Building a global brand

The Russian factor and a touch too much sun has meant a flat year for chocolate at Cadbury Schweppes. Confectionery stream managing director Ian Johnston speaks to Andrew Don about extracting more value.

The last financial year had its share of hair-raising moments for Ian Johnston. Economic upheaval in Asia and Eastern Europe, the collapse of the Russian markets last August - which also impacted on Germany France, and to a lesser extent in Spain and Poland - and adverse weather in other parts of the world, kept the 52-year-old Australian on his toes.

Total confectionery sales fell from £2.22bn in 1997 to £2.17bn last year on trading profit down from £282m to £280m.

Confectionery sales declined in the UK, the Americas, Pacific Rim and in Africa and other smaller markets. But sales in Europe climbed £26m despite the second-half Russian crisis which is classified within the region's figures.

It did not always follow that a decline in sales meant a fall in trading profits. UK trading profits climbed £2m to £134m and by £2m to £43m in the Americas but Europe was flat on £23m.

Underlying profit before tax for the whole Cadbury-Schweppes group - before disposals and exceptionals in 1997 and 1998 - climbed 11% to £609m at constant exchange rates. Disposals earned a pre-tax profit of £38m last year and there was a £68m exceptional charge mainly relating to the write-down of the confectionery assets in Russia.

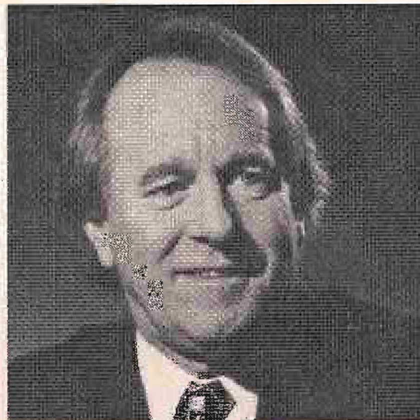
Johnston, who has been with the group 17 years, comes across as a man who takes it all in a day's work.

Those who know him describe him as friendly, down to earth and with an impressive grasp of detail.

In fact if he is ever criticised by chief executive John Sunderland, it is usually that he gets too close to the nitty-gritty and should take a step back from it.

Johnston loves the dynamism of confectionery and its ability to secure "quick results for your efforts in a marketing sense".

That said, his strategy is based on the long haul rather than the short, sharp sprints to which he is partial for his daily exercise fix.



Ian D Johnston - Managing Director, Confectionery Stream Cadbury Schweppes plc

He attributes to himself the ability to bounce back "when things sometimes do not go as well as you hope" - a resource he will have needed to draw on last year.

Last December saw Cadbury-Schweppes agree to sell most of its beverages brands and concentrates plants outside the US, France and South Africa to The Coca Cola Company for US$1.85bn (£1.1bn) which will net a profit over book value of about £650m.

> No plans to compete more broadly in the U.S.

The group also announced the proposed separate sale of the associated bottling assets and a number of minor brands over the next year which is expected to raise at least a further £500m.

These businesses accounted for less than 9% group trading profit before exceptional items so beverages will still account for more than 52% of overall group trading profit.

But the group sells more confectionery in value terms even though beverages produce more profits. Beverage sales were £1.937bn last year compared with confectionery sales of £2.169m. Beverage trading profits were £82m higher than confectionery's at £362m.

The longer-term options in Russia are still up for discussion. Johnston says: "The longer-term pretty well depends on what your view is about the stability of Russia and whether the Russian economy is going to grow again and whether it will always be in turmoil. I think we are confident enough to say Russia will show improvements."

Russia has the second largest confectionery volume sales outside of the US and Johnston says the company has quickly taken steps to limit future damage.

It now pays its Russian salesforce based heavily on commission rather than a flat salary, there are more direct van sales - many of the distributors have disappeared - and it is sourcing everything it can within the country rather than expose itself again to foreign exchange currency market translations.

But he adds that the fall-out has spread this year to markets such as South Africa, Brazil and other South American countries.

Adverse weather conditions hit confectionery last year in New Zealand, Australia and some smaller markets such as Egypt which endured prolonged exceptional heat.

Chocolate sales were below expectation in the UK although sugar confectionery did well.

"If you take that context our performance was very strong and very

Cadbury Schweppes' U.S. drinks business booms

Cadbury Schweppes American soft drinks business - Dr Pepper/Seven Up (DPSU) - is the lynchpin of the company's success. It accounts for 30% of Cadbury Schweppes sales and 50% of all profits. You can expect that John Broek, managing director of Cadbury's Beverages Stream, breathed a sigh of relief when the first quarter sales came in.

As the table shows, DPSU turned in an excellent performance across the board, outpacing market growth by 50%. Particularly impressive was the flagship Dr. Pepper brand, the biggest brand in the portfolio, which grew at two-and-a-half times the market growth rate.

CS is now reaping the benefits from steps it took last year to "fix" its U.S. distribution. A year ago CS was struggling with a fragmented distribution system over which it had little control. Accidents of history meant that some DPSU brands were being distributed by Coca-Cola, others by PepsiCo and others by independent bottlers. A 2% fall in 7-Up sales in the first half of 1998 rattled investors and was blamed squarely on distribution problems. Cadbury promised they would get their bottlers to perform and they have been true to their word.

Cadbury has put some good distribution deals together. For example, it signed a seven-year distribution deal with Coca-Cola Enterprises for Dr Pepper. For CCE Dr Pepper is an important brand because, as it is neither a cola nor an orange drink, it adds to CCE's portfolio. In another deal CS created American Bottling Corp, a joint venture with Carlyle group, to take control of its own distribution in the mid-West.

Cadbury Schweppes' U.S. ambitions got a further boost in April when it agreed to buy Hawaiian Punch from Procter & Gamble for $203 million. The deal was first rumoured in October last year. Hawaiian Punch had sales to the year ending June 1998 of $131 million. Hawaiian Punch will be integrated into the Dr Pepper/7Up portfolio.

Cadbury Schweppes still has a long way to go in re-structuring its U.S. distribution and it is still only a distant third-place in the U.S. market (see Table 2) but it has demonstrated what it is capable of when it rolls up its corporate sleeves. Expect more good news yet.

TABLE 1 - DPSU BRAND GROWTH, Q1

Brands	Growth
Dr Pepper	+5%
7 Up	+5%
A&W	+7%
Sunkist	+20%
Squirt	+3%
Welch's	+8%
Canada Dry	+8%
Country Time	+32%
Total DPSU	+3%
Total market	+2%

TABLE 2 - U.S. SOFT DRINKS MARKET SHARES

Coca-Cola	43.9%
PepsiCo	30.9%
Cadbury Schweppes	14.5%

Competition intensifies in Latin American margarine market

A local manufacturer claims to be challenging Unilever's lead in the world's third largest spread (margarine) market. According to Gazeta Mercantil, Brazil's business newspaper, Saadia, Brazil's biggest food group, has built up an 18% share of the country's $850 million spead market with its Qualy brand. As elsewhere, the market is dominated by Unilever, with 49% share, through its Gessy Lever operation.

Saadia is said to have plans to invest $30 million to set up a new margarine production facility at Duque de Caxias, Rio de Janeiro. Rival Santista, the second-biggest player in the market, which had total sales of Reals1.5 billion ($880 million) in 1998, is fighting back by investing Reals 2.5 million in advertising and promotion in 1999 to back its "All Day" margarine brand.

Only America (over $2 billion) and Germany (c.$1.9 billion) have bigger spread markets than Brazil.

BRANDS IN BRAZIL'S MARGARINE MARKET

	Manufacturer Share	Brand share
Gessy Lever (Unilever)	49%	
- Doriana		14.1%
Santista	27.8%	
- Delicia		7.7%
- Bonna		0.3%
Saadia	23.2%	
- Qualy		18.1%
- Deline		5.1%

News Digest

Continued from page 12

market, retail consolidation and competition are likely to make it tough for some time to come. The company has also been left behind in innovation by rival Mars. Hershey's share price of $54 is well below the high of $75 it achieved back in October. Sadly for Hershey it may go lower yet.

U.S. COMPANY AIMS TO DOUBLE SHARE IN JAPAN

Swift and Co, the fresh pork arm of U.S. food processing giant ConAgra, said it aims to double its share of the Japanese import market for U.S. pork in two years. The company's share is currently 11-12%. The company believes it can achieve this by improving its quality and increasing the variety of cuts and meat it offers to Japanese consumers. The company also emphasised the importance of food safety to its business strategy, adding that the company coordinates microbiological testing with its clients, especially in Japan, to ensure the long shelf-life necessary to maintain quality during the transportation of the product.

OATS AND DRINKS SALES RISE BOOSTS QUAKER PROFITS

Quaker Oats Co. saw first-quarter operating profit rise a better-than-expected 35% to $152.3m as hot cereal sales rebounded and its Gatorade drink brand posted strong off-season results. Hot cereal sales volume rose 15% in the first quarter, a dramatic recovery from a disappointing fourth-quarter when sales were hit by an unusually warm winter and fierce competition from lower-priced private label brands. Surprisingly, Gatorade profits rose 20% to $27.8m in the first quarter on sales up 14% to $336.7m. The big surprise is that the first quarter is typically a slow period for the sports drink which enjoys its strongest sales in the summer months. Although sales actually fell 28% in Latin America - largely as the result of Brazilian devaluation - the fall was more than offser by a 30% gain in the U.S. and Canada. Quaker Oats urged analysts not to ratchet up earnings expectations for the full year. "We've got one very strong quarter under our belts and we're feeling good about that," said Robert Morrison, CEO, pointing to the fact that there were three more uncertain quarters to go.

acceptable," says Johnston.

The company has cash to spend following the Coca-Cola deal. Speculation has linked it to an acquisition of Hershey to elevate it from fourth place in the world rankings behind Nestle, Mars and Kraft Jacobs Suchard.

Cadbury already has a U.S. presence through a licensing agreement for products such as Creme Eggs and branded block tablets with Hershey and through its acquisition of the companies that now make up Trebor Allan in Canada. Trebor has given the company a presence in the U.S. sugar confectionery market of a little less than 1%.

Johnson says he has no plans to compete more broadly in the US than that. "Everyone longs for the magic 1% of the US. We are quite pleased with the way our relationship with Hershey goes and our modest slowly growing sugar business is progressing and for us that is a sufficient exposure and involvement."

Future strategy is based on growing strong positions in important markets by organic growth and by acquisitions and to strengthen key brands by strong investment in marketing and innovation.

With our managing for value philosophy we are very selective about where we want to be involved

The managing for value concept has been incorporated for the last 18 months with the aim of increasing earnings per share by at least 10% annually, generating £150m of free cash flow every year and doubling the value of shareholder investment within four years.

The confectionery stream has manufacturing plants in 25 countries and sales in a further 170. The latest on board is Wedel, Poland's leading chocolate producer for $77m. Johnston gives the impression that there are no other major acquisitions on the immediate horizon but stresses that he would look at any acquisition which enhanced shareowner value.

Some analysts cite Lindt as a possible target, to which Johnston says: "If there were businesses like Lindt available we would, like many others, have a close look but I am not aware it is for sale.... We would look at any European business as we would look at any business around the world. But with our managing for value philosophy we are very selective about where we want to be involved."

Johnston points out the world's top six confectionery players have less than a 50% share of the global market. "One would have to say that in the medium to longer term there will be consolidation and we would see ourselves as participating in that consolidation. We don't have to make a very big acquisition. We have the scale and spread of operations to make us a viable strong vibrant aggressive player around the world and we are market leader in many of our countries in which we operate."

He believes developing countries hold great opportunity, investing in places such as Egypt, India and Africa. Cadbury has built a green field factory in Beijing, China, which although loss-making since opening, is on-track to break even next year.

"We are now in something like 23 cities in China with our own salesforce. Although small in volume, the growth rates are fantastic, doubling each year.

"In places like Indonesia we are busy building our brands and position for the future and consolidating our position. We were hurt in 1998 but we have come out of the year a lot stronger than people might have hoped. Russia could well have the same pattern."

Johnston has no grand ambitions to play catch-up with Nestlé. "We are interested in being a value creating company. There are few major markets in the world in which we do not participate but there are a small handful of large markets where our involvement is small such as Brazil, Mexico and some of the Eastern European countries and Japan. In each of those we have at the moment different arrangements for marketing and selling our products and I would think it is likely we will continue to develop in that way rather than any other in the future."

TOP 10 GLOBAL CONFECTIONERY MARKET PLAYERS, SHARE BY VALUE (EUROMONITOR)

Company	Share
Nestlé	9.4%
Mars	8.6%
KJS	6.0%
Cadbury	5.3%
Ferrero	4.7%
Hershey	4.6%
Warner-Lambert	4.3%
Wrigley	3.4%
Lotte	1.9%
RJR Nabisco	1.9%

He says it is unlikely Cadbury's will build any new factories. He wants to build both global and local brands. "We are interested in building global brands but we are pragmatic enough to know that in acquiring businesses around the world we have also acquired some strong local brands so we do need both."