff has been a more stable and more senior management team. "I have only lost one of my top business unit leaders in the past eight years," explains Craigie. "Why? Because we are winning, and the stock price has tripled in the past eight years. They say, 'I'm not leaving Church & Dwight. I'm building a growing business, having a lot of fun—and getting rich at the same time.'"

Engage actively with investors. Having reinvented the company's business and financial strategies, Craigie focused on the last element in Church & Dwight's transformation: to make sure that its investor strategy was aligned with these changes. He began engaging more actively with the company's investors, being as explicit as possible about how the company intended to deliver attractive and sustainable TSR.

"When I first came to Church & Dwight," says Craigie, "we were more or less the Rodney Dangerfield of consumer-packaged-goods companies. We were tiny compared to the Procter & Gambles and Unilevers of the world. And while our investors liked our TSR performance, they didn't really understand what made us tick."

With the help of investor interviews conducted by BCG, Craigie came to understand that in order to build investor confidence in the company, he would have to "deal with the reality of the Wall Street environment" and start looking at the company the way that investors did. This meant developing a detailed, action-oriented, investment thesis that would deliver top-quartile returns and being clear and public about the "TSR math" that would allow the company to deliver on that thesis.[2]

Taking a page from the book of late-night TV host David Letterman, Craigie developed a presentation that he titled "Ten Reasons to Buy This Company." The reasons covered the logic underlying Church & Dwight's portfolio, including the central role of gross margins in driving TSR, the company's strategic and highly selective M&A strategy, the fact that Church & Dwight's free-cash-flow conversion—at more than 100 percent of net income—was best in class in its industry, and the TSR orientation of the workforce. "We had always set very high EPS targets in the past," says Craigie. "But now our investors understand how we plan to get there. And, then, we deliver on what we promise—top-quartile TSR."

The result: "Church & Dwight has gone from being the Rodney Dangerfield of consumer packaged goods to being a company that is admired by many and now featured by analysts as the top packaged-goods value creator. Investors and analysts understand how we operate the business and, as a result, have bought into our value-creation strategy. They have a much better understanding today of what makes us tick than they did in 2005."

A New Inflection Point?

As the old investment cliché goes, however, past performance is no guarantee of future results. Craigie and his team have had an incredible run. But how will they ensure that Church & Dwight continues to deliver superior shareholder value in the future?

"We're in a recessionary environment," Craigie says bluntly. "Nobody wants to call it that anymore, but it is. It's a dismal outlook in the world right now. We still target 10 percent earnings growth. How do we pull the right set of levers to get it? That's the chess game we are involved in out there."

But if Church & Dwight, like many other companies, is facing macroeconomic headwinds, the idea that the company may be at an inflection point in how it delivers value is nothing new. The fact is, Craigie and his team have become very good at refining their value-creation model to take into account new circumstances and the company's current starting position.

"Every two years we refresh the model," says Craigie. "In my time here, we have already shifted from emphasizing growth by acquisition to emphasizing organic growth and gross-margin improvement to emphasizing shifts in financial policy by increasing the dividend. So we'll probably have to emphasize something else again in the near future. Just as long as we never deviate from the underlying value-creation strategy." Odds are that Church & Dwight will find new ways to keep its foot on the gas.

Notes

1. See the section "Understanding Valuation Multiples" in *Avoiding the Cash Trap: The Challenge of Value Creation When Profits Are High,* The 2007 Value Creators Report, September 2007, pp. 13–16.
2. See "The CEO as Investor," BCG Perspectives, March 2012.

APPENDIX

Study Methodology

Our study is based on a sample of 208 global companies across four consumer-industry sectors: FMCG, consumer durables and apparel, retail, and travel and tourism. The rankings show the top ten companies within each of the four consumer sectors that we analyzed, and how the performance of those top companies compares with that of the total sector samples.

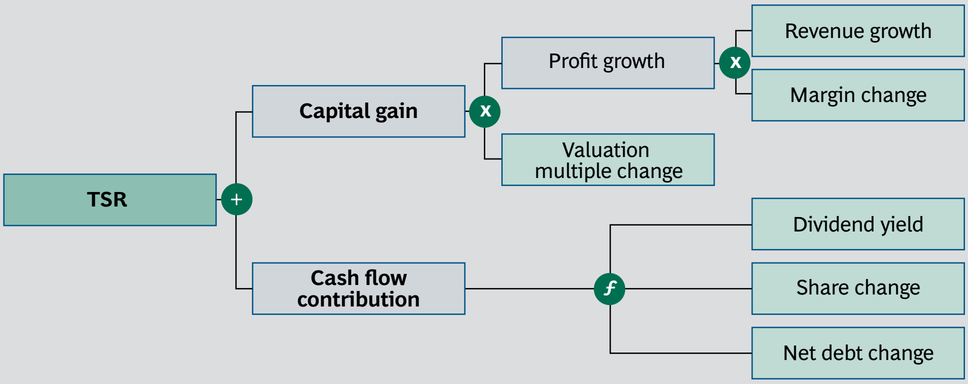
To arrive at this sample, we began with TSR data for more than 9,000 companies provided by Thomson Reuters. We then refined the sample by taking the following three steps: We eliminated all companies that were not listed on a world stock exchange for the full five years of our study or did not have at least 25 percent of their shares available on public capital markets. We also eliminated all companies that were not in the four sectors of the consumer industry we were tracking, to end up with about 1,000 companies. We then established an appropriate minimum market valuation hurdle for each sector to eliminate the smallest companies. This year's sample includes the 54 largest FMCG companies, the 57 largest consumer durables and apparel companies, the 58 largest retailers, and the 39 largest travel and tourism companies. We defined the largest companies by using the following sector-specific market-value hurdles (in U.S. dollars): FMCG companies with a market valuation of at least $9 billion, consumer durables and apparel companies with a market valuation of at least $2.5 billion, retail companies with a market valuation of at least $8 billion, and travel and tourism companies with a market valuation of at least $2.5 billion.

The rankings are based on five-year TSR performance from 2007 through 2011. We also show TSR performance for 2012, through June 30. In addition, we break down TSR performance into six investor-oriented financial metrics that BCG has identified in previous Value Creators reports as critical value drivers. The weighted-average annual TSR for the full set of 208 global companies in our sample was 5.4 percent. This performance (below the long-term historical average of approximately 10 percent) incorporates the precipitous decline in market values in late 2008 owing to the global financial crisis—a decline that the rebound in 2009 equity values only partly recovered. (See *Value Creators 2010: Rebound but Not Yet Recovery,* BCG report, March 2010.)

The Components of TSR

Total shareholder return is the product of multiple factors. Regular readers of BCG's Value Creators reports should be familiar with our model for quantifying the relative contribution of the various sources of TSR. (See the exhibit "TSR Is the Product of Multi-

TSR Is the Product of Multiple Factors



Source: BCG analysis.
Note: "Share change" refers to the change in the number of shares outstanding, not to the change in share price.

ple Factors.") The model uses the combination of revenue (that is, sales) growth and change in margins as an indicator of a company's improvement in fundamental value. It then uses the change in the company's valuation multiple to determine the impact of investor expectations on TSR. Together, these two factors determine the change in a company's market capitalization. Finally, the model also tracks the distribution of free cash flow to investors and debt holders in the form of dividends, share repurchases, or repayments of debt to determine the contribution of free-cash-flow payouts to a company's TSR.

The important thing to remember is that these factors all interact—sometimes in unexpected ways. A company may grow its earnings per share through an acquisition and yet not create any TSR, because the new acquisition has the effect of eroding the company's gross margins. And some forms of cash contribution (for example, dividends) have a more positive impact on a company's valuation multiple than others (for example, share buybacks). Because of these interactions, we recommend that companies take a holistic approach to value-creation strategy.

FOR FURTHER READING

The Boston Consulting Group publishes many reports and articles on corporate development and value creation that may be of interest to senior executives.

Improving the Odds: Strategies for Superior Value Creation
The 2012 Value Creators Report, September 2012

Enabling PMI: Building Capabilities for Effective Integration
A Focus by The Boston Consulting Group, July 2012

How Value Patterns Work
BCG Perspectives, June 2012

Value Patterns: The Concept
BCG Perspectives, May 2012

Back to the Future: Investors Refocus on Yield
The BCG 2012 Investor Survey, April 2012

The CEO as Investor
BCG Perspectives, March 2012

First, Do No Harm: How to Be a Good Corporate Parent
A report by The Boston Consulting Group, March 2012

The Power of Diversified Companies During Crises
A report by The Boston Consulting Group and HHL—Leipzig Graduate School of Management, January 2012

M&A: Using Uncertainty to Your Advantage
A Focus by The Boston Consulting Group and UBS Investment Bank, December 2011

Gaining a Value Creation Advantage in Volatile Times
The 2011 Consumer Value Creators Report, November 2011

No Time Like the Present to Plan an IPO
A report by The Boston Consulting Group, October 2011

Risky Business: Value Creation in a Volatile Economy
The 2011 Value Creators Report, September 2011

Riding the Next Wave in M&A: Where Are the Opportunities to Create Value?
A report by The Boston Consulting Group, June 2011

The Art of Planning
A Focus by The Boston Consulting Group, April 2011

Does Practice Make Perfect? How the Top Serial Acquirers Create Value
A Focus by The Boston Consulting Group and HHL—Leipzig Graduate School of Management, April 2011

Best of Times or Worst of Times?
A joint White Paper by The Boston Consulting Group and the Royal Bank of Scotland, January 2011

Threading the Needle: Value Creation in a Low-Growth Economy
The 2010 Value Creators Report, September 2010

Accelerating Out of the Great Recession: Seize the Opportunities in M&A
A report by The Boston Consulting Group, June 2010

Cross-Border PMI: Understanding and Overcoming the Challenges
A Focus by The Boston Consulting Group, May 2010

Megatrends: Tailwinds for Growth in a Low-Growth Environment
A Focus by The Boston Consulting Group, May 2010

After the Storm
The 2010 Creating Value in Banking Report, February 2010

Time to Engage—Or Fade Away: What All Owners Should Learn from the Shakeout in Private Equity
BCG White Paper, published with the IESE Business School of the University of Navarra, February 2010

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