

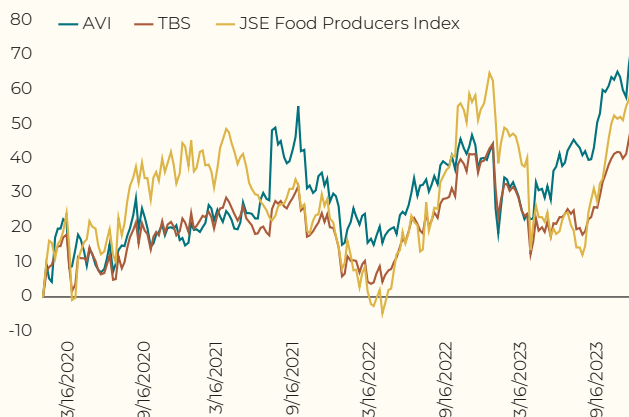
# Portfolio Watch

February 2024

## AVI: THRIVING THROUGH TURBULENCE WITH STRATEGIC AGILITY

Amidst persistently high inflation levels during 2023, global food producers grappled with formidable challenges, with South Africa experiencing particularly harsh conditions. With soaring input costs, many companies were forced to sacrifice volumes to protect margins. However, in the midst of this economic turmoil, one food industry leader, AVI, proved to be more resilient than peers. While competitors adopted defensive measures to weather the storm, AVI skilfully navigated the environment, demonstrating both resilience and agility. Unlike other companies that saw inflation as a single threat, AVI recognised it as a multifaceted challenge requiring a nuanced response. Consequently, rather than merely surviving, AVI is now strategically positioned to thrive as economic conditions stabilise.

Graph 1: AVI's total return (%) relative to peers (Tiger Brands and the JSE Food Producer's Index) – 2020-2023



Sources: Refinitiv Datastream, Private Clients by Old Mutual Wealth



**BIANCA LAKHA**

Junior Analyst at Private Clients by Old Mutual Wealth

### THE POWER OF DIVERSITY AND INNOVATION

AVI is more than just a food producer – it is a major player in the local Fast-Moving Consumer Goods (FMCG) market. This well-diversified business boasts an extensive portfolio of over 50 brands, many of which are deeply ingrained in SA culture, spanning various categories. These include Food & Beverages (Five Roses tea, Frisco coffee, I&J frozen foods and Bakers biscuits); Personal Care (Yardley and Exclamation fragrances) and Fashion (Lacoste apparel, Gant and Tosoni footwear).

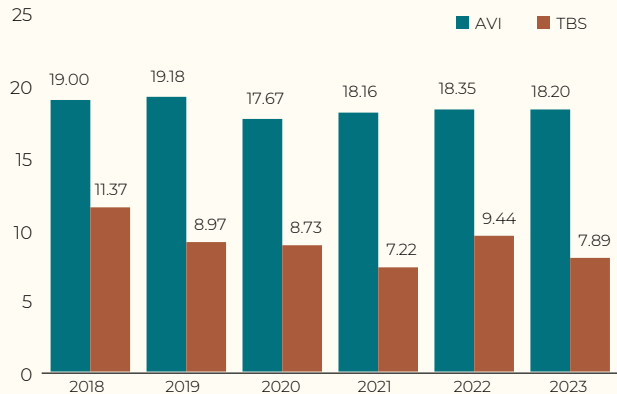
Unlike many food producers with fewer categories, AVI's diverse portfolio became its anchor. When inflationary pressures squeezed one segment, others provided a ballast, enabling the company to adjust prices and product offerings without sacrificing consumer loyalty. This strategic approach allowed AVI to gain market share through a challenging period when its peers struggled.

In addition to diversity, innovation has helped AVI defend margins, with its focus on value-for-money packs in certain segments, catering to price-sensitive customers, being an example of this.

### CATCHING THE TIGER BY THE TAIL

Within the local FMCG scene, AVI and Tiger Brands are the market leaders, each adopting distinct operational philosophies and efficiency approaches. AVI, with its diversified portfolio across segments and products, contrasts sharply with Tiger Brands, which primarily focuses on essential foods such as grains, baking products and processed foods. And while this concentration offers economies of scale in production and distribution, it limits Tiger Brands' reach, making it vulnerable to changes in both commodity prices and consumer preferences.

Graph 2: Operating Margins in AVI & Tiger Brands (%)



Sources: Company data, Private Clients by Old Mutual Wealth

In terms of operations, AVI prioritises agility and innovation, which manifests in value-engineered products. This enables the company to adapt to evolving market demands and navigate cost pressures. Tiger Brands, on the other hand, leverages strong supply chain management and vertical integration. This optimises production processes, minimises external dependencies, and ultimately leads to cost control and operational efficiencies. While both approaches are commendable, AVI's financial metrics highlight the efficacy of its approach.

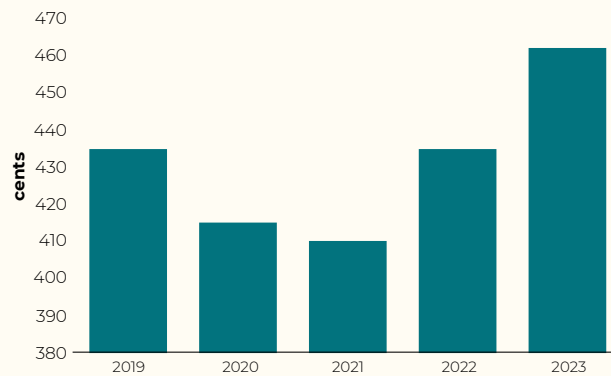
### METRICS THAT MATTER

In the face of market pressures, AVI maintained a healthy average return on equity (ROE) of 36% during 2023, showcasing its adept resource management and proficient profit generation. This is more than double Tiger Brands' average ROE of 15% over the same period.

Notably, during periods of economic downturns, AVI's revenue has been more resilient than peers, with its profit margins serving as a testament to its strategic pricing across a broad range of brands. As shown in graph 2, Tiger Brands' margins are consistently lower, due to its less diversified portfolio and reliance on commodity-related products, which leaves little room to pass on inflation.

AVI has long been an investor favourite due to its attractive dividend yield. Before 2020, AVI consistently grew its dividend, with its dividend yield in excess of 4%. However, in 2021 AVI's dividend per share was 6% lower than in 2019, reflecting the challenges posed by the COVID-19 pandemic. Demonstrating a commitment to long-term dividend sustainability, management prioritised prudent financial management and implemented cost-cutting measures to protect cash flow, enabling them to

Graph 3: AVI dividend per share



Sources: Company data, Private Clients by Old Mutual Wealth

pay higher dividends post the pandemic. This robust dividend profile played a key role in our decision to include AVI in our Equity Income Portfolio, which is designed to balance long-term capital growth with a steadily growing income stream.

### PRIVATE LABELS: TAILWIND OR DISRUPTOR?

While the proliferation of supermarket private label ranges during the past few years has undoubtedly challenged food producers, private label products can also present opportunities. Typically, private label products are cheaper than their branded counterparts. Therefore, if AVI were to lower their prices to compete with private label products, margins would come under pressure, potentially resulting in increased competition as supermarkets could lower their prices even further. Furthermore, in an inflationary environment where consumers are particularly cost-conscious and therefore susceptible to downtrading, private label products have the potential to significantly erode AVI's market share.

That said, every challenge is also an opportunity for growth. Through innovation, AVI would be able to counter private label competition by offering unique features, higher quality ingredients, or convenience factors that justify its higher price. Strategically focusing on premium segments, where consumers prioritise value and quality over price, is another avenue of potential growth for AVI. Additionally, forging special collaborations with supermarkets to develop exclusive private label ranges could yield significant benefits for both AVI and the partnering supermarkets.

In essence, while private label competition is likely to persist, even as inflation recedes, AVI can maintain a competitive edge by leveraging its strengths in innovation, brand equity and partnerships.

### A SURVIVOR AND A THRIVING FORCE

In the face of a challenging trading environment that tested the mettle of many companies, AVI has undoubtedly demonstrated its resilience and strength. We believe that the company's diverse portfolio, focus on innovation, strong brand equity and commitment to operational efficiency will continue to equip it to adapt to evolving consumer preferences and economic conditions. As inflation subsides, AVI's adaptability and resilience are poised to drive it to greater heights, further solidifying its leadership in the local FMCG market.

Private Clients  
by Old Mutual Wealth

Old Mutual Wealth Private Clients (Private Clients) is a division of Old Mutual Wealth Trust Company (Pty) Ltd ("OMWTC"), a licensed Financial Services Provider, Reg No: 1925/002721/07. Private Clients is authorised to provide financial services on the OMWTC licence.

To report unethical behaviour, call the Anonymous Reporting line 0800 222 117, email [toahotline@tip-offs.com](mailto:toahotline@tip-offs.com) or visit [www.tip-offs.com](http://www.tip-offs.com).

Old Mutual Wealth, Mutualpark, Jan Smuts Drive, Pinelands, 7405 | Tel: +27 (0)21 524 4678 | Email: [privateclients@omwealth.co.za](mailto:privateclients@omwealth.co.za)

This document is for information purposes only and does not constitute financial advice in any way or form. It is important to consult a financial planner to receive financial advice before acting on any information contained herein. Old Mutual Wealth and its directors, officers and employees shall not be responsible and disclaims all liability for any loss, damage (whether direct, indirect, special or consequential) and/or expense of any nature whatsoever, which may be suffered as a result of or which may be attributable, directly or indirectly, to the use of, or reliance upon any information contained in this document.