

# Fighting Inflation with Pricing Power

May 2021



## Overview

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Global economies have been severely gutted by the Covid 19 pandemic since early 2020. The healthcare crisis led to a deflationary environment as economic entered lockdowns and spending came to a halt. However, with the ongoing vaccine rollout across the globe, economies are gradually reopening and recovering. The focus has suddenly shifted to rising prices and potential inflationary concerns with rising commodity prices and supply chain disruptions. It is evident that in a post Covid reflationary environment, these rising costs and constraints would negatively impact a company's profitability margins.

In such a scenario, it becomes crucial to look out for segments/corporations which provide unique products & services with little competition. It is these companies which are able to raise prices without affecting demand, thereby protecting margins. They would also benefit from the sharp recovery in economic growth led by pent up demand as accumulated savings are unleashed.

In this report, we present to you certain names from different sectors that can withstand inflationary pressures better as they have capacity to exploit any sudden surge in demand. It has been seen historically that stocks with better pricing power outperform when inflation is rising which looks like a plausible scenario moving ahead.





# Ubisoft Entertainment SA (UBI FP)

Ubisoft is a French video game company and one that operates in a competitive marketplace, and that said, it still enjoys an element of pricing power due to:

- **Their explicit focus on high quality AAA franchises** at the front-end of their catalogue, supported by ever increasing production budgets put them at the top end of the quality curve in terms of the types of games available in the marketplace and, at a market level, we see pricing for premium games moving up (the most recent step has seen premium titles move from \$60 per unit ASP to \$70).
- For game franchises which are already established and for which there is an **in-game monetization channel**, there is also scope to drive increased yield via downloadable content (DLC) packs and Season passes. Although technically yield rather than straight pricing, the net effect on their business is the same- more revenue from the same consumer.
- **The move at a market level toward more digital sales** (away from physical retail) as well as the proliferation of digital storefronts (including via Uplay, their own digital storefront) is reducing the take rate for third party distributors and driving a higher rate of monetization/gross margin for Ubisoft as a publisher/developer.



Mkt Cap (M)	Last Price	YTD %	5-Yr CAGR	FCF Yield	EV/EBITDA	Country
6722.54	54.40	-31.00	12.57	12.90	7.34	FRANCE
Div. Yield	Fwd PEG	Fwd P/E	ROE	Net Debt/EBITDA	Price/Sales	Sector
	0.91	18.58	6.94	0.24	2.92	Communication Services





## DuPont de Nemours (DD US)

DuPont's specialty chemicals business is among the best in the world, developing products such as Kevlar and Tyvek that command pricing power and generate healthy profit margins.

- The group benefits from the **ability to produce patented specialty chemicals that command pricing power**, and these products tend to have a wide range of applications across multiple industries. For example, in the water and protection business, Kevlar, a proprietary product, has become the material of choice for military and law enforcement safety and protection. Similarly, Nomex is the material of choice for firefighters due to its heat resistant properties. Tyvek is the market-leading housewrap material.
- For these products and others, **DuPont develops multiple versions for end markets**, with products such as Kevlar and Nomex being used in both consumer and industrial applications. Even when a product goes off patent, the company creates new applications for that product that allow premium prices to be maintained. Although Kevlar started as a material used for safety and protection, the material is now used in aerospace and automotive vehicles, consumer products, fiber optics, and in adhesives, sealants, and coatings.
- DuPont has proven the ability to continually generate new products. This keeps **profit margins** elevated as patents expire and competitors develop generic substitutes. The company's specialty chemicals portfolio, which demands elevated margins, enjoys **higher barriers to entry** and has stickier customer relationships.



Mkt Cap (M)	Last Price	YTD %	5-Yr CAGR	FCF Yield	EV/EBITDA	Country
44295.53	83.24	17.06	5.12	6.23	42.50	UNITED STATES
Div. Yield	Fwd PEG	Fwd P/E	ROE	Net Debt/EBITDA	Price/Sales	Sector
1.44	0.91	19.26	9.17	5.50	3.06	Materials





## Nike Inc (NKE US)

Nike is the world's leading sporting goods company, marketing, innovation and performance product powerhouse, dominating the global footwear market with a 27% share. Its pricing power comes from:

- **Sector growth fueled by global Health & Wellness movement**, increased sporting events, and increase casualization of apparel (athleisure/streetswear trend) driving growth in lifestyle segment (~30% of sales)
- **Digital business** only 15% of sales but is growing strong double digits (+54% F3Q21, >35% of group sales) as NKE pushes Direct-to-Consumer strategy via own website and dedicated apps (SNKRS, Nike) while decreasing wholesale exposure (65% FY20 vs 77% FY15).
- **Attractive Direct-to-Consumer channel economics** (E-comm EBIT dollars are 2 times the Wholesale) is a clear driver of margin leverage (4% expansion expected by consensus over 2021-2025); near term China demand headwind (cotton controversy) to weigh on shares but offers attractive entry points.



Mkt Cap (M)	Last Price	YTD %	5-Yr CAGR	FCF Yield	EV/EBITDA	Country
214764.92	135.93	-3.92	20.26	1.79	42.33	UNITED STATES
Div. Yield	Fwd PEG	Fwd P/E	ROE	Net Debt/EBITDA	Price/Sales	Sector
0.81	0.91	34.33	32.68	0.06	5.54	Consumer Discretionary





# Continental AG (CON GY)

Continental AG is one of Europe's largest manufacturers of tires for cars, trucks, motorcycles, agricultural and construction vehicles.

- Continental's **consistent product or process technology innovation**, combined with the ability to commercialize new technology, enables more favorable pricing relative to many automotive industry suppliers overall. Suppliers cannot simply cost-cut their way to prosperity and must support measures to expand the top line.
- In Germany, Continental is in the **top third of the most active patent applicants**, and for all of Europe, the EU patent office says the company is among the top 50 of all patent filers.
- Automakers are willing to pay for components and systems that provide **substantial product differentiation**, weight reduction, enhanced safety, reduced cost, or a unique cost-effective solution to meeting regulatory requirements.
- Pricing power is further enhanced for suppliers with **diverse customer bases** in varying geographic locations as innovative technology can then be reserved for customers that are willing to meet the suppliers' pricing objectives



Mkt Cap (M)	Last Price	YTD %	5-Yr CAGR	FCF Yield	EV/EBITDA	Country
22948.69	114.74	-5.37	-7.00	7.04	11.20	GERMANY
Div. Yield	Fwd PEG	Fwd P/E	ROE	Net Debt/EBITDA	Price/Sales	Sector
	0.91	10.11	-5.64	1.55	0.63	Consumer Discretionary





# Merck & Co. (MRK US)

Patents, economies of scale, and a powerful intellectual base buoy Merck's business and keep it well shielded from the competition.

- As the bedrock of Merck's wide moat, **patent protection** should continue to keep competitors at bay while the company strives to introduce the next generation of drugs.
- Further, the company's **enormous cash flows** support a powerful salesforce that not only sells currently marketed drugs, but also serves as a deterrent for developing drug companies seeking to launch competing products.
- Also, the company's **entrenchment in the emerging immunology area** should strengthen Merck's competitive position with drugs that carry very strong pricing power in areas of unmet medical need.
- Investors can expect **improving margins** over the near term as overall sales are represented by more specialty-oriented drugs that carry strong pricing power and need less marketing support.



Mkt Cap (M)	Last Price	YTD %	5-Yr CAGR	FCF Yield	EV/EBITDA	Country
198234.85	78.29	-4.29	10.87	3.28	20.72	UNITED STATES
Div. Yield	Fwd PEG	Fwd P/E	ROE	Net Debt/EBITDA	Price/Sales	Sector
3.32	0.91	10.96	26.45	2.26	4.13	Health Care

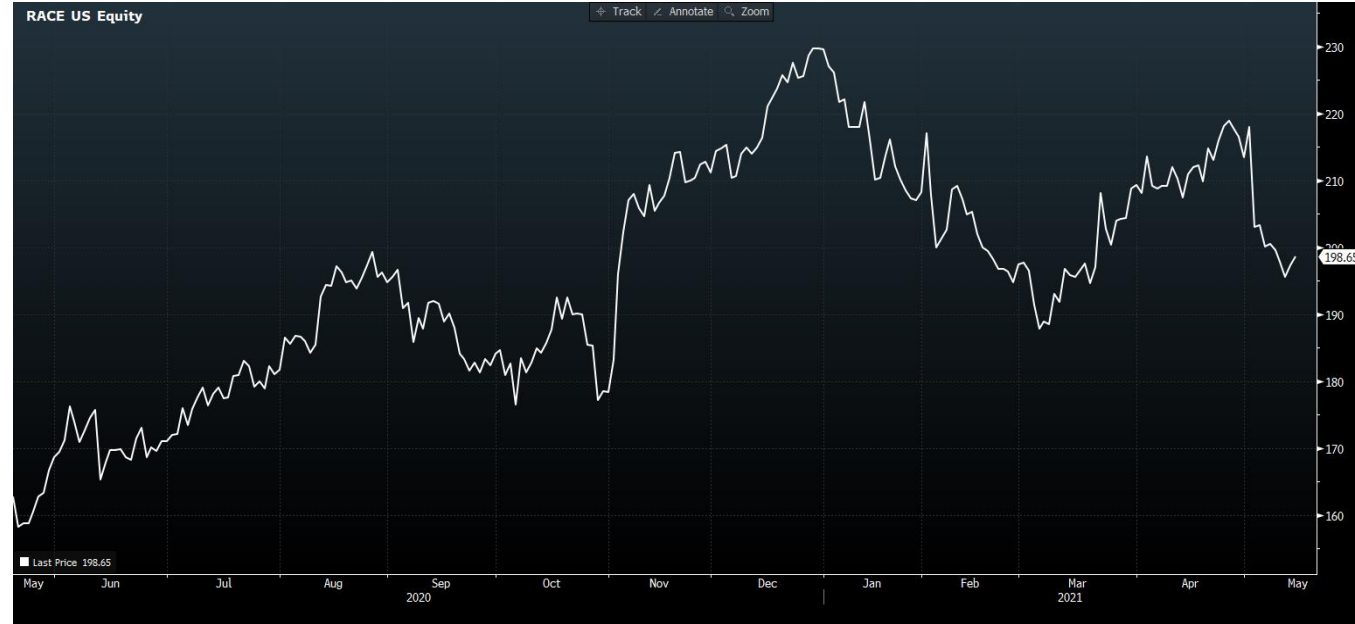




# Ferrari NV (RACE IM / RACE US)

Ferrari NV designs and manufactures sports cars while offering new and used vehicles, warranty programs, financial supports, and maintenance, as well as watches, apparels, earphones, caps, and other accessories worldwide.

- Ferrari is **massively profitable**, with the best operating margins in the auto business (and zero tax-credit sales).
- Its sales volumes are tiny and likely to stay that way: While Tesla is hoping to sell a million vehicles a year before long, Ferrari is quite content to be selling 10,000 or thereabouts.
- While Ferrari **deliberately limits its annual production** to preserve its exclusivity and pricing power, it does have a plan to boost its profits and margins.
- That plan is centered on a **series of new models**, some of which will enter new territory for the brand (there's an SUV-like Ferrari in the works, with plans to launch a fully electric sports car in 2025), and some of which will be high-priced, limited-production models for Ferrari's most loyal and deep-pocketed fans.



Mkt Cap (M)	Last Price	YTD %	5-Yr CAGR	FCF Yield	EV/EBITDA	Country
36737.34	198.65	-13.45	37.75	1.77	26.26	ITALY
Div. Yield	Fwd PEG	Fwd P/E	ROE	Net Debt/EBITDA	Price/Sales	Sector
0.53	0.91	35.45	37.24	1.08	8.54	Consumer Discretionary







# The Walt Disney Co. (DIS US)

Disney is a global entertainment company with operations in media networks, park experiences & consumer products, studio entertainment and Direct-to-Consumer networks and channels. For full-year fiscal 2020, sales for the year decreased 6%, largely as a result of the negative economic effects created by the coronavirus pandemic. However, Disney has several market advantages over its peers:

- Its **media library and content-creation machine**, which work together to give Disney an unbeatable edge. The entertainment company owns several production studios, and it's planning to release more than 100 new entertainment titles a year for the next few years through its direct-to-consumer (DTC) operations.
- A **significant DTC focus** is Disney+, which has been an outstanding success since the streaming service launched in November 2019. Between Disney+, paid Hulu subscriptions, and ESPN+, the company has more than 150 million paid subscribers. It also recently started launching a global general content-streaming site called Star in several global locations. Direct-to-consumer revenue was up 73% year over year in the 2021 first quarter.
- It's also the **leader in theme parks**, which are currently partially open and running at a limited capacity. As vaccinations increase and the pandemic ends, management fully expects that the segment will get back to its typical sales growth (which was 13% for full fiscal 2019).



Mkt Cap (M)	Last Price	YTD %	5-Yr CAGR	FCF Yield	EV/EBITDA	Country
315601.10	173.70	-4.13	12.99	0.42	52.55	UNITED STATES
Div. Yield	Fwd PEG	Fwd P/E	ROE	Net Debt/EBITDA	Price/Sales	Sector
	0.91	35.91	-5.13	5.72	5.39	Communication Services





# Diageo Plc. (DGE LN)

The UK-based company is a global leader in spirits and liqueurs, boasting a portfolio of world-renowned brands such as Smirnoff vodka, Captain Morgan rum, Johnnie Walker whisky, Baileys Irish cream, and Tanqueray gin. It also makes beer, including Guinness, and wine.

- With more than 200 global, local, and luxury brands, it **owns some two dozen of the world's top 100 premium spirits labels**. Diageo rings up sales in virtually every country in the world and has 150-plus production sites globally.
- Diageo returned to **organic net sales growth** in the first half to December and has continued to deliver a good recovery in 2021. Performance in North America, Diageo's biggest market, has remained particularly strong, reflecting **resilient consumer demand**, the breadth of their portfolio and the effectiveness of their marketing and innovation.
- In Europe, the drinks giant is benefitting from **strong execution in the retail channel** and the partial re-opening of bars, clubs and restaurants in certain markets.
- With its on-trade sales in bars, clubs and restaurants virtually disappearing for large parts of 2020 and the beginning of 2021 the company did a **good realignment job** – focusing its marketing on the off-trade as people enjoyed their Guinness or Johnnie Walker at home instead.



Mkt Cap (M)	Last Price	YTD %	5-Yr CAGR	FCF Yield	EV/EBITDA	Country
78463.44	3353.50	16.52	15.37	3.07	37.06	BRITAIN
Div. Yield	Fwd PEG	Fwd P/E	ROE	Net Debt/EBITDA	Price/Sales	Sector
2.10	0.91	26.28	15.68	4.98	6.86	Consumer Staples





# ASML Holding NV (ASML NA)

ASML Holding N.V. is one of the world's largest makers of semiconductor manufacturing equipment, specializing in photolithography systems used to imprint circuitry patterns onto silicon wafers. ASML's products include EUV (extreme ultraviolet) lithography systems, DUV (deep ultraviolet) lithography systems, refurbished systems, and metrology and inspection systems.

- ASML may be helped by the **global chip shortage** a bit longer than its chipmaker customers because only ASML can supply EUV and deep ultraviolet lithography, or DUV, tools.
- ASML is in a "sweet spot" with the main semi equipment technology transition to extreme-ultraviolet lithography ("EUV") in logic, followed by shift to EUV in DRAM. Lithography **demand will see a secular increase** as an integral part of front-end semi equipment spending till this transition is completed.
- They are pretty much **the only game in town** to supply EUV tools. ASML's market share in lithography segment exceeds 80-89% (or 100% in Europe), virtually with an envious pricing power. ASML's EUV is the key to TSMC and Samsung Electronics' chip development for new iPhones and products, and the only maker of the \$150-\$200 million EUV tools could grow sales strongly.



Mkt Cap (M)	Last Price	YTD %	5-Yr CAGR	FCF Yield	EV/EBITDA	Country
221495.10	528.00	32.81	45.85	1.83	35.18	NETHERLANDS
Div. Yield	Fwd PEG	Fwd P/E	ROE	Net Debt/EBITDA	Price/Sales	Sector
0.59	0.91	35.61	35.46	0.00	13.86	Information Technology





# Taiwan Semiconductor Manufacturing Company (TSM US / 2330 TT)

TSMC is the largest dedicated contract semiconductor manufacturer in the world, handling manufacturing for semiconductor and integrated device companies that don't have their own manufacturing facilities. TSMC's customers include AMD, Broadcom, NVIDIA, QUALCOMM, Intel and others.

- SMC enjoys a **leadership position** in the semiconductor foundry industry, as the company enjoys a market share of close to 60%, due to its technological leadership. These two factors constitute a **competitive advantage** over peers in the long term, making TSMC one of the best stocks to own in the semiconductor industry.
- Beyond this solid profile, TSMC is also **benefiting in the short term from the chip shortage**, which is making its factories working at full capacity, while, over the long term, the semiconductor industry has good secular growth prospects.
- TSMC has announced that it intends to invest about \$100 billion over the next three years in new capacity and R&D. To put these numbers into context, TSMC has spent \$3.7 billion in R&D and \$17.4 billion in capex during 2020, up together by 18% YoY, to a new record high for combined investments in one year.



Mkt Cap (M)	Last Price	YTD %	5-Yr CAGR	FCF Yield	EV/EBITDA	Country
14235778.87	549.00	3.58	35.07	2.03	14.57	TAIWAN
Div. Yield	Fwd PEG	Fwd P/E	ROE	Net Debt/EBITDA	Price/Sales	Sector
1.82	0.91	20.88	29.91	-0.37	10.23	Information Technology





## NXP Semiconductors NV (NXPI US)

NXP is a leading maker of mixed-signal processors and microcontrollers, which are used in automotive, communications, security, Internet of Things, In addition to its former parent Philips, NXP's customers include Apple, Bosch, Delphi, Ericsson, Nokia, Panasonic, Samsung, and Sony.

- NXP, one of Europe's largest chipmakers, is often overlooked in discussions about driverless and electric vehicles. However, the Dutch company became **the world's largest automotive chipmaker** six years ago after acquiring its rival Freescale.
- NXP's automotive business, which accounted for 44% of its revenue last year, suffered a slowdown last year and offset the growth of its industrial IoT (Internet of Things) and mobile chip businesses. The softness of its communication infrastructure business exacerbated that slowdown. But this year, analysts expect NXP's revenue and earnings to increase 23% and 58%, respectively, as its auto business recovers.
- The **chip shortage** could still throttle NXP's recovery by delaying shipments of new cars. NXP manufactures most of its own chips, but it outsources some of its production to TSMC. As a result, its long-term recovery could still partly depend on TSMC's ability to boost its capacity and stabilize the global chip market.
- However, NXP remains a **balanced play for conservative investors** who want some exposure to the automotive chip market but don't want to take outsized risks on speculative EV makers and SPACs.



Mkt Cap (M)	Last Price	YTD %	5-Yr CAGR	FCF Yield	EV/EBITDA	Country
53018.51	192.27	20.92	18.58	4.34	22.16	NETHERLANDS
Div. Yield	Fwd PEG	Fwd P/E	ROE	Net Debt/EBITDA	Price/Sales	Sector
1.17	0.91	18.20	4.91	2.17	5.86	Information Technology





# British American Tobacco PLC (BATS LN)

BATS is the world's second largest publicly traded tobacco company by market share (after Phillip Morris).

- For the past decade **net cigarette prices have risen** by about 6% on average, globally. When there have been tax rises in individual countries the companies have almost always been able to pass these on to consumers.
- This is an **oligopolistic industry**, where each player knows the only way to grow profits is through price rises.
- Companies rarely engage in destructive price competition because tax usually accounts for 70-80% of the retail price of cigarettes, and **consumers are generally loyal** to individual brands.
- Furthermore, growth in tobacco is now driven by reduced risk products, not market share gains in conventional cigarettes.



Mkt Cap (M)	Last Price	YTD %	5-Yr CAGR	FCF Yield	EV/EBITDA	Country
64868.80	2827.00	4.39	-2.36	11.69	9.29	BRITAIN
Div. Yield	Fwd PEG	Fwd P/E	ROE	Net Debt/EBITDA	Price/Sales	Sector
7.63	0.91	8.08	10.11	3.57	2.51	Consumer Staples





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