Portfolio Watch

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INTRODUCING KENVUE INC: JOHNSON & JOHNSON'S SPINOFF

Johnson & Johnson(J&J) recently embarked on the largest restructuring in its 135-year history by spinning off and listing its consumer health segment, Kenvue Inc. The listing was well received by the market, with Kenvue's share price rising by 22% from its initial public offer (IPO) price on the day it came to market. With a market capitalisation of about US$50 billion, Kenvue also became the largest US IPO in over a year, a notable feat given the current challenging market environment for new listings.

In part, the enthusiasm from investors was due to the limited number of shares available. J&J still owns 90.9% of Kenvue and has committed to reducing its stake later this year by way of a dividend distribution to shareholders. However, one immediate benefit of having Kenvue listed separately is that investors are now able to better gauge how attractive this consumer health business is compared to peers such as Procter & Gamble (P&G), Unilever and Reckitt.

REPUTABLE BRANDS

While the name Kenvue is unrecognisable to most people, the group's products and brands are well-known and pervasive. Kenvue is split into three segments, namely, Self-Care; Skin Health & Beauty; and Essential Health. In each of these segments, the business owns brands with leading global positions in their respective categories. Examples include Neutrogena, Tylenol and Listerine. Importantly, each of these three brands is the most recommended brand by healthcare professionals in the US (Tylenol for adult pain medication, Neutrogena for acne and Listerine for mouthwash). Given the strong influence of professional recommendations on consumer purchasing decisions, this metric augurs well for the brands maintaining their leading positions.

KENVUE'S LEADING BRANDS

	Selected Brands	Selected Leadership Positions		
Self Care	Tylenol, Nicorette, Zyrtec, ORSL, Motrin, Zarbee's Naturals, Calpol	Tylenol #1 Pain Brand Globally	Nicorette #1 Smoking Cessation Globally	Zyrtec #1 Allergy Brand Globally
Skin Health and Beauty	Neutrogena, Aveeno, OGX, Dabao, Le Petit Marseillais, Lubriderm, Dr.Ci:Labo, Rogaine	Neutrogena #1 Facial Care Brand in the U.S	Neutrogena #1 Sun Care Brand Globally	OGX #1 Premium Hair Care Brand in the U.S.
Essential Health	Listerine, Johnson's, Band-Aid, Stayfree, o.b., Neosporin, Desitin, Carefree	Listerine #1 Mouthwash Brand Globally	Johnson's #1 Baby Toiletries Brand Globally	Band-Aid #1 Adhesive Bandage Brand Globally

Source: Company reports

Across its portfolio, Kenvue has 10 brands that generate more than US$400m in annual revenue, with seven holding the number one position globally in their categories.

One area of differentiation is that Kenvue's portfolio is exclusively focused on health products. Unlike peers such as Clorox, Unilever, and P&G, Kenvue's brand portfolio is largely made up of over-the-counter health products that consumers are familiar with. As such, with approximately US$15 billion in annual revenue, Kenvue offers investors the largest pure exposure to the consumer health theme via branded products.

PRODUCT INNOVATION TO BOOST GROWTH

The consumer health market continues to benefit from several long-term tailwinds. An ageing population, a growing middle class in emerging markets, premiumisation and increased consumer consciousness of preventative health and wellness are all drivers that we expect to continue to support growth in the coming years. According to Euromonitor, a market research firm, the consumer healthcare market is estimated to be US$369 billion in size. During the COVID-19 pandemic (2019 – 2022), the sector grew at a compound annual growth rate of 4.8%.

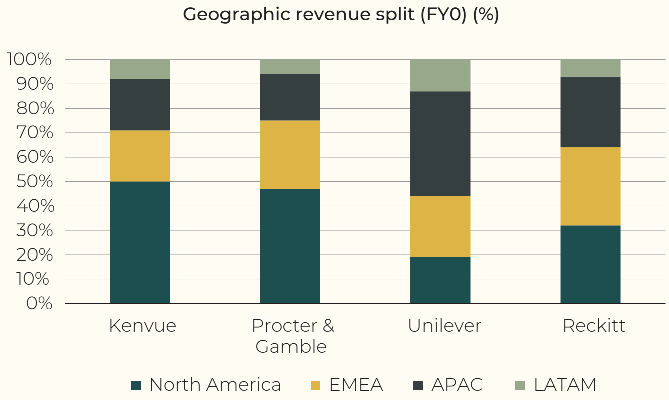
Over the coming three years, industry growth is expected to slow down to between 3% - 4% as some of the pandemic tailwinds abate. While we believe that the sector remains defensive, this expected growth rate is pedestrian, highlighting the need for companies to innovate in order to grow market share.

With its origins in J&J, Kenvue boasts a long, proven history of strong product innovation. For example, the group created the first adhesive bandage category in 1921, a product that remains a global leader today through the brand Band-Aid. Furthermore, the group continues to invest heavily in research and development and has introduced more than 100 new product innovations since 2020. The estimated revenue from product innovations launched during the preceding three-year period has accounted for about US$1.5 billion of revenue each year since 2020. We expect this innovative culture to stand Kenvue in good stead.

STACKING UP AGAINST PEERS

With approximately half of its revenue generated from North America, we estimate that among its peers, Kenvue's geographic diversification is most akin to P&G. Both businesses generate the bulk of their profits from developed markets, versus Unilever for example, which generates over 40% of its revenue from emerging markets.

Graph 1: Geographic exposures



Source: Refinitiv/OMW Private Clients estimates

However, when considering how Kenvue ranks relative to peers on several quality metrics, the results are mixed. For example, while Kenvue's gross margins are higher than peers (likely due to its pure exposure to consumer health), the group has lower operating and EBITDA margins, showing that its operations are not as efficient as the industry leaders. As a result, the group's profitability (return on equity) lags peers. Positively, the group's cash generation ability is superior, however, given its limited history as a standalone entity, it will take time to get a clearer sense of how cash conversion compares with peers over time. While operating margins are currently lower than peers, a reoccurring trend we see across business that are spun out from larger entities is that they improve as standalone businesses. This trend is often attributed to management of the new standalone company being able to allocate capital without the constraints of their parent company. As a result, we will be watching Kenvue's margins and profitability closely in the coming quarters, with the expectation of an improvement.

Despite the share price increase post the IPO, it is worth noting that Kenvue's relative valuation metrics are not far off its peers. At present, Kenvue is trading at a lower multiple than P&G and similar to Unilever and Reckitt. We view this as reasonable, given the overhang stemming from the litigation from baby powder lawsuits and J&J's intention to distribute the remainder of its shares.

METRICS ACROSS SELECT CONSUMER HEALTH COMPANIES

	Kenvue	Procter & Gamble	Unilever	Reckitt
Market cap (US$bn)	50.1	366.0	140.4	58.3
Revenue (US$bn)	15.0	81.0	63.1	18.9
EBITDA (US$bn)	3.6	21.1	12.0	4.8
EBITDA margin	24%	26%	19%	25%
Operating margin	17.9%	22.2%	17.6%	22.3%
Gross margin	55.8%	47.7%	40.2%	57.9%
Return on Equity	10.3%	31.7%	42.3%	27.8%
EV/EBITDA multiple	13.5	18.9	13.9	13.8
P/Cash flow multiple	19.82	22.0	18.23	17.41
Trailing PE multiple	21.0	26.7	20.3	18.9
Operating cash conversion	121%	113%	88%	74%
Free cash flow conversion	103%	92%	67%	60%

Source: Refinitiv/OM PCS estimates

THE ELEPHANT IN THE ROOM

One of the key questions leading up to Kenvue's spinoff was whether the company will carry the potential liability related to the ongoing lawsuits arising from baby powder products containing talc. Kenvue's separation agreement with J&J indemnifies Kenvue of all talc-related liabilities from the US and Canada. Given that most of the claims have arisen from the US, the expectation is that J&J will bear most of this risk. However, Kenvue will be liable for any claims outside these two countries.

Recent news that J&J secured a commitment to settle more than 60 000 of the approximately 90 000 claimants in the US for US$8.9bn payable over 25 years was widely regarded as a positive step towards a resolution. While the talc liabilities remain a risk to both J&J and Kenvue, the recent commitment to settle by most claimants increases confidence that a full resolution is possible within a reasonable time frame.

THE BOTTOM LINE

Despite increased market uncertainty, Kenvue's IPO was well received. We expect the group's exposure to the attractive consumer healthcare sector, coupled with its well-known brands to provide stable defensive earnings over the coming years. However, given the slowdown as sector tailwinds abate post-COVID, we see continued R&D and new product launches as a prerequisite for the group to grow ahead of peers. Currently, valuation relative to peers appears reasonable and takes the uncertainty related to the possible talc liabilities outside the US and Canada into account. For now, we attain exposure to Kenvue through J&J's 90.9% shareholding.

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