Sugar tax on the rise: The current global state of play

By Elly Irving

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Finance Minister Tito Mboweni's announced in his Budget Speech that the Health Promotion Levy (HPL) - aka sugar tax - will be hiked from 2,1 cents to 2,21 cents per gram of sugar per 100ml (with the first four grams of sugar still exempted from taxation) on 1 April 2019, the first anniversary of its implementation.

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Evidenced by the implementation of the tax – and its increase one year on, we believe that sugar – globally – has become an increasingly important driver of the food and beverage industry and that there are key catalysts that could result in Big Food becoming the next Big Tobacco, potentially resulting in lower sales growth, higher costs and large scale litigation.

Sugar consumption and its contribution to a wide range of health problems, such as diabetes, high blood pressure and obesity (which collectively are known as metabolic syndrome), are central to this risk.

Below we take a look at the risks, how the industry is responding and why investors and the investment industry should be incorporating this risk into investment processes.

Sugar is a key strategic issue for the sector

- ### Catalyst 1: Increasing awareness among consumers and public health bodies

  Increasing awareness of the health effects of sugar is leading to volume and price growth declines across the consumer staples sector, partly as a result of tougher regulations. While soft drinks have shouldered the bulk of this burden, food producers are next in the firing line.

- ### Catalyst 2: Rising healthcare costs

  Sugar is adding to governments' increasingly burdensome healthcare bills, thanks to the part it plays in the global prevalence of obesity, diabetes and non-communicable diseases. Governments around the world - now including South Africa - have reacted by introducing sugar taxes, raising revenue and making products more expensive for consumers. Those companies that have already reformulated their ranges or have less exposed portfolios should benefit relative to slower peers.

- **Catalyst 3: Increased possibility of large scale litigation**

  Litigation risk is material. Despite challenges quantifying and attributing the damages caused by sugar consumption, we estimate the impact could be over 1% of the consumer staples sector's current earnings. Companies with portfolios which are structurally less exposed to sugar are in the strongest positions.

The industry is responding

- **M&A, divestment and the threat from activist investors**

  Since 2015 we've seen the continued rise of smaller challenger brands creating a wide range of M&A opportunities for the food majors. We have also seen the food majors themselves become a target of activism regarding their commitment to R&D into healthier products.
- **Reformulation, reducing portion sizes and product innovation**

  Food and beverage majors are also reformulating existing product portfolios to respond to consumer demand and the threat of sugar taxes. But the results of their efforts have been mixed; reformulation can be costly and can damage the brand if it doesn't meet consumer expectations.
- **Increase in advertising spend**

  Another response we've seen is an increase in advertising to help offset the move to healthier alternatives.

Taking steps to mitigate sugar risk

- **Engaging for better disclosure**

  We have seen an improvement in corporate disclosure with greater coverage of the issues around sugar in the last four years.
- **Company research and stock recommendations**

  Our proprietary research platform at Schroders includes over 40 instances of analysts factoring sugar risk into their recommendations, research or company discussions. There are over 50 references to sugar taxes alone.
- **Portfolio construction**

  That analysis is feeding into portfolio decisions across Schroders with teams adjusting their sector exposure to mitigate potential balance sheet risk faced by the food and beverages sector.

Conclusion

Sugar risk are on the rise. We believe that trends such as the implementation of sugar taxes, regulations regarding advertising and selling practices, and ongoing changes in consumer tastes will continue to create headwinds for the food and beverages sector. Food companies now face greater pressure to reformulate and innovate to protect future earnings.

ABOUT THE AUTHOR

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