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Correction: Household Personal Care, Beverages and Tobacco 2016 Playbook

[This version corrects a link on the front page. We apologize to our readers for any inconvenience this may have caused.]

Using a combination of key areas of dialogue at the sub-sector level (across Tobacco, Beverages, and Household and Personal Care), we have created 3 "investable buckets" for various investment styles (growth, value, income, etc.). As our Macro Strategy team highlighted in RBC's Global Market Trajectories 2016 Outlook, multiples should broadly continue to inflate for names where growth is not necessarily higher, but rather where the risk is lowest—justifying a preference for staples versus other sectors. Within this context, we prefer names across our HPC, Beverage and Tobacco coverage in three investable buckets: de-risked opportunities (COT, ENR), special situations (EPC) and yield hedgers (RAI, STZ, EL). We see NWL as both a yield-hedger and a special situations play. Similar to prior years, our current preferences are more US-centric than global mainly due to ongoing pressure on international macros and the risk of a further appreciating dollar.

De-Risked Opportunities: Over the past three months COT and ENR shares have underperformed the staples sector by 9 pp and 20 pp respectively—though our long-term bullish thesis for each name is unchanged. We believe at current levels each name is effectively de-risked, with a low likelihood of downward revisions relative to the rest of our coverage. Cott continues to offer investors a 13% FCF despite rising 66% YTD and has more control of its free cash flow generation given its acquisition of DS Services. We believe investor focus to shift from simple EPS delivery to FCF generation. ENR shares have sold off due to disappointing 2016 guidance, which we believe is achievable even in the event of further deterioration in the FX environment. In both cases, we see more upside to numbers than downside over the next 12 months.

The Yield Hedgers: Our Economic Research team expects the 10-year treasury to offer a 3.05% yield by the end of 2016, a 90 bps increase from current levels and the third highest annual increase in the past 20 years. Given this backdrop, we see NWL, RAI, STZ and EL as high-quality names that will continue to deliver growth on the top and bottom lines ahead of expectations. Each name should also continue to increase its dividend in line with earnings, justifying further upside amid a rising rate environment. We also maintain our Outperform rating on MNST though we prefer taking a 3-year view in owning the name.

Special Situations: We see HPC and beverage names continuing to engage in tuck-in M&A throughout 2016, with the potential for some to do more transformational M&A such as the recently announced tie-up of Newell and Jarden. In conjunction with this note, we are swapping our Top Pick rating from Jarden to Newell as we believe there is significant upside to NWL shares via organic growth, cost savings upside and potential top line synergies. Please see our note entitled "From Graco to Great Co" for more details. We also remain of the view that Edgewell Personal Care is still a likely take out candidate.

Priced as of prior trading day's market close, EST (unless otherwise noted).
All values in USD unless otherwise noted.
For Required Conflicts Disclosures, see Page 124.

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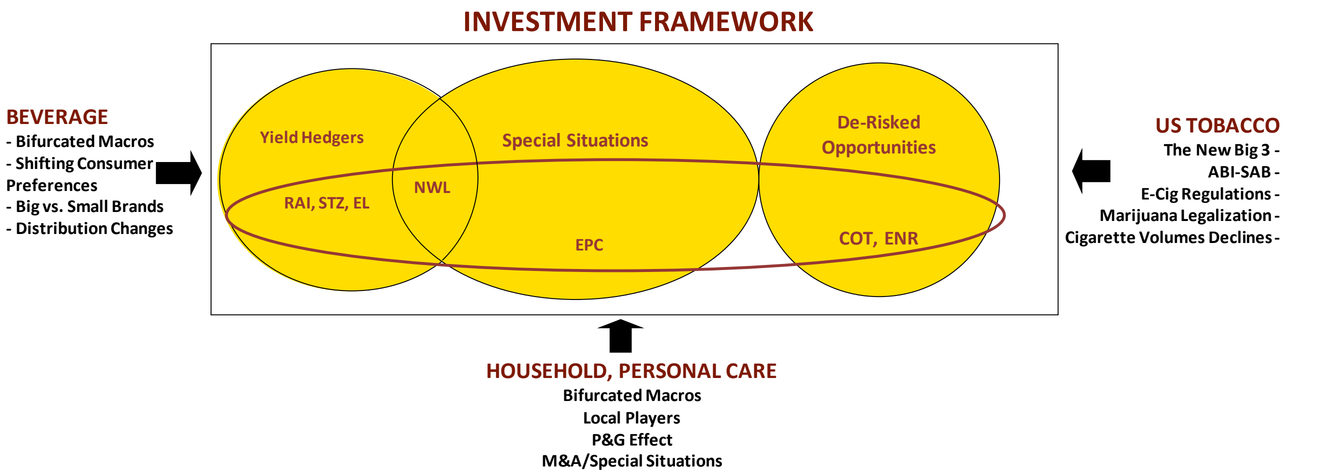
Beverages, HPC & Tobacco – 2016 Playbook

Using a combination of key areas of dialogue at the sub-sector level (across Tobacco, Beverages, and Household and Personal Care), we have created 3 "investable buckets" for various investment styles (growth, value, income, etc.). As our Macro Strategy team highlighted in RBC's Global Market Trajectories 2016 Outlook, multiples should broadly continue to inflate for names where growth is not necessarily higher, but rather where the risk is lowest—justifying a preference for staples versus other sectors. Within this context, we prefer names across our HPC, Beverage and Tobacco coverage in three investable buckets: de-risked opportunities (COT, ENR), special situations (EPC) and yield hedgers (RAI, STZ, EL). We see NWL as both a yield-hedger and a special situations play. Similar to prior years, our current preferences are more US-centric than global mainly due to ongoing pressure on international macros and the risk of a further appreciating dollar.

Exhibit 1: Investment framework



Source: RBC Capital Markets

Exhibit 2: Investment matrix: segmenting our top ideas by investable bucket and investment style

	De-Risked Opportunities	Special Situations	Yield Hedgers
Growth			ESTĒE LAUDER; Constellation Brands
Income			RAI Reynolds American
Value	Cott	Edgewell™ PERSONAL CARE; Newell Rubbermaid	

Source: RBC Capital Markets

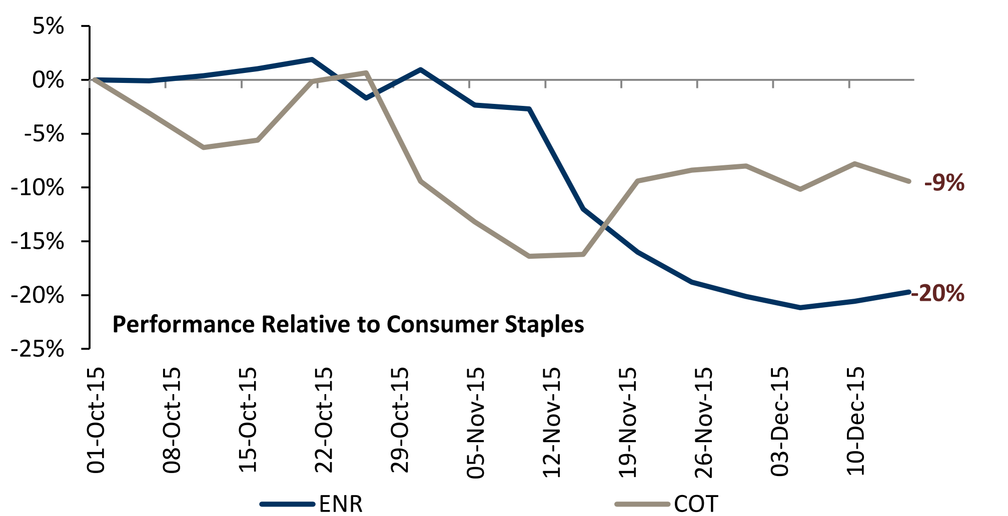
Investable Bucket #1: De-risked Opportunities

Thus far, companies providing perspective on 2016 have largely disappointed investors. With international macros on shaky ground, geopolitical risk mounting and the potential for further appreciation of the dollar versus key currencies, we suspect we will see our fair share of disappointing annual guides when we get into 2016 (when 90% of our coverage provides perspective on 2016 goals). Within this context, we have identified stocks where 2016 earnings have already been de-risked.

Upon earnings, COT and ENR shares have underperformed the staples sector by 9 pp and 20 pp respectively—though our long-term bullish thesis for each name is unchanged. We believe at current levels, each name is effectively de-risked, with a low likelihood of downward revisions relative to the rest of our coverage. Cott continues to offer investors a 13% FCF yield despite the shares rising 52% YTD and has more control of its free cash flow generation given its acquisition of DS Services. We believe investor focus is shifting from simple EPS delivery to FCF generation. In addition, ENR shares have sold off due to disappointing 2016 guidance, which we believe is achievable even in the event of further deterioration in the FX environment. In both cases, we see more upside than downside over the next 12 months.

During this past earnings season, ENR and COT were significant underperformers, though our bullish thesis for each name is unchanged.

Exhibit 3: ENR and COT relative performance to staples



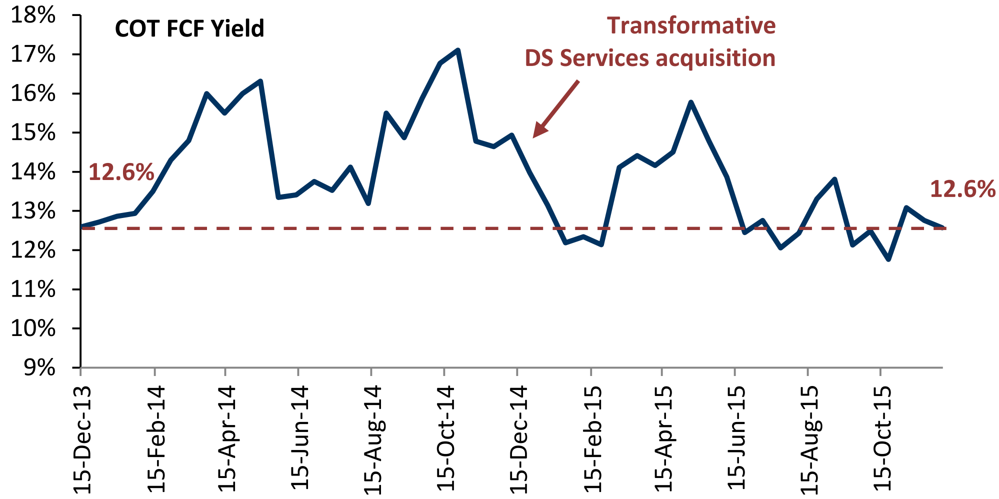
Source: Company reports and RBC Capital Markets estimates

Cott

Following Cott's acquisition of DS Services, the business has transformed and investors are now able to predict the company's future free cash flow with more conviction. In our view, more visibility into Cott's future suggests the name is less risky than it was prior to the deal, and thus deserves a much lower FCF yield. And, while Cott's ~13% FCF yield is lower than 17% levels in the month prior to the deal, it remains in line with levels just following the deal and two years ago. This essentially leaves the name de-risked as the company delivers on FCF goals, leading shares higher and the FCF yield lower, appropriately toward staples peers at 5%. Our $16 price target implies an 8% FCF yield.

Despite the transformative DS Services acquisition a year ago, Cott's FCF yield is at the same level as it was following the deal and two years ago.

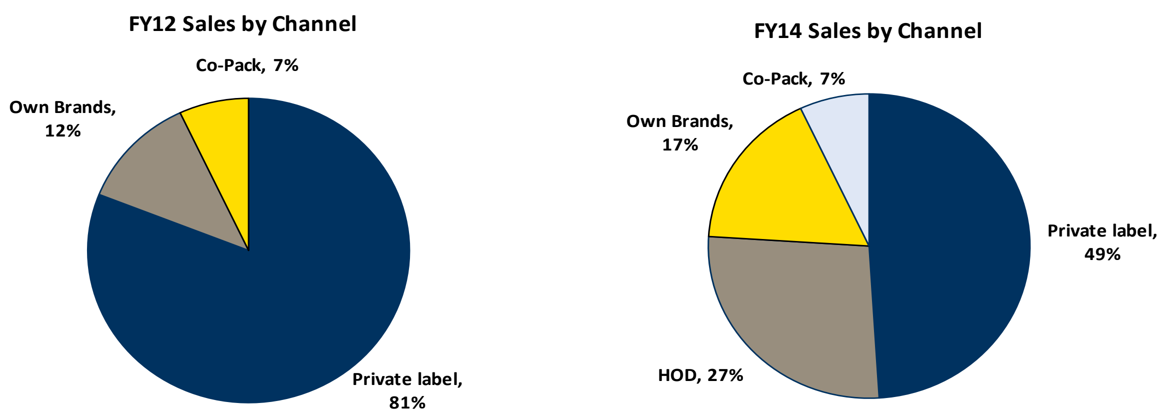
Exhibit 4: COT FCF yield



Source: FactSet

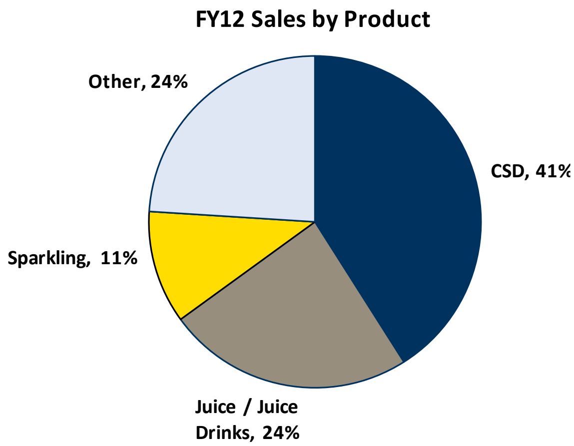
Today, Cott is a very different company than just three years ago. In terms of channel, Cott's private label business was reduced from 81% of sales in FY12 to ~49% of sales today. Also, as it relates to product, CSDs now only account for 19% of Cott sales versus 41% in 2012.

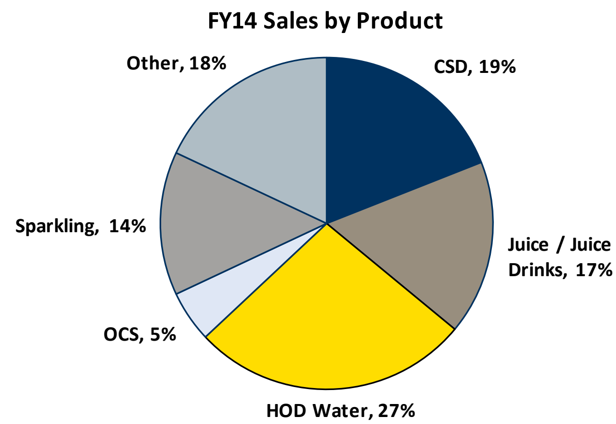
Exhibit 5: Cott channel sales breakdown transition



Source: Company reports and RBC Capital Markets estimates

Exhibit 6: Cott product sales transition





Source: Company reports and RBC Capital Markets estimates

Energizer

The case for owning de-risked names is particularly compelling given the level of disparity among sell-side estimates. Due to global uncertainty and movements in FX, a number of management teams have suggested that they are finding it increasingly difficult to forecast earnings. This has also carried into sell-side consensus EPS estimates. The dispersion between the highs and lows of sell-side estimates has widened significantly. And, while Energizer's December 2015 estimates have 67% dispersion, FY16 dispersion is only 12%—a level we would expect to further narrow as the company navigates transitory issues.

Exhibit 7: Disparity among sell-side estimates

Dec-15					
	Low	Cons.	High	Dispersion	% Delta
EPC	$0.27	$0.63	$0.72	$0.45	167%
ENR	$0.51	$0.72	$0.85	$0.34	67%
AVP	$0.06	$0.08	$0.09	$0.03	50%
COTY	$0.32	$0.34	$0.39	$0.07	22%
KO	$0.35	$0.38	$0.42	$0.07	20%
PEP	$0.94	$1.06	$1.12	$0.18	19%
EL	$1.05	$1.11	$1.22	$0.17	16%
CLX	$0.98	$1.04	$1.13	$0.15	15%
DPS	$0.90	$0.98	$1.03	$0.13	14%
SAM	$1.11	$1.16	$1.27	$0.16	14%
CCE	$0.49	$0.52	$0.55	$0.06	12%
STZ	$1.23	$1.29	$1.38	$0.15	12%
MNST	$0.79	$0.82	$0.86	$0.07	9%
BF.B	$0.92	$0.95	$0.99	$0.07	8%
PG	$0.94	$0.98	$1.01	$0.07	7%
CL	$0.71	$0.73	$0.76	$0.05	7%
RAI	$0.49	$0.50	$0.52	$0.03	6%
NWL	$0.55	$0.56	$0.58	$0.03	5%
KMB	$1.40	$1.43	$1.46	$0.06	4%
JAH	$1.18	$1.20	$1.23	$0.05	4%
CHD	$0.80	$0.81	$0.83	$0.03	4%
MO	$0.67	$0.68	$0.69	$0.02	3%

FY 2016					
	Low	Cons.	High	Dispersion	% Delta
AVP	$0.17	$0.32	$0.45	$0.28	165%
COTY	$0.81	$1.09	$1.34	$0.53	65%
SAM	$7.40	$8.32	$9.05	$1.65	22%
STZ	$5.26	$5.83	$6.30	$1.04	20%
MNST	$3.58	$3.94	$4.17	$0.59	16%
ENR	$1.92	$2.09	$2.15	$0.23	12%
KMB	$5.84	$6.20	$6.47	$0.63	11%
NWL	$2.28	$2.40	$2.48	$0.20	9%
RAI	$2.19	$2.32	$2.37	$0.18	8%
EPC	$3.21	$3.29	$3.46	$0.25	8%
CL	$2.88	$2.98	$3.10	$0.22	8%
KO	$2.02	$2.07	$2.17	$0.15	7%
EL	$3.10	$3.20	$3.30	$0.20	6%
DPS	$4.23	$4.33	$4.50	$0.27	6%
PEP	$4.71	$4.83	$5.00	$0.29	6%
BF.B	$3.68	$3.80	$3.90	$0.22	6%
PG	$3.67	$3.76	$3.87	$0.20	5%
CCE	$2.69	$2.77	$2.83	$0.14	5%
JAH	$3.09	$3.18	$3.25	$0.16	5%
CHD	$3.41	$3.50	$3.57	$0.16	5%
CLX	$4.81	$4.87	$4.97	$0.16	3%
MO	$3.02	$3.05	$3.10	$0.08	3%

Source: FactSet – Note: We excluded Cott from the calculation due to only a limited number of sell side consensus estimates and a wide range of consensus estimates (ranging from negative to positive) that made comparison difficult

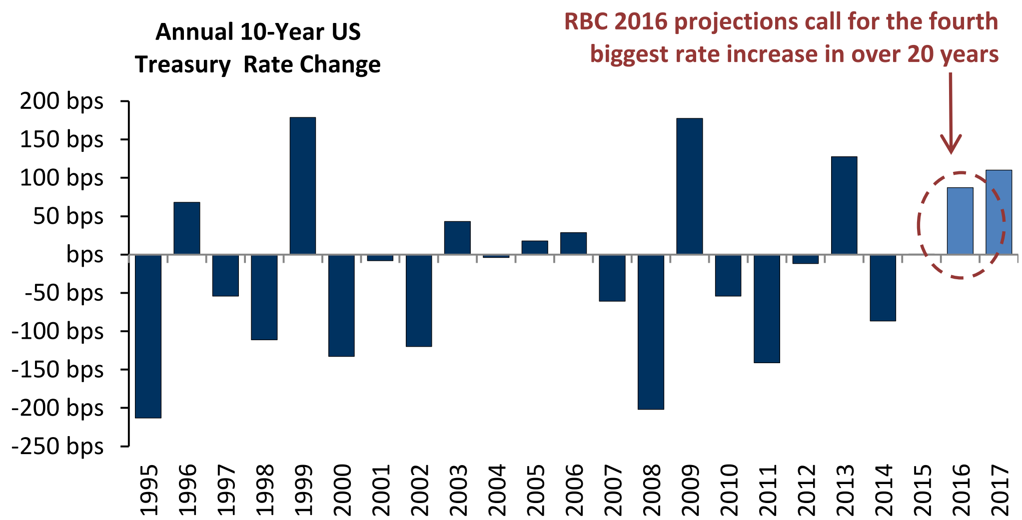
This past quarter and corresponding sell-off in ENR shares now leaves the name de-risked, in our view. At their analyst day earlier in the summer, ENR saw an adjusted base for EBITDA of $310– $325M. Then this past quarter, ENR guided to EBITDA of $275M–$295M, below consensus $316M. We believe two factors are driving the delta: (1) FX – Energizer is receiving fewer hedging benefits than expected and the company had to suspend hedging for a period of time during the separation. This, coupled with increasing FX headwinds, is pressuring profitability in 2016 (as it is for all companies with international exposure); and (2) conservatism due the inherent complexity in rebuilding a global cost structure separate of the parent company. We also believe ENR management is taking a cautious approach for next year given Berkshire will officially take over Duracell in early 2016 (though, we continue to believe Berkshire will look to optimize pricing/margins in the battery category).

Investable Bucket #2: The Yield Hedgers

Our Economic Research team expects the 10-year treasury to offer a 3.05% yield by the end of 2016, a 90 bps increase from current levels and the third highest annual increase in the past 20 years. Given this backdrop, we see RAI, STZ, NWL and EL as high-quality names that will continue to deliver growth on the top and bottom lines ahead of expectations. Each name should also continue to increase its dividend in line with earnings, justifying further upside amid a rising rate environment. We also maintain our Outperform rating on MNST though we prefer taking a three-year view in owning the name.

The specter of rising rates raises the bar for EPS and dividend growth delivery to outperform.

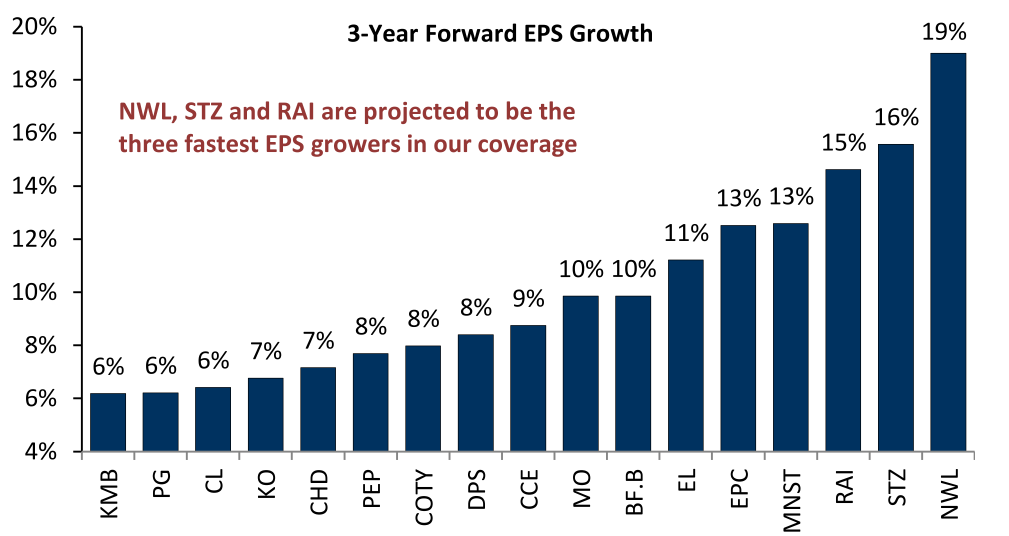
Exhibit 8: Annual change in US 10-Year Treasury



Source: S&P, Compustat, FactSet and RBC Capital Markets

NWL, STZ and RAI are projected to be the fastest EPS growers in our coverage

Exhibit 9: Consensus 3-year forward EPS growth



Source: FactSet and RBC Capital Markets Estimates – Note: We use RBC Capital Markets Estimates for Newell

We also expect upward EPS revisions to STZ, RAI and EL in 2016.

Exhibit 10: RBC estimates versus consensus

CY16 Revenue	Consensus	RBC	Delta
STZ	6,801	6,923	2%
RAI	12,527	12,659	1%
EL	11,609	11,618	0%

CY16 EPS	Consensus	RBC	Delta
STZ	5.73	6.03	5%
RAI	2.32	2.37	2%
EL	3.41	3.45	1%

Source: FactSet and RBC Capital Markets Estimates – Note: Revenue in $M

Please see Appendix 1 for more detail on Reynolds American and Estee Lauder and our separate report published today for detail on Constellation Brands.

Investable Bucket #3: Special Situations

We see HPC and beverage names continuing to engage in tuck-in M&A throughout 2016, with the potential for some to do more transformational M&A such as the recently announced tie-up of Newell and Jarden. In conjunction with this note, we are swapping our Top Pick rating from Jarden to Newell as we believe there is significant upside to NWL shares via organic growth, cost savings upside and potential top line synergies. Please see our note entitled "From Graco to Great Co" for more details. We also remain of the view that Edgewell Personal Care is still a likely take out candidate.

We would play the special situations theme through EPC, where our weighted $111 price target implies 40% upside from current levels.

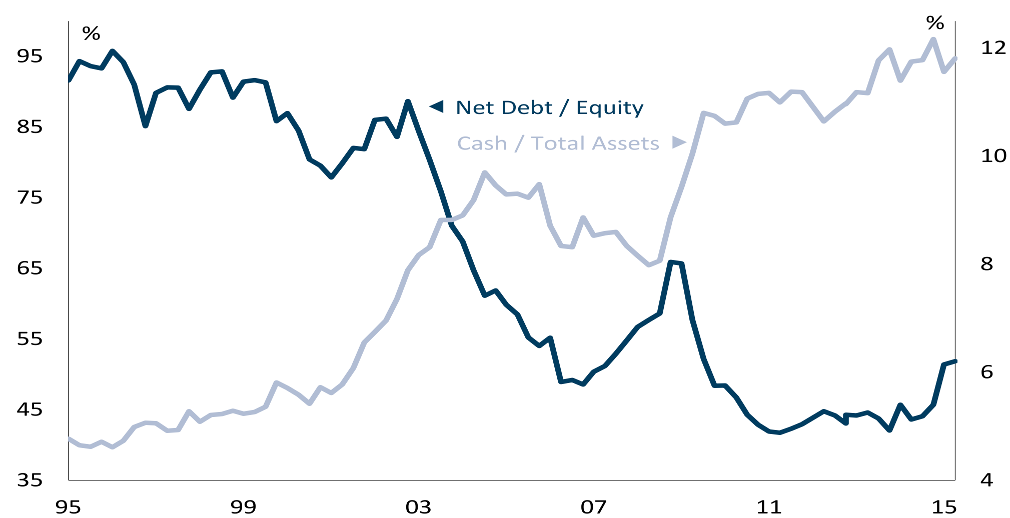
Exhibit 11: Edgewell scenario valuation

Edgewell Scenario Valuation	2017 EBITDA ($M)	Multiple	Price Target	Probablity	Weighted Value
Fundamental Value	489	11.2x	$73	20%	$15
Personal Care Takeout	489	17.2x	$120	80%	$96
Price Target					$111

Source: RBC Capital Markets estimates

Balances as a percentage of total assets are near record highs, and we expect cash drawn-down to continue for our coverage into 2016, driven in part by M&A.

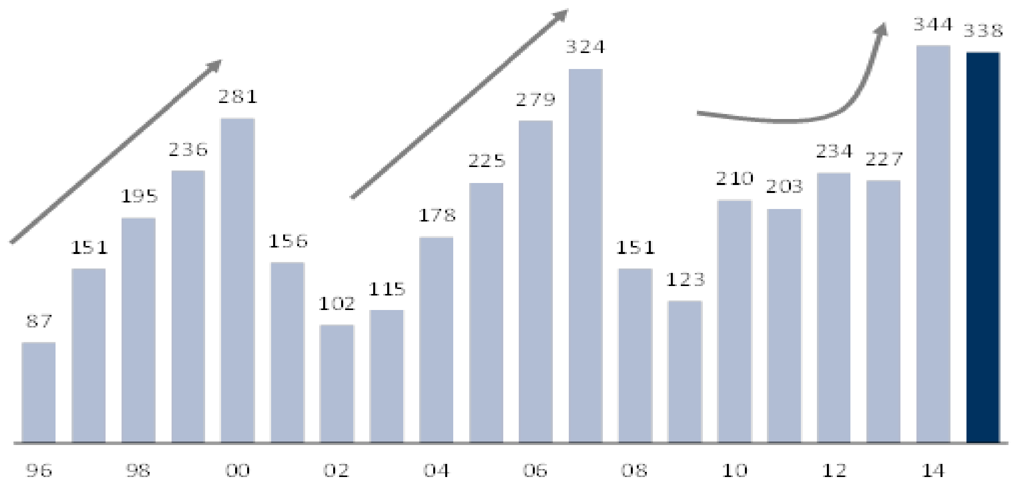
Exhibit 12: Cash as a percentage of total assets



Source: S&P, Compustat, FactSet and RBC Capital Markets

Total number of M&A deals over $1B spiked in 2014 and 2015, a level we expect to remain elevated in 2016.

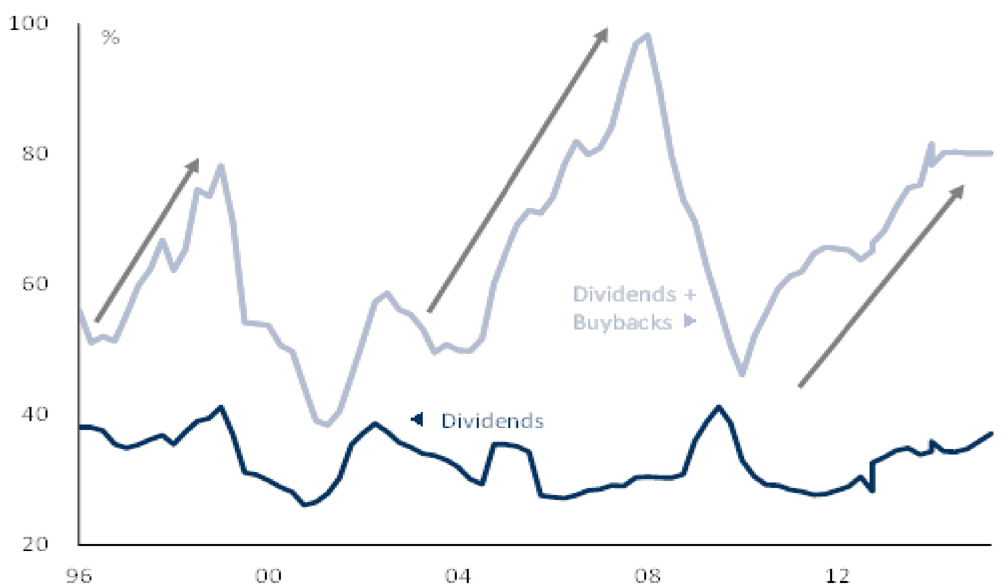
Exhibit 13: Number of M&A deals over $1B



Source: S&P, Compustat, FactSet and RBC Capital Markets

Simultaneously with M&A, consumer companies have returned cash to shareholders through stepped-up share repurchases.

Exhibit 14: Companies have also stepped up capital returns to investors through share repurchases



Source: S&P, Compustat, FactSet and RBC Capital Markets

Cross-Sector Themes

We see a few themes that overlap sectors in staples—specifically the broad ranging themes of bifurcated macros and corporate actions.

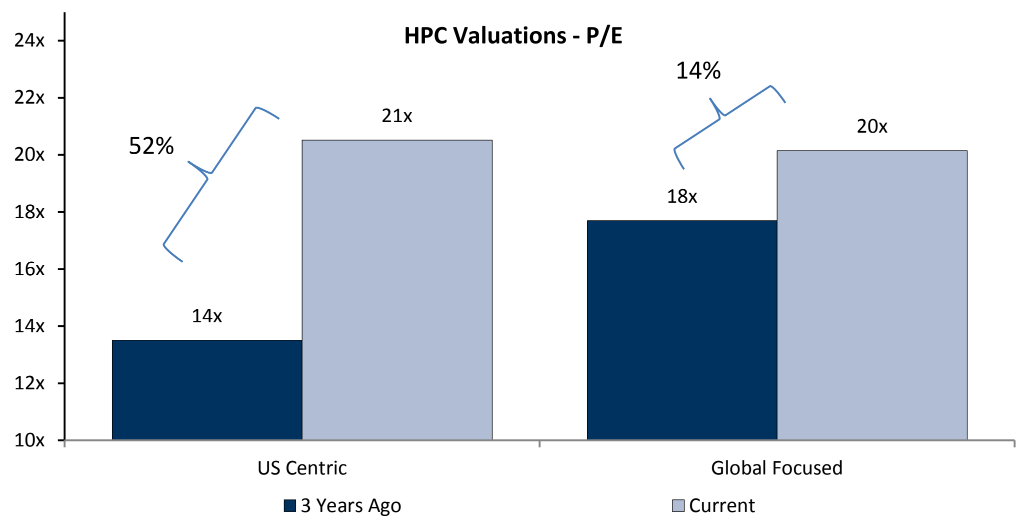
Bifurcated macros

Since 2013, we have witnessed a slow but steady divergence in the economic trend of the US and international economies—a trend we expect will further continue in 2016. While emerging markets continue to slow and Europe faces persistent deflation risk, the US economy has rebounded strongly—leading to a bifurcation of not just economic performance but stock valuations as well.

In both HPC and Beverages, the stocks that have had the best performance (and the richest valuations) are those with over-exposure to the US market—which counters the conventional logic of previous years where the focus has been on companies with exposure to the emerging markets (due to expectations for higher growth).

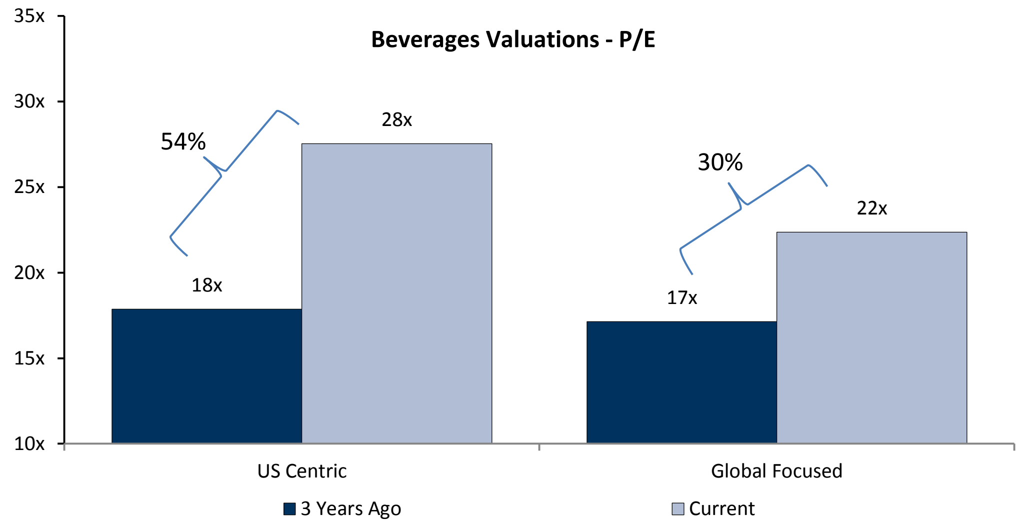
Exhibit 15: HPC sector valuation – global companies vs. US centric

Bifurcated stock performance has led to US-centric players witnessing greater multiple expansion than globally focused names.



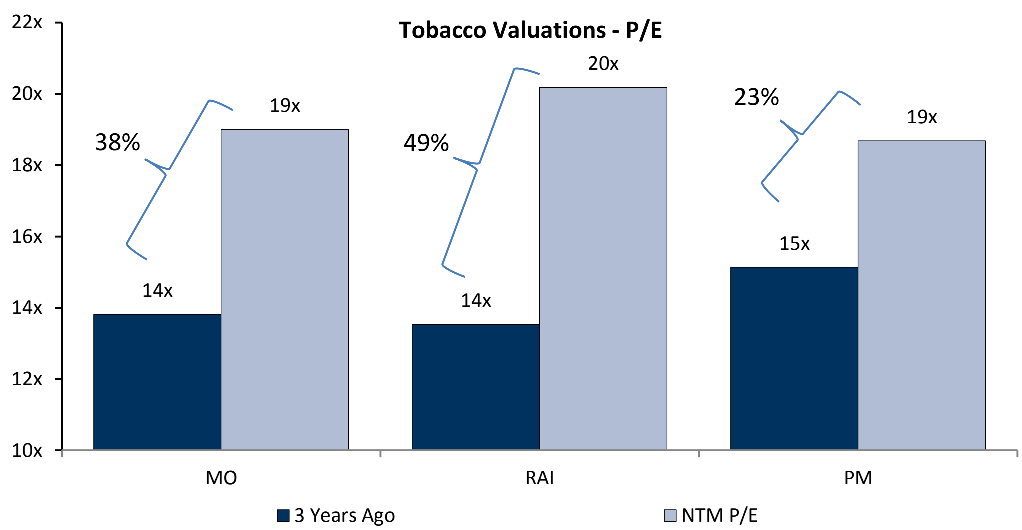
Note: Global names include CL, PG, AVP, KMB, and COTY. US-centric includes NWL, ENR, EL, CLX, CHD, and JAH
Source: FactSet

Exhibit 16: Beverages sector valuation – global companies vs. US centric



Note: Global names include KO, CCE, PEP, and BF.B. US centric names include STZ, MNST, DPS, and SAM
Source: FactSet

Exhibit 17: US Tobacco sector valuation – global companies vs. US centric



Source: FactSet

Looking forward to the remainder of 2016 and beyond, we believe the US-centric theme will continue to play out and expect these stocks to continue to outperform. We look at this conclusion through the lenses of economies, commodities and currencies.

Economies

Based on commentary from most global consumer staples companies, it is clear that the US consumer is faring better than most other regions. In fact, while most globally exposed companies have experienced sequential slowing over the past quarter, companies with predominant US exposure have seen acceleration. And the recovery has not been limited to just the higher end, with low-income consumer also benefiting from lower prices and improving employment outlook.

Based on our analysis of worldwide macros, we hesitate to take a too-bullish view on globally exposed companies. Outside of the US, most countries continue to struggle, particularly China and Brazil. China's 3% yuan devaluation and disappointing economic growth paired with Brazil's recession (which some expect may expand to depression) has shocked economies all over the world.

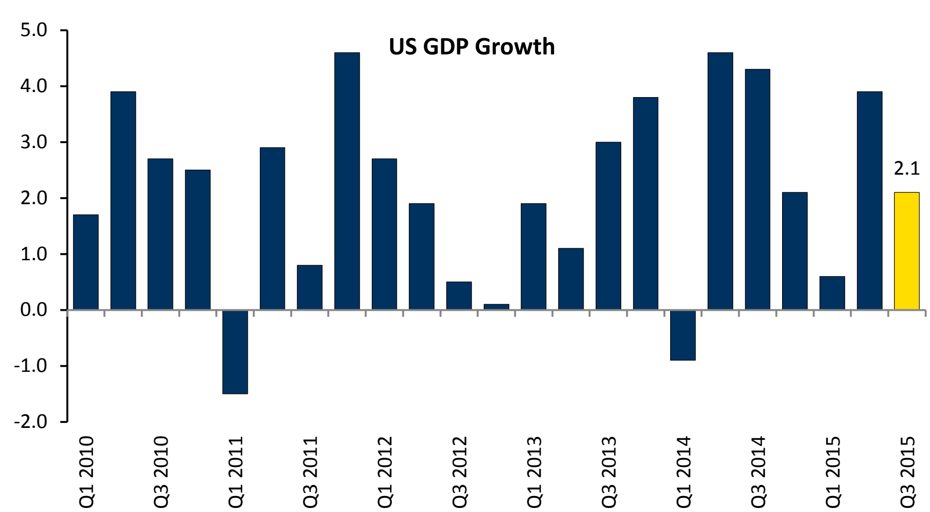
United States

In 2015, the US economy progressed fairly well relative to the rest of the world. Steady domestic spending served as a crutch to 3Q'15 GDP growth, which came in at an annualized 1.5%, just shy of expectations. The latest reading lags the average growth of the prior four quarters by just two-tenths, and comes against a difficult 3.9% 2Q comparison. We believe that 2016 will be defined by many of the same characteristics as the year gone by. 2015 is on track to be the tenth consecutive year of sub-3% GDP growth. Forecasts for 2016 and 2017 point to a continuation of this trend.

Consistent with modest GDP growth, consumer confidence pulled back slightly in September though remains well above the historical average. It is, however, worth pointing out that lower gas prices and an improved employment outlook are finally beginning to trickle down to the low-end consumer, providing a significant near-term benefit.

And while many public retailers have expressed concerns during 1H15, we believe retail has also become a tale of two cities, where online retailers, convenience stores as well as small businesses have seen sales accelerate, while larger format retailers struggle.

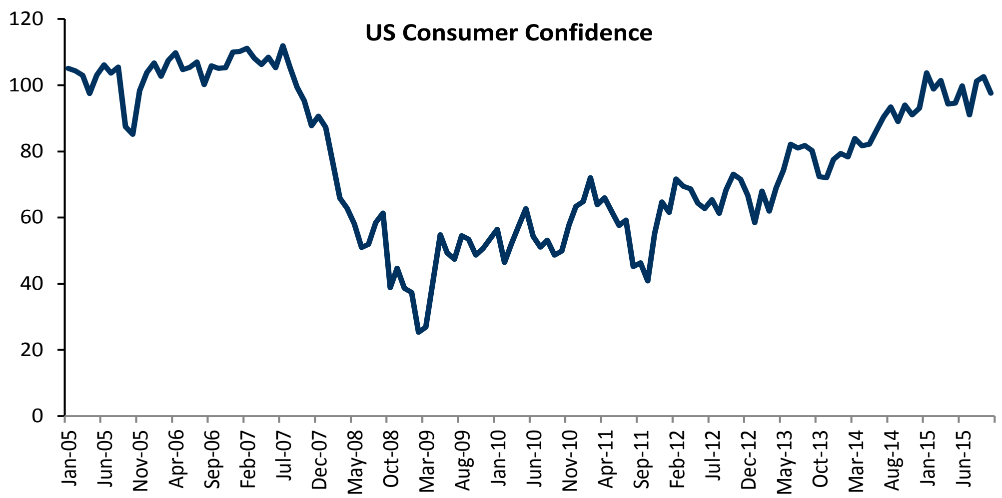
Exhibit 18: US GDP growth



Source: FactSet

Exhibit 19: US consumer confidence index

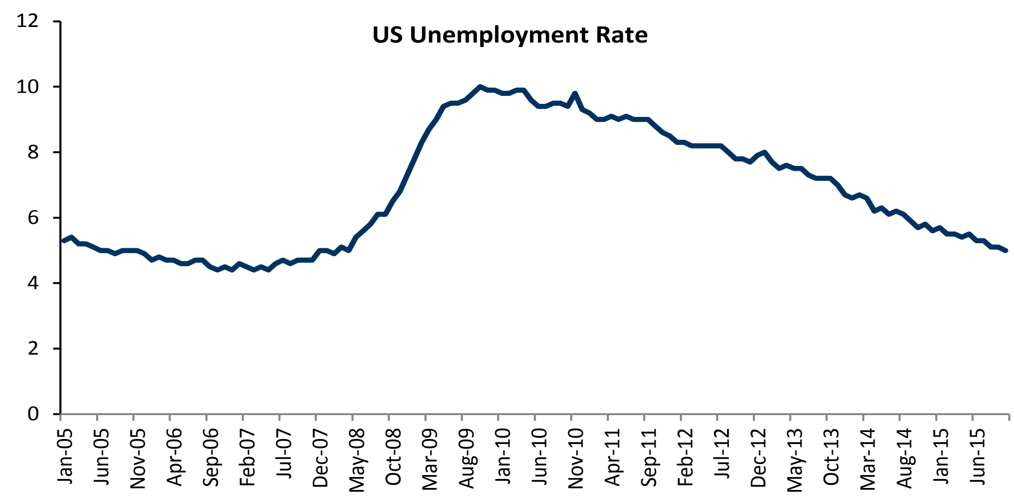
US consumer confidence continues its positive trend, though registered a slight decline from the September reading.



Source: RBC Capital Markets, FactSet

Exhibit 20: US unemployment rate

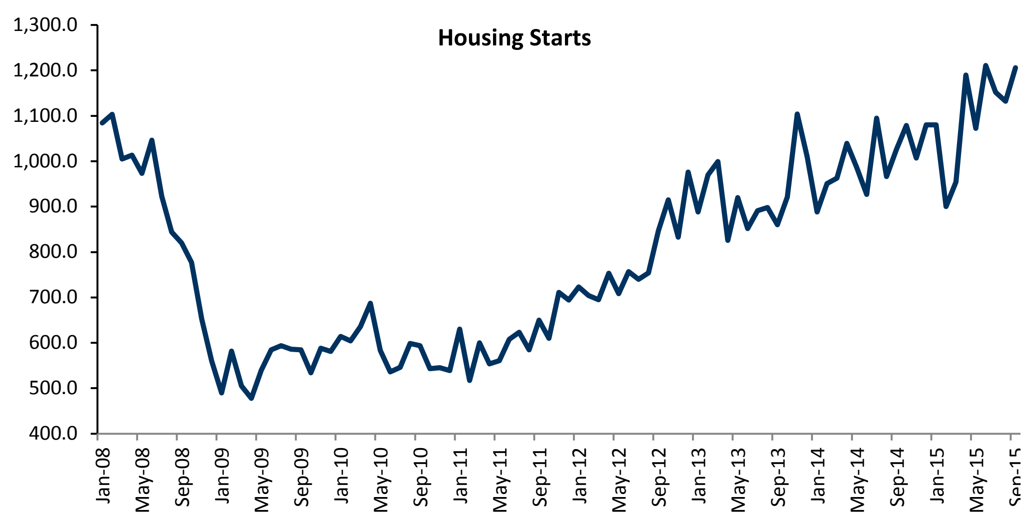
The US unemployment rate has fallen meaningfully from peak recession levels.



Source: RBC Capital Markets, FactSet

Housing starts are above 1.2M for just the second time since the recession.

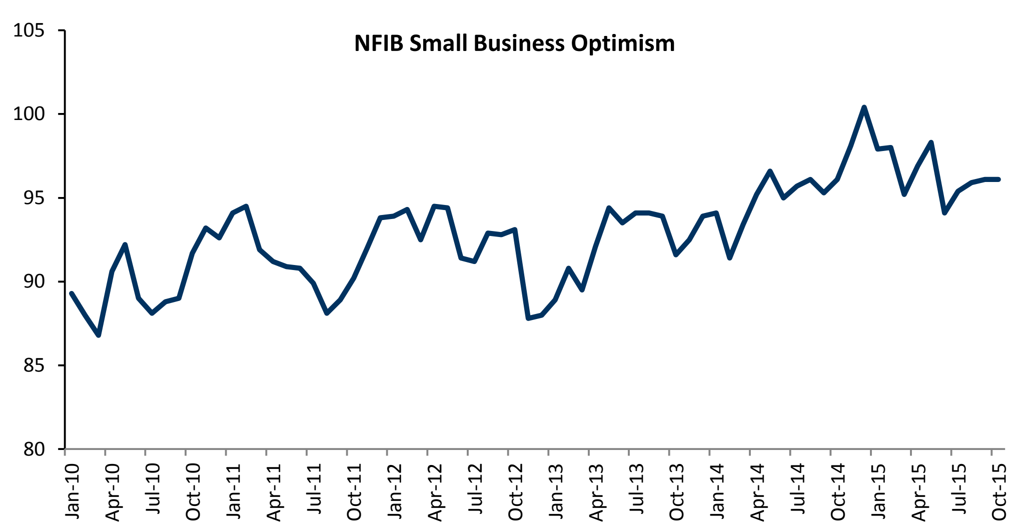
Exhibit 21: Housing starts (000s)



Source: FactSet

Small business optimism has moderated, though still remains above historical levels.

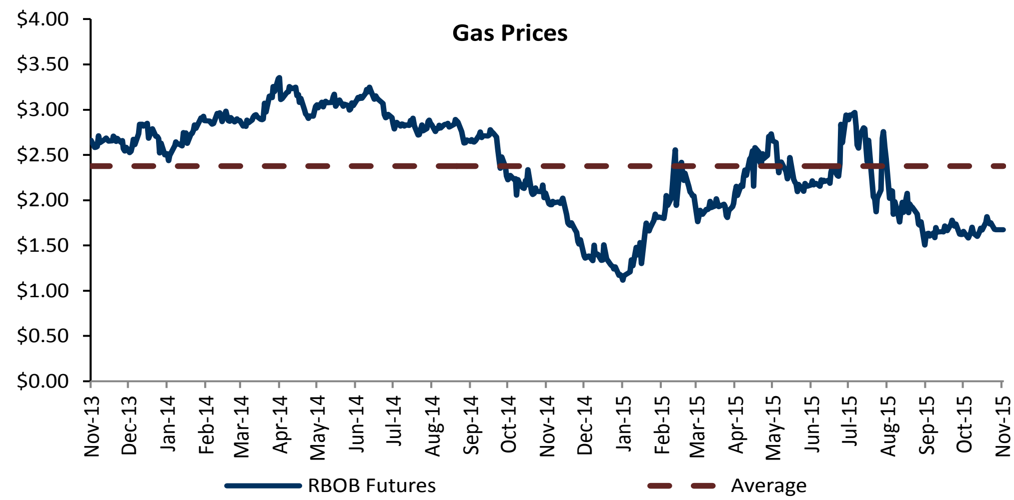
Exhibit 22: Small business optimism index



Source: Bloomberg

Exhibit 23: Gas prices – regular

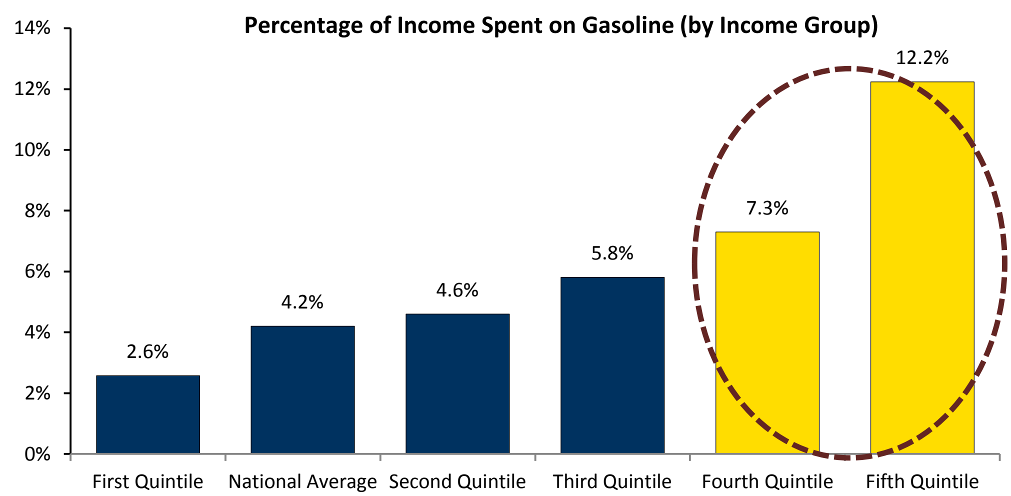
Gas prices have recovered slightly though still remain below historical averages.



Source: Bloomberg

Exhibit 24: Percentage of income spent on gasoline

Low-income consumers benefit the most from lower gas prices.



Source: Bureau of Labor Statistics

Western Europe

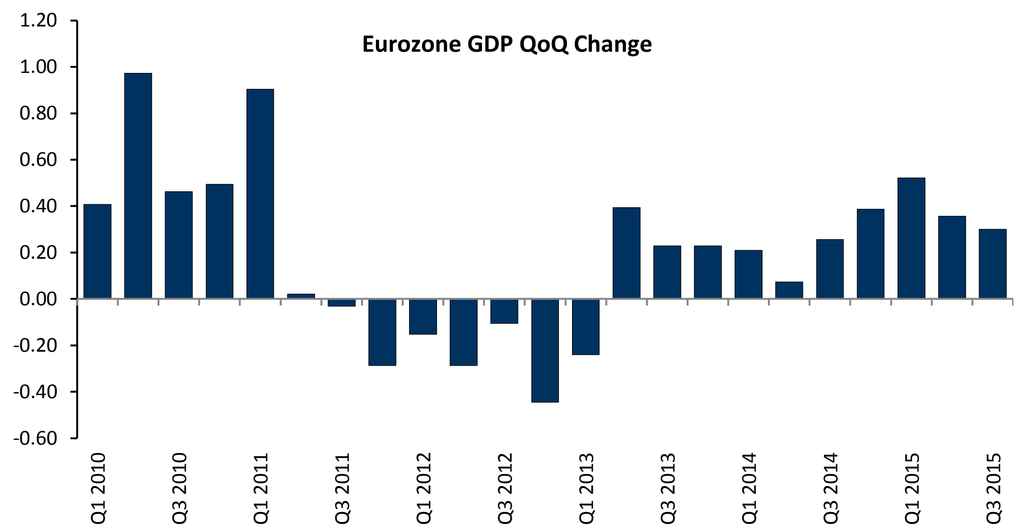
Over the past few years, the European economies have been hit with low to no economic growth and persistent threat of deflation. While the Eurozone posted 3Q GDP in positive territory, up 0.3%, Eurozone consumer confidence declined all throughout 2015. We note the economy here will largely continue to struggle in the coming year as unemployment remains high, retail sales lag and the promotional environment remains elevated. A renewed threat of terrorism could also weigh on consumer confidence in the region.

Discussions with experts around currencies suggest the Euro is set to further depreciate against the dollar in 2016, potentially below parity, leading us to believe companies are going to take a very conservative approach to 2016 guidance mainly due to uncertainty around FX. This data point puts recent guidance from Jarden and Energizer into perspective (the two companies already assuming FX rates get worse).

Within our coverage, the companies most impacted by these dynamics include CCE, KO, PEP, PG and COTY. We note that these companies also face increased headwinds from the declining euro, which is down -12% YTD and -15% in the past 12 months against the dollar.

Eurozone GDP growth has remained very modest over the past two years.

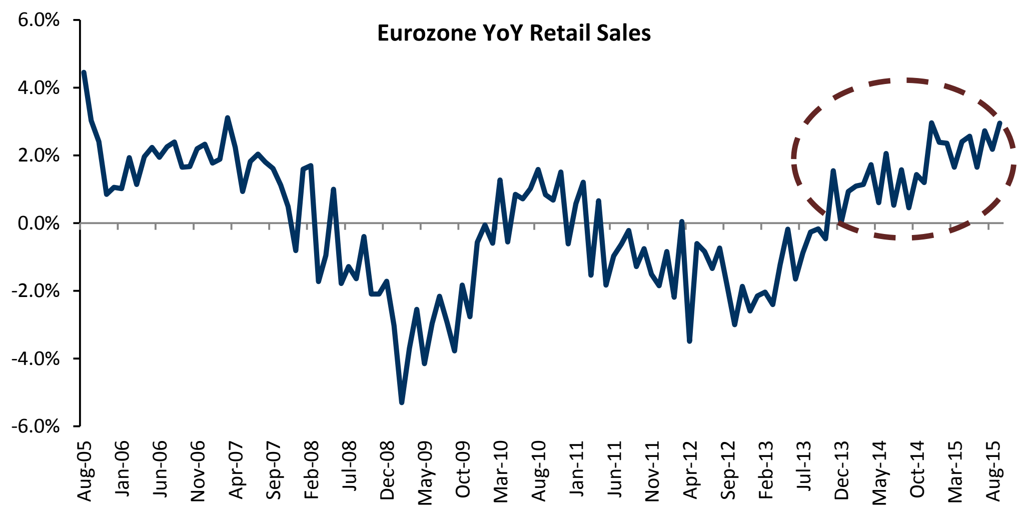
Exhibit 25: Eurozone GDP growth



Source: RBC Capital Markets, FactSet

Eurozone retail sales have remained consistently over 1% growth from a year ago, though sequential acceleration has been challenging.

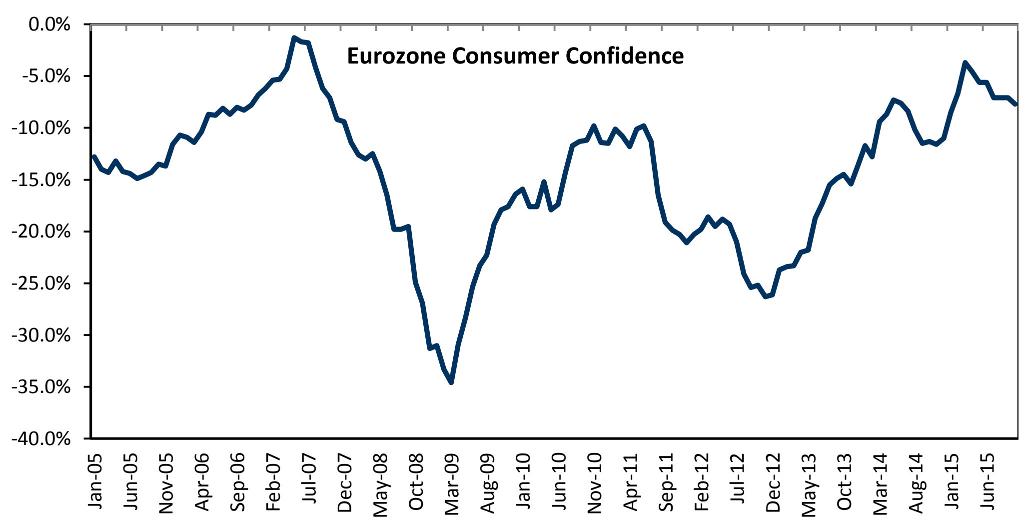
Exhibit 26: Eurozone retail sales growth [same title as Exh 30]



Source: RBC Capital Markets, FactSet

Eurozone confidence has weakened all throughout 2015.

Exhibit 27: Eurozone consumer confidence



Source: RBC Capital Markets, FactSet

Japan

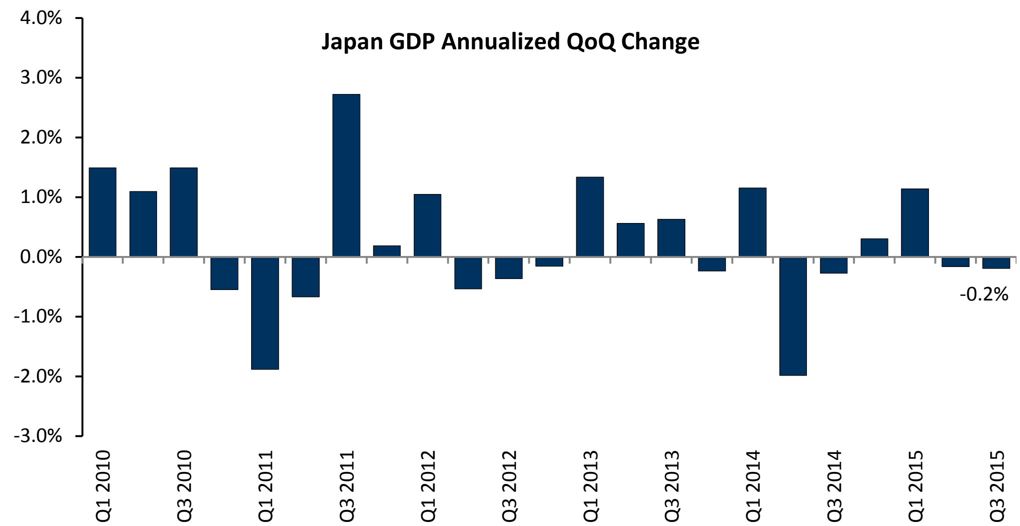
The Japanese economy deteriorated more severely than expected in 3Q, falling at an annualized rate of 0.8% in the July–September quarter, and shrinking by a seasonally adjusted 0.2% from the three months ending in June. Worsening business confidence led the decline, as companies reduced investment in the quarter and drew on their inventories rather than increase production.

The latest GDP reading marks the third time Japan has entered a recession since the global financial crisis of 2008. We remain cautious on the Japanese economy as it is highly influenced by China, which accounts for 60% of Japan's GDP and capital spending.

With that said, we do not expect Japan to be a major developed market tailwind for our coverage. Our largest exposure to Japan is Coca-Cola, with strong profit contribution to consolidated P&L (~12%).

Japan entered into recession territory in 2014 for the third time since 2008.

Exhibit 28: Japan GDP growth



Source: RBC Capital Markets, FactSet

China

China's growth rate recently dropped to 6.9%, a high number almost anywhere else in the world, but low in a country that averaged 10.6% growth in 2010. Over the past two years, the US dollar has appreciated in value while China's economy slowed, making it increasingly difficult for the government to justify pegging the yuan to the dollar. As a result, China's central bank abruptly devalued the yuan by roughly 3%, leading economists to believe the country is in worse shape than previously forecasted.

Within our coverage, we see PG, EL, COTY, CL, KMB, KO and PEP continuing to feel the impact of a slowdown in China. However, we note that particularly for EL, the International Air Transport Association (IATA) expects Chinese travelers (both internationally and domestically) to drive global air travel growth in the future—a forecast that bodes well for EL's travel retail business (12% of sales, and 25% of profits).

China GDP growth has consistently decelerated since 2010, though remains one of the faster-growing economies in the world at 6.9%.

Exhibit 29: China GDP growth

Source: RBC Capital Markets, FactSet

Exhibit 30: China retail sales growth

Driving part of the deceleration in Chinese GDP growth has been the slowdown in Chinese retail sales growth, now trending at 10.8%, a slight pickup from a low in April.

Source: RBC Capital Markets, FactSet

Brazil – A key area of concern for 2016

Brazil's economy has slipped into its worst recession in 25 years, hit by high inflation, and a string of tax hikes and spending cuts by President Dilma Rousseff. The central bank's IBC-Brazil economic activity index indicates economic activity fell 1.41% in the third quarter from the previous three months. That follows contractions of 2.09% in the second quarter, 1.05% in the first and 0.50% in the last quarter of 2014.

As Latin America's largest economy, we expect Brazil's slowdown will be a significant headwind for companies in our coverage, especially AVP, CL, PG, COTY, KMB, KO, PEP. AVP in particular will be impacted by a new cosmetics tax that will be levied on its representatives, which could hinder the company's active rep growth. Coupled with the headwind of a depreciating Real, we expect the Brazilian economy to provide significant challenges to these companies in 2015. According to RBC's FX team, the Real could depreciate a further 15–20% in 2016.

Brazil GDP declined from a year ago in the latest reading, despite playing host to the 2014 World Cup.

Exhibit 31: Brazil GDP growth

Source: RBC Capital Markets, FactSet

Since the beginning of this year, Brazil unemployment has spiked, reaching its highest level in five years.

Exhibit 32: Brazil Unemployment

Source: RBC Capital Markets, FactSet

India

Of the emerging markets, India's economy seems to have the most momentum. India's economic growth is expected to exceed 7.3% in the current fiscal year, with continued momentum into 2016, despite weakness in rural demand due to poor rainfall in the last two years.

The latest government data shows retail inflation surged to a four-month high in October and industrial production grew at a slower-than-expected pace in September.

India's economy slowed more than other emerging markets starting in 2011, but it is now turning around faster. We note that while this growth is encouraging, local players in India are a growing concern that could potentially impact multinational consumer players within our coverage universe. PG, CL and KO have the largest exposures to India, but strength in this region may be mitigated by weakness in other emerging markets.

Russia

Russia's 3Q GDP fell -4.1%, a slight improvement from -4.6% in 2Q. Russia's economy has been hit by falling global commodity prices and is under stress from sanctions imposed on it by mainly Western nations in response to what they see as Russia's aggressive policy toward Ukraine. Recovery prospects have been dimmed by signs that the excess supply of oil globally will continue for the foreseeable future, keeping the price of Russia's main export depressed.

Interestingly, this past earnings season, Russia and Ukraine were not cited as the concern that we expected. Though, as global sanctions against Russia remain and with ongoing military conflicts in the region, we believe it is best to take a cautious approach on this market. PEP, PG and AVP have the largest exposure to Russia across our coverage.

Middle East and Africa

The Middle East and Africa have been the largest hotbed of global volatility—with unrest in Iraq, Syria, Israel/Palestine, Saudi Arabia, Nigeria and Libya—all of which have major implications for the price of oil. Brent crude now sits below $40 per barrel.

Looking forward, we believe that the biggest issue in the Middle East and Africa is the high levels of unemployment among the young population. Without jobs and steady sources of income, further disruption and unrest in these volatile regions may occur.

Election risks

We believe it is prudent to keep a close eye on markets where elections could lead to swings in consumer confidence, government policies and in a worst case lead to local unrest. Markets where large-scale elections are set to take place include Peru, Taiwan, Philippines, Vietnam, India and Russia. In Peru's case, a Presidential election will take place, where there are group of candidates with differing views across the field—though Keiko Fujimori is determined to be the most pro-business and free trade among the candidates. Outside of emerging markets, there are also elections in Ireland, Portugal and Japan (half of the upper house is up for vote in July) in 2016. Germany and France have major elections in 2017.

Foreign exchange

Given our tempered view on global economies (and the relative strength of the US), we are not expecting to see currencies swing favorably for consumer staples companies in 2016. On average, recent movements in FX are expected to be a 230 bps headwind to our total HPC and beverage coverage in 2016. CCE and Avon are expected to face the largest headwind with 100% revenue recognition outside the United States for CCE and 90% for Avon. CL, PG, PEP and KO are also expected to see significant FX headwinds due to their large international exposure.

The Brazilian Real and Japanese Yen are two currencies of leading concern, with the potential to depreciate over 10% in 2016 irrespective of the US rate environment. In the Real's case, depreciation could be as high as 20%. The biggest issue being that given policy and economic growth forecasts for the US relative to the rest of the world, current spot rates may not appropriately factor further dollar appreciation, translating to further downward top line and EPS growth revisions. As we mentioned earlier, some of our conversations with RBC FX experts suggest the euro could drift below parity with the dollar.

Exhibit 33: Estimated 2015 foreign exchange headwinds (excluding hedging)

	Dec-15	2015	Mar-16	Jun-16	Sep-16	Dec-16	2016
CCE	-9.7%	**-13.8%**	-4.2%	-3.7%	-3.9%	-2.6%	**-3.6%**
PEP	-7.7%	**-9.3%**	-4.0%	-4.5%	-1.5%	-0.9%	**-2.9%**
KO	-7.0%	**-7.6%**	-4.0%	-4.0%	-1.4%	-0.6%	**-2.7%**
BF.B	-7.5%	**-9.3%**	-3.5%	-3.2%	-1.8%	-1.1%	**-2.4%**
MNST	-3.0%	**-3.7%**	-1.6%	-1.3%	-0.6%	-0.3%	**-1.0%**
COT	-2.4%	**-3.2%**	-1.0%	-1.3%	-0.8%	-0.4%	**-0.9%**
STZ	-1.6%	**-1.5%**	-0.8%	-0.9%	-0.3%	-0.2%	**-0.6%**
DPS	-1.7%	**-1.6%**	-0.9%	-0.8%	-0.1%	0.0%	**-0.5%**
Average	**-5.1%**	**-6.2%**	**-2.5%**	**-2.5%**	**-1.3%**	**-0.8%**	**-1.8%**
AVP	-16.7%	**-18.3%**	-10.8%	-9.9%	-3.2%	-1.1%	**-6.7%**
CL	-13.1%	**-14.9%**	-8.4%	-7.2%	-2.3%	-1.0%	**-5.0%**
COTY	-8.2%	**-9.1%**	-4.1%	-4.0%	-2.7%	-1.6%	**-3.2%**
ENR	-6.4%	**-8.9%**	-3.4%	-3.0%	-1.1%	-1.0%	**-2.2%**
PG	-8.0%	**-9.7%**	-4.6%	-4.4%	-1.9%	-1.1%	**-3.1%**
EL	-6.0%	**-7.9%**	-3.0%	-2.8%	-1.7%	-1.1%	**-2.2%**
JAH	-4.1%	**-5.3%**	-2.3%	-2.0%	-0.8%	-0.6%	**-1.5%**
NWL	-4.2%	**-4.8%**	-2.4%	-2.0%	-1.0%	-0.5%	**-1.5%**
CHD	-2.6%	**-2.9%**	-1.5%	-1.3%	-0.6%	-0.3%	**-0.9%**
CLX	-1.3%	**-1.3%**	-0.8%	-0.8%	-0.2%	-0.1%	**-0.5%**
KMB	-7.8%	**-9.0%**	-4.7%	-4.4%	-1.5%	-0.8%	**-3.0%**
Average	**-7.1%**	**-8.4%**	**-4.2%**	**-3.8%**	**-1.6%**	**-0.8%**	**-2.7%**
Beverages + HPC Average	**-6.3%**	**-7.5%**	**-3.5%**	**-3.2%**	**-1.5%**	**-0.8%**	**-2.3%**

Source: RBC Capital Markets estimates

Exhibit 34: Change in foreign exchange rates versus the US dollar

Western Europe	Companies w/ Exposure	12M
Euro	EL, AVP, CL, PG, ENR, NWL, CCE, BFB, KO,MNST	-15%
British Pound	EL, AVP, CL, PG, ENR, CCE, BFB, COT, MNST	-7%
Swiss Franc	CL, PG, ENR	-5%
Swedish Krona	CL, PG, CCE	-21%

Eastern Europe	Companies w/ Exposure	12M
Russian Ruble	EL, AVP, CL, PG, ENR, PEP, KO	-79%
Polish Zloty	EL, AVP, CL, PG, BFB	-18%
Czech Koruna	AVP, CL, PG	-14%
Turkish Lira	AVP, CL, PG, KO	-35%

Asia	Companies w/ Exposure	12M
Japanese Yen	EL, AVP, PG, ENR, KO, MNST	-17%
Chinese Yuan	AVP, EL, CL, PG, ENR, KO, PEP	-4%
Korean Won	EL, CL, PG, ENR	-16%
Australian Dollar	EL, AVP, CL, PG, ENR, BF.B	-24%
Thai Bhat	EL, AVP, CL, PG, KO, PEP	-12%
Taiwan Dollar	EL, AVP, CL, PG, KO, PEP	-8%
Indian Rupee	AVP, CL, PG, KO, PEP	-9%
Indonesian Rupiah	AVP, PG	20%
Philippines Peso	EL, AVP, CL, PG, ENR	-7%

Americas	Companies w/ Exposure	12M
Canadian Dollar	EL, AVP, CL, ACV, PG, ENR, STZ, COT, DPS, PEP, MNST	-18%
Brazillian Real	AVP, CL, PG, ENR, KO, PEP, MNST	-59%
Mexican Peso	EL, AVP, CL, ACV, PG, CLX, ENR, KO, BFB,DPS, PEP, MNST	-28%
Venezuelan Bolivar	EL, AVP, CL, PG, CLX	-11%
Argentinean Peso	AVP, CL, PG, CLX, KO, PEP	-11%
Chilean Peso	EL, AVP, CL, PG, CLX, KO	-16%

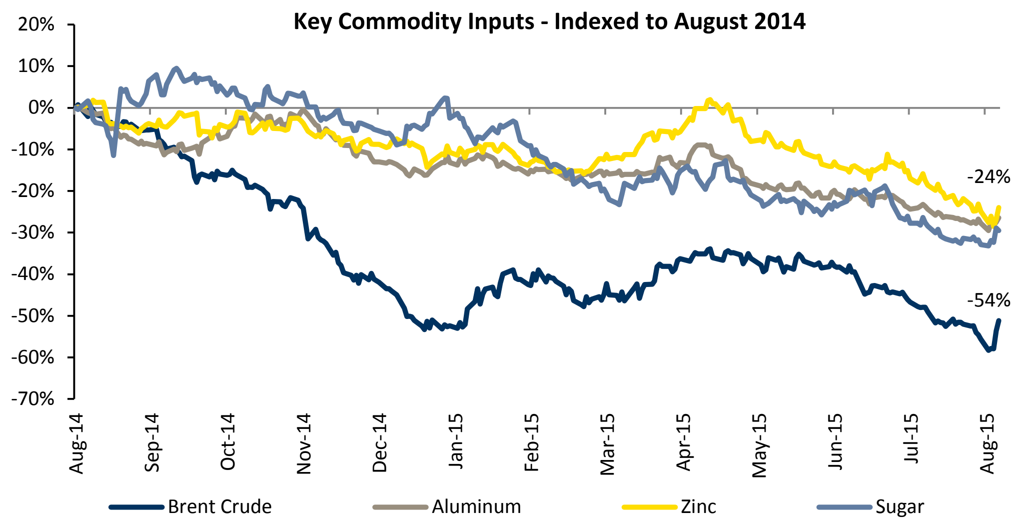
Source: FactSet

Commodities

In 2016, we expect HPC and Beverage players will continue to have a tailwind from commodity prices, offset by FX headwinds – albeit the benefits will likely vary by company.

Oil prices are down nearly 54% from a year ago, a big positive for the coverage. At the same time, prices for aluminum, zinc and sugar are also down nearly 25%.

Exhibit 35: Y/Y change in key commodity inputs (except resin where we discuss below)



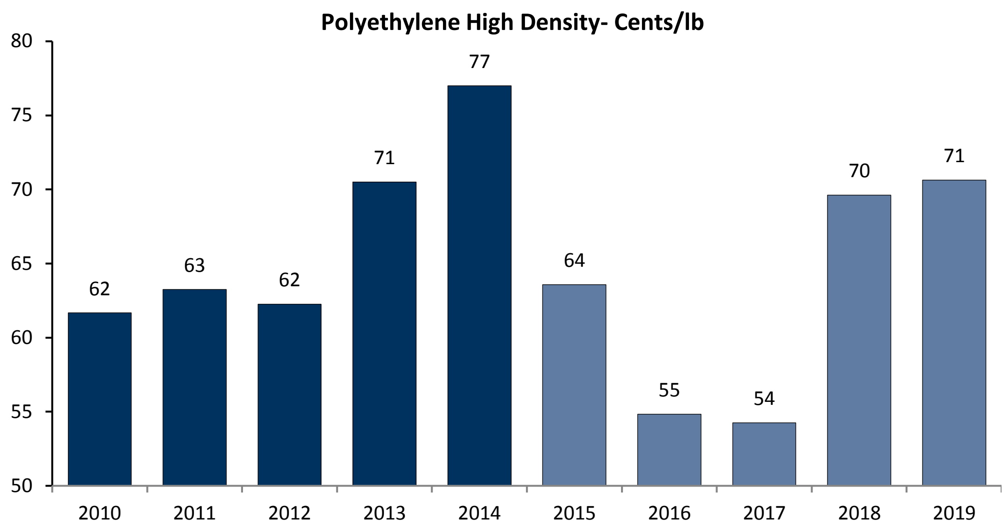
Source: FactSet

Leading CPG packaging supplier, Sonoco, reported lower packaging prices related to lower input costs—a read thru that was reaffirmed by Kimberly-Clark, Unilever and Dr. Pepper Snapple results. Kimberly-Clark benefited by $40M from lower input costs, which more than absorbed FX headwinds, while Unilever's home care business operating margins expanded 220 bps in the quarter.

The most encouraging sign for HPC is on the resin front, where the IHS is expecting contract polyethylene to decline significantly next year (-16%). We note the latest forecasts are down from those witnessed in early December, when IHS expected resin prices to be down only -4% in 2015. However, we note that some companies (most recently Newell) have called out capacity constraints issues for resin, which could lessen the positive impact to companies in our coverage.

Resin prices are expected to see a significant contraction in 2015 and then remain stable going forward.

Exhibit 36: IHS polyethylene resin annual price forecast



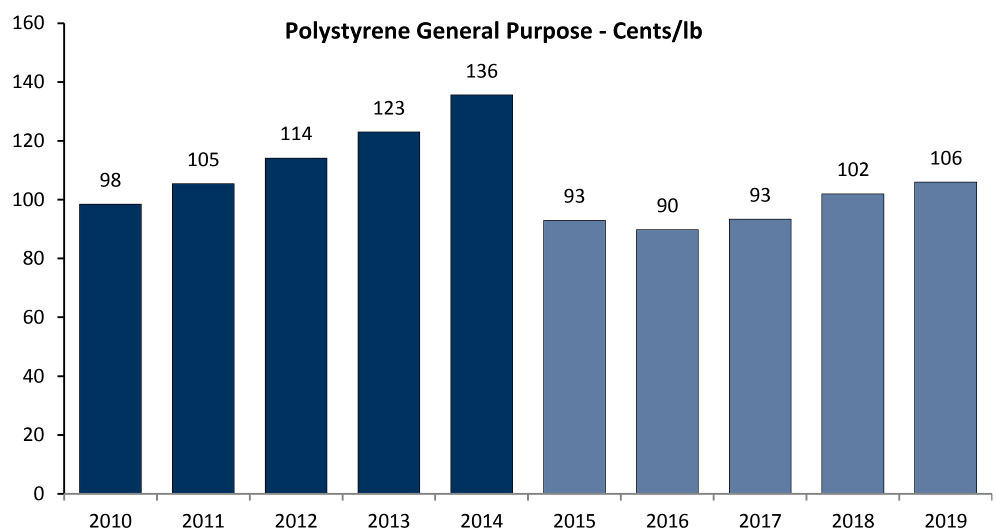
Source: IHS and RBC Capital Markets estimates

Inputs become especially important for Clorox given the company's trash bag products are made from polystyrene, a resin that includes benzene, which tracks oil even more closely than polyethylene. Given the recent decline in oil prices, polystyrene prices could be down as much as -30% in 2015.

Like polyethylene, the forward outlook for polystyrene is below current 2014 levels, suggesting years of relative input cost relief for the likes of Clorox, Church & Dwight and P&G.

The leading input for trash bags among other HPC products is expected to be down in 2015, for the first time in five years.

Exhibit 37: IHS polystyrene resin annual price forecast



Source: IHS and RBC Capital Markets estimates

Corporate actions

Last year was an active year for corporate action, and we have seen this trend roll over to 2016 as well. The beverage industry saw its fair share of “corporate action” in 2014. Beam was purchased by Suntory, PepsiCo continued to face activist pressure (and has delivered better fundamentals as a result), and Coca-Cola provided more granularity on its US refranchising efforts as well as announced a large-scale cost savings and productivity program. Coca-Cola also took a significant stake in Monster Beverage Corp (with Monster beginning to repurchase shares in 2016). This year, Constellation Brands announced a dividend and Cott acquired DS Services.

In HPC, the biggest corporate actions were Energizer’s decision to separate its business into two companies (household and personal care) and the recent news that Newell Rubbermaid and Jarden will be combining. In addition, P&G shed nearly 100 brands from its portfolio, with its announced sale of Duracell to Berkshire Hathaway and part of its beauty portfolio to Coty. We have seen a number of bolt-on acquisitions from the likes of Church & Dwight (Lil Drugs), Jarden (Milfori, Cadense and Rexair), Newell (Ignite and Bubba Brands) and Estée Lauder (Le Labo, Rodin Olio Lusso and Editions de Parfums Frederic Malle). Jarden also announced large-scale acquisitions of the Waddington Group and Jostens. We believe the combination of activist interest, low global growth, record amounts of cash on hand and low interest rates will continue to foster “corporate action” across the space.

Tobacco: Key Themes

We believe the five themes/areas of dialogue that we believe will be most prominent going forward are: (1) The new Big 3; (2) industry volume declines; (3) e-cigarette regulations; (4) marijuana regulation and (5) ABI-SAB implications. Within our coverage, we prefer Outperform rated Reynolds American (RAI) over Sector Perform Altria (MO).

Exhibit 38: Tobacco coverage summary

Company	Rating	Target	Current Price	Implied Upside	Target Multiple	Thesis	Key Topics
Reynolds American	Outperform	$53.00	$45.04	18%	20.9x	With the Lorillard acquisition completed, we believe RAI's stock could rally to $53 through 15% deal accretion on FY17 EPS estimates (via $900mm in synergies/productivity). And while our synergy estimates only bake in opportunities on the cost side, we believe there exists the opportunity for revenue synergies as well, especially from a more rational pricing environment over the long run and Newport potentially receiving better spacing at retail as part of RAI.	Top-line Synergies Game Changer Plan Execution Pricing E-Cigarettes (Vuse)
Altria	Sector Perform	$62.00	$57.52	8%	20.5x	We believe Altria provides investors with good fundamental performance, but every stock has a price. Today, Altria trades at a 10-year high P/E, at a premium to the consumer staples sector average, and a 3.7 turn premium to the S&P 500 (vs. no premium five years ago). We do not believe there is much multiple upside from here and EPS performance is limited to the company's 7-9% long-term growth target. As such, we rate Altria Sector Perform.	Pricing Dynamics arising from RAI/LO Deal Marlboro share trends ABI/SAB Deal

Source: RBC Capital Markets – Note: Priced as of December 14, 2015

Theme #1 – The new Big 3

On June 12, 2015, RAI closed its acquisition of Lorillard, which propelled the firm to a market share of 34% (from 26%) and enhanced its positioning in the category. To alleviate antitrust concerns, Reynolds American divested its flagship Winston cigarette brand, along with the Kool, Salem and Maverick brands (and the blu e-cigarette brand) to Imperial Tobacco. With Lorillard out of the picture (and with help of the acquired RAI assets), Imperial Tobacco, now holds the title of third largest tobacco company in terms of market share, thus formulating the new big three – Altria, Reynolds American, and Imperial Tobacco.

With the closing of the deal out of the way, investors have turned their focus to how the promotional/pricing environment will unfold going forward and what, if any, will be the impact of potential transition related disruption to RAI.

Expecting pricing to remain rational despite a more aggressive ITG Brands

While Imperial Tobacco has indicated it will step up promotional spend behind Winston and Kool, we note these increases vary by state. With that said, our field intel suggests Winston (after its new promotional program) will be at parity with Marlboro Special Blends, a 20% discount to base Marlboro and about a 10% discount to base Camel. Again, these are very rough numbers given promo rates change by state, but we wanted to provide some context about the range of discounts Winston will have relative to other large brands. It is important to remember that the pricing environment has remained robust despite the existence of Marlboro Special Blends.

As for KOOL, the promotional program is a bit more aggressive. Exhibit 42 details state-by-state promotions for KOOL between November 16th, 2015 and April 3rd, 2016. It is clear that ITG Brands is looking to get aggressive with KOOL in key Newport markets. For instance, the buydown rate in NY (Newport's largest market) is going up $0.95/pack.

Altria's cigarette business has been executing on all cylinders. Operating growth has decelerated in the most recent quarter, though still remains well ahead of historical levels.

Exhibit 39: ITG Brands Kool buydown values November 16, 2015 – April 3, 2016

State	Buydown Value	Value Increase	State	Buydown Value	Value Increase	State	Buydown Value	Value Increase
AL	$1.00	$0.50	MO	$0.40	$0.00	NYC	$0.44	$0.00
AR	$0.50	$0.00	MS	$1.05	$0.35	OH	$0.70	$0.00
CT	$1.00	$1.00	NC	$1.10	$0.80	PA	$1.20	$0.90
CA	$0.30	$0.00	NJ	$1.20	$0.95	RI	$0.90	$0.90
DC	$0.45	$0.00	NY	$1.20	$0.95	SC	$1.00	$0.70
DE	$0.80	$0.35	IN	$1.10	$0.80	TN	$0.30	$0.00
FL	$1.30	$1.00	KY	$0.30	$0.00	TX	$1.10	$0.40
GA	$1.05	$0.75	LA	$0.90	$0.00	VA	$0.90	$0.60
HI	$0.20	$0.00	MD	$1.15	$0.70	WI	$1.20	$1.00
IL	$1.10	$0.40	MI	$1.20	$0.50			

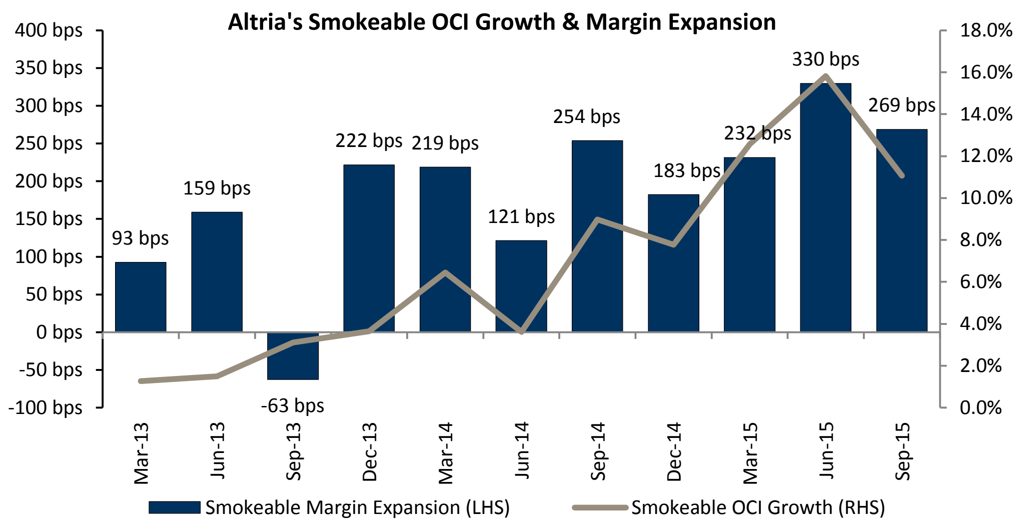
Source: ITG Brands, For Hawaii – the $2 buydown is in addition to $4 off-invoice promotion and therefore is $6 in total discount

While the depth of some of these promotions might be concerning, keep in mind that Marlboro Menthol is already in line with these post promotion price points. In fact, even after some of the stepped-up promotions on KOOL, Marlboro Menthol would still be cheaper in most states. Newport has prospered despite these competitive prices on menthol brands. We also point out that RAI recently introduced its 2016 EDLP program to provide retailers with incentive on both Camel and Newport for making Pall Mall the lowest-priced cigarette in their store. RAI currently has 60% participation in the program and believes it can raise that to 70% through the addition of Newport. This program will further help Newport stay competitive in the market place through additional promotions, but will also make sure Pall Mall maintains the integrity of pricing at the low-end of the market.

We remain of the view that Altria is the only company that could substantially upset the pricing "apple-cart". However, we do not expect Altria to change promotions in response to Imperial's strategy given the strong momentum in Marlboro's franchise and the tailwinds currently driving industry volumes (not to mention it already has some of the most competitive price points via Marlboro Special Blends and Marlboro Menthol).

Altria's cigarette business has been executing on all cylinders. Operating growth has decelerated in the most recent quarter, though still remains well ahead of historical levels.

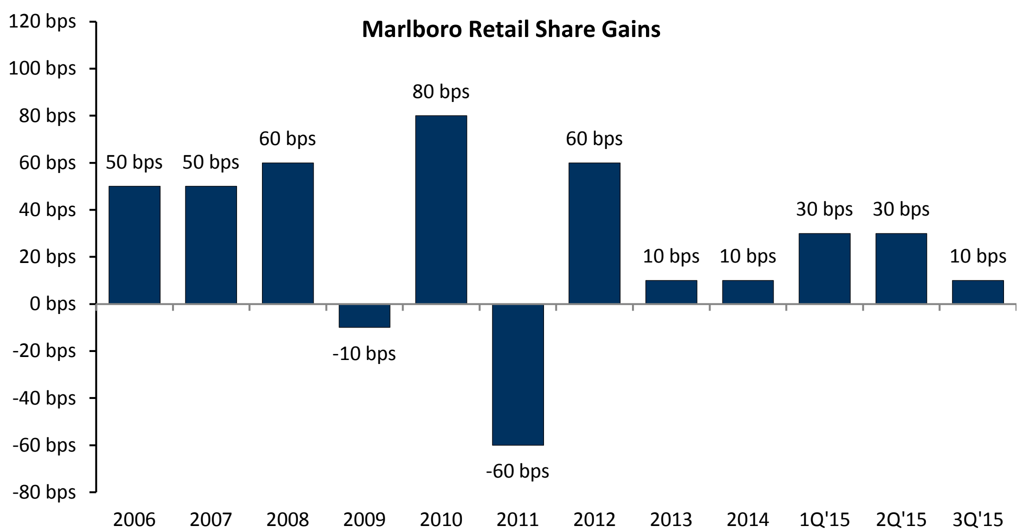
Exhibit 40: Altria's smokeable OCI growth & margin expansion



Source: Company reports and RBC Capital Markets estimates

PM USA has also seen modest share momentum in Marlboro.

Exhibit 41: Marlboro retail share gains



Source: Company reports and RBC Capital Markets estimates

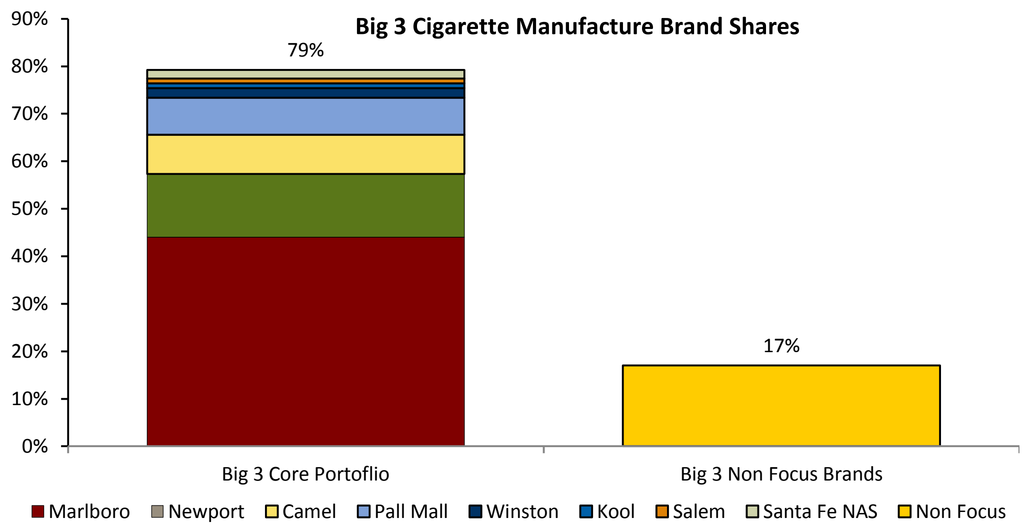
We also believe Altria's new 2016 Wholesale Leaders Program will further aid Altria in maintaining its share momentum on Marlboro, especially via a new provision entitled, the "PM USA Share Maintenance Incentive", which essentially holds wholesalers accountable for maintaining or growing Marlboro's share on a year-over-year basis.

Tail brands to become source of share

Considering some of the increases in promotional rates for Winston and KOOL along with a very talented sales organization (that ITG inherited from Lorillard), we would not be surprised to see share stabilization for these two brands in particular. Even in this scenario, we remain positive on the overall pricing environment. Why? Keep in mind that all the tobacco companies define winning based on the performance of their "focus brands". Marlboro in the case of Altria; Newport, Camel, Santa Fe and Pall Mall in the case of RAI; and now Winston, KOOL and to a lesser extent Salem, USA Gold and Maverick for ITG Brands.

We believe the most likely scenario to play out for the next 3–5 years is all three major manufacturers are able to hold/gain share in their core portfolio, at the expense of continued share losses in their non-core portfolio. Currently, the focus brands for the big three comprise 79% of the market, while the non-focus portfolio represents 17 share points. We expect the companies to continue to gain share in their focus portfolio by chipping away at the 17-share points of "non-focus" brands.

Exhibit 42: Big 3 cigarette manufacture brand share



Source: Company Reports and RBC Capital Markets

Reynolds American should be a top performer in 2016

RAI hosted their analyst day(s) on November 13th (London) and 16th (New York). We came away from the analyst day incrementally positive on the business, and believe the company has ample flexibility to beat cost synergies guidance and deliver on revenue synergies.

Momentum for Newport is strong, with the brand growing 3% this past quarter and we believe this performance has likely carried into the fourth quarter as well. RAI attributed the performance of Newport to greater sales support for the brand. Interestingly, the strongest growth came from Newport's non-core markets—the very markets where LO had virtually no sales representation for the brand. We believe Newport's momentum provides upside to 2016 estimates.

Other takeaways that struck us, include:

1) NAS Intl. sale proceeds will be used to pay down debt, which could bring the company to a 2.5x leverage ratio by mid next year. RAI is comfortable operating at the high end of its LT target range of 1.5x–2.5x.

2) New digital coupon initiative is more efficient than prior attempts, and encourages cross selling (key for C-store retailers).

3) New VUSE innovations coming to the market next year, including a tank/cig-a-like hybrid that could address potential regulatory concerns around open format e-cigs.

4) Procurement and leaf savings are among potential sources of upside for cost savings.

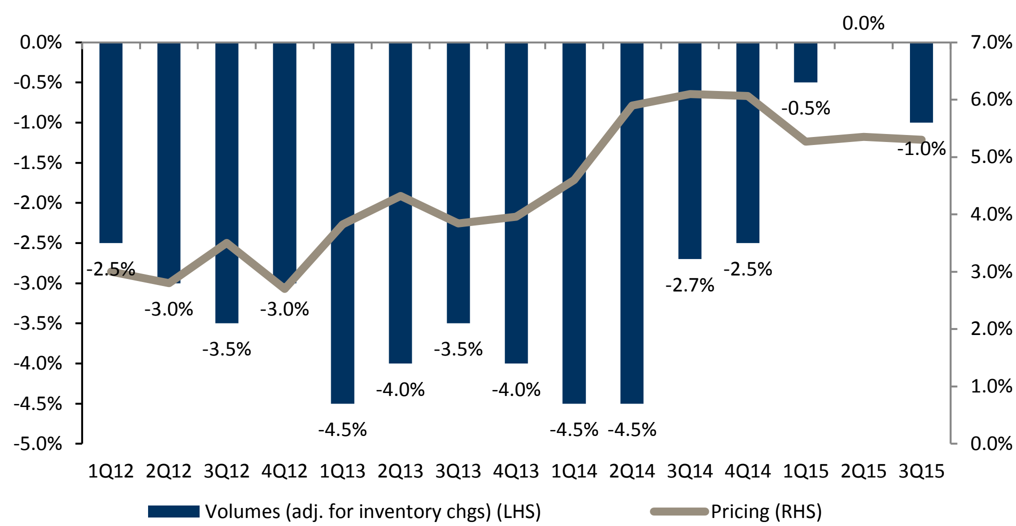
5) Most cost synergies should be realized in 2H'16.

6) Menthol regulation is not on the FDA's unified agenda.

Theme #2 – Industry volume declines

While cigarette industry volumes have performed better than expected in 2015, we are cautioning investors to keep expectations in check. We do not believe the category is in a new normal where cigarette volumes will decline -1% to -2% annually. Rather, we view 2015 as a positive anomaly that benefited from: (1) lower gas prices combined with wage inflation for low income consumer consumers, (2) retailers decision to reduce ecig/vape inventory in favor of premium branded cigarettes and (3) consumer migration away from untracked nicotine alternatives (roll-your-own, little cigars, etc.) and back into premium branded cigarettes. Our current expectation is for cigarette industry volume declines to return to down 3–4% in 2016 and we believe the tobacco companies will use the same expectation in their 2016 guidance (RAI recently indicated a range of down 2% to 4% at its recent Analyst Day).

Exhibit 43: Industry volume and pricing trends

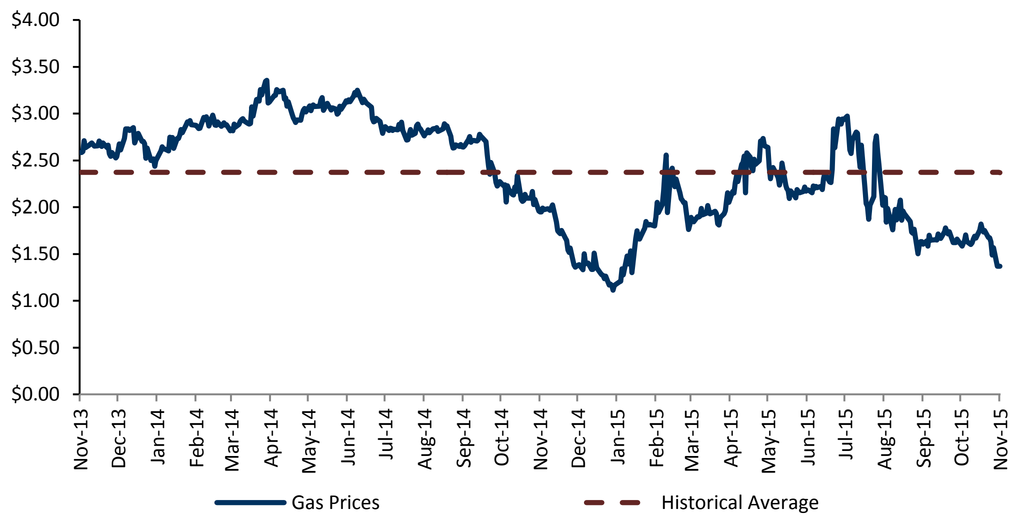


Source: Company reports and RBC Capital Markets estimates

While we prefer to take a more conservative posture to cigarette industry volume declines, we fully acknowledge the state of the tobacco consumer is in very good shape. Despite slowing growth in emerging markets, many multinational companies have called out North America for improving trends—suggesting that the outlook for the core tobacco consumer is positive. Gas prices are down meaningfully YoY, supplementing the low-end consumer with more discretionary income. Also, a combination of key metrics such as core tobacco unemployment, housing starts, and consumer confidence suggest that the tobacco consumer is enjoying a nice recovery, providing some potential upside to our down 3–4% assumption.

Exhibit 44: Gasoline price per gallon

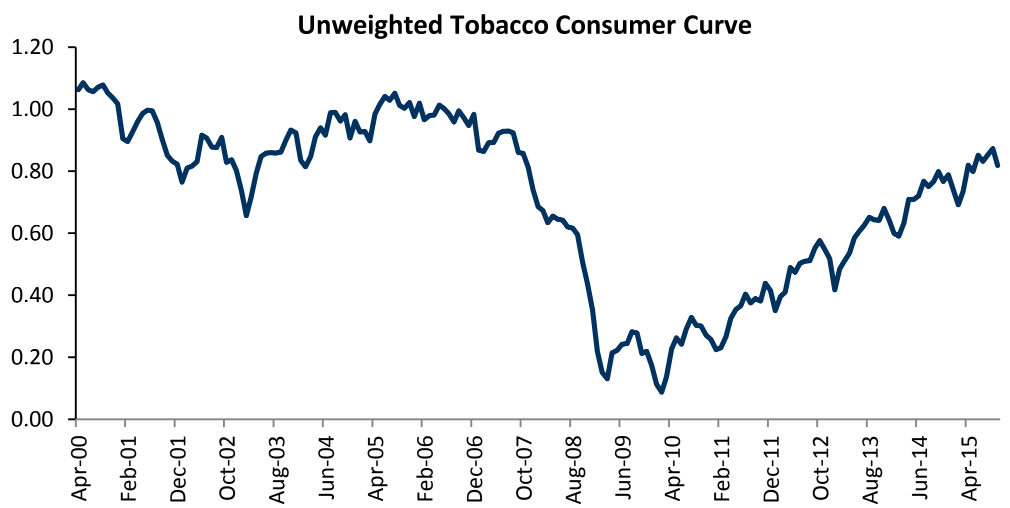
Lower gasoline prices leave core tobacco consumers with relatively more discretionary income to spend on tobacco products.



Source: FactSet

Exhibit 45: Unweighted tobacco consumer curve

The strength of the core tobacco consumer continues to improve, as measured by our "tobacco consumer curve".



Note: Tobacco consumer curve is defined as an average index of consumer confidence, housing starts and core tobacco consumer unemployment (mfg, hospitality and construction unemployment).
Source: RBC Capital Markets

Theme #3 – E-cigarette regulations

The e-cigarette category has garnered significant attention over the past few years (though we'd argue that most industry participants and investors have overinflated expectations). Looking forward, we believe e-cigs will continue to command significant attention (especially with clarity on deeming regulations likely in the coming months).

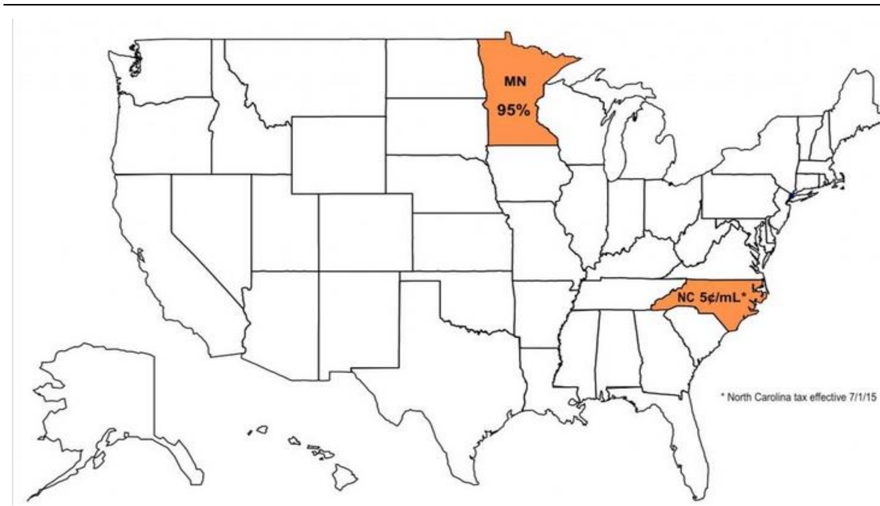
To date, 19 states (+DC) have imposed some sort of regulation with respect to e-cigarette or vapor products. Looking forward, we expect a large regulatory following—at both the state and federal level—that will likely impact category sustainability. According to the US Food and Drug Administration, e-cigarettes have not been fully studied, and as a result, consumers are denied crucial information such as the potential risk of products when used as intended, the amount of nicotine or other potentially harmful chemicals that are being inhaled during use, and whether there are any benefits associated with using the products. As category awareness increases, we expect health officials will place an increased emphasis on the regulatory process.

Staying vigilant ahead of looming deeming regulations

On October 19, the FDA submitted its much-awaited final proposed deeming rule to the Office of Management and Budget (OMB) for review. While the FDA has not officially stated what the final rule includes, most industry participants are not expecting it to change significantly from the draft regulations released in 2014. In fact, a leaked version of the rules that surfaced in November suggests that the pre-market approval process will stifle innovation in the industry and put significant burden on smaller manufacturers by increased compliance cost and procedures. Because of the stringent pre-market approval requirements, products that are already close to development will likely require significant further investments to ensure they are survivable under the requirements of the approval process, which could delay innovation in the market in the near future. Furthermore, because products that are approved by the pre-market approval process cannot be used in the less burdensome Substantial Equivalent approval process, it is likely that approval of new e-cigarettes products will be very slow and not many new products are likely to come on the market. We believe that should the rules be finalized in this form, the industry is likely to see consolidation into a handful of players who have the resources to comply with FDA regulations.

In Minnesota, e-cigs and e-juice are considered tobacco products and are subject to the Tobacco Tax, which is currently 95% of the wholesale cost of any product containing or derived from tobacco. North Carolina also imposed a $0.05/mL vapor tax that went into effect 7/1/15.

Exhibit 46: State excise tax on e-cigarettes/vapor products



Source: Nato

Exhibit 47: Passed e-cigarette/vapor regulations

State	Bill Summary	Status
Arkansas	Allows individuals under 18 to buy e-cigs if acting on behalf of tobacco control agents.	4/6/2015 – Signed by Governor
	Limits smoking on educational campuses and long-term care facilities.	3/31/15 – Signed by Governor
	Regulates e-cigarettes, vapor products, and alternative nicotine products; amends certain Laws concerning the regulation of tobacco products.	4/7/2015 – Signed by Governor
California	Prohibits sale of non-nicotine vapor delivery systems to minors	10/11/15-Signed by Governor
Connecticut	Regulates the public use of electronic nicotine delivery systems and vapor products—requires child resistant packaging for liquid nicotine	7/6/15 Signed by the Governor
District of Columbia	Taxes vapor products at the OTP tax rate of 70% (included in FY2016 budget)	5/27/15- Budget bill adopted by the DC Council
Hawaii	Prohibits use of e-cigarettes where smoking is prohibited, effective July 1, 2016 (in SB 757 and HB 940)	4/23/15 –(HB940) Signed by Governor
Idaho	Prohibits minors from selling and distributing tobacco products and electronic cigarettes.	3/26/15- Signed by Governor
Indiana	Would regulate the sale and manufacture of e-liquid	5/7/15- Signed by the Governor
	Requires a license to sell electronic cigarettes and child-resistant packaging for liquid nicotine products, passed the House and returned to the Senate with amendments on April 15, 2015. Amendments loosen certain restrictions in the state smoking ban and assign certain issues to the 2015 public policy interim committee (e-cigarette taxation and the fiscal impact of a cigarette tax increase).	5/7/15- Signed by the Governor
Maine	Prohibit use of e-cigarettes in areas where smoking is banned	7/4/15 Became law without the Governor's signature
Maryland	Would prohibit the sale of components for an electronic device or a product used to refill or resupply an electronic device to a minor	5/12/15- Signed by the Governor
Missouri	Prohibits the sale or transfer of alternative nicotine products to individuals under the age of 18 and requires vapor liquid to be sold in childproof containers.	7/8/15 – Signed into law
Montana	Revises the Youth Access to Tobacco Products Control Act to provide a definition for "electronic smoking devices" and to revise the definition of "tobacco product" to include electronic smoking devices. Defines an electronic smoking device as "any product containing or delivering nicotine or any other substance for human consumption that can be used by a person to inhale vapor or aerosol devices. Prohibits the sale or use of these devices by minors.	4/28/15- Signed by Governor
Nevada	Prohibits the sale of vapor products to minors	6/4/15-Signed by Governor
New Mexico	Relates to trade practices. Would require the use of child-resistant packaging for nicotine liquid.	4/8/15- Signed by Governor
	Introduced and referred to the Senate Public Affairs and Judiciary Committees on 2/3. Would amend the Tobacco Products Act to change the title of the act to the Tobacco Products and E-Cigarette Act. Would prohibit the sale of e-cigarettes to minors. Would require nicotine liquid containers to be sold in child-resistant packaging. Prohibits the online internet sale of e-cigarettes to a minor in New Mexico.	4/8/15- Signed by Governor
North Carolina	Prohibits the sale of e-liquid containers without child resistant packaging and safety warning labels.	Signed by Governor 6/30/15; Goes into effect 60 days after end of 2015 NC session.
North Dakota	Makes a technical change in the definition of "other tobacco products." Electronic cigarettes would not be included in this revised definition. * The Tobacco sections were removed in the February 11, 2015 engrossed version of this bill.	4/9/15- Signed by Governor
	Prohibits the sale and use of vapor products and alternative nicotine products by minors, requires child resistant packaging for liquid nicotine containers, and prohibits self-service displays. However, there is an exemption that allows self-service displays in tobacco specialty stores.	4/8/15- Signed by Governor
Oregon	Defines inhalant delivery system; amends laws concerning sale of tobacco products to, and use of tobacco products by, minors so those laws equally apply to inhalant delivery systems; provides for further regulation of inhalant delivery systems; expands scope of offense of endangering welfare of a minor from knowingly causing sale of tobacco products to minors to knowingly allowing sale of tobacco products to minors and adds distribution and sale of inhalant delivery systems.	5/26/15- (HB2546) Signed by Governor
Tennessee	Prohibits individuals under the age of 18 access to e-cigarettes.	5/7/15 – Enacted into law
Texas	Relates to the regulation of vapor products. Creates offenses for sales or gifts of such products to minors	5/28/15- (SB97) Enacted
Utah	Regulations on electronic cigarette products	4/24/15-Signed by Governor
Vermont	Imposes a tax on tobacco substitutes (electronic cigarettes) at 46% of wholesale and restricts public use where smoking is prohibited (Tax on tobacco substitutes amended out)	6/5/15 Signed by the Governor

Source: NATO (status as of 11/12/15)

E-cigarettes – latest developments

For much of the past three years since the emergence of the category, some investors had a sense of worry that e-cigarettes will have a profoundly negative impact on the cigarette category. While it made logical sense that e-cigs could be a legitimate replacement for traditional cigarettes, we believe product efficacy of e-cigs still has a long way to go before we start seeing core cigarette consumers fully migrating over to the e-cig category.

Interestingly, we have continued to see a moderation in the rate of cigarette industry volume declines despite all the hype around e-cigarettes. Adjusted industry volumes for the June quarter were flat, and have been trending well above average in recent quarters, reaffirming of our view that e-cigs/vapor are not adversely affecting traditional cigarette trends in a material fashion.

Exhibit 48: Y/Y change in adjusted cigarette industry shipments

	2Q'12	3Q'12	4Q'12	1Q'13	2Q'13	3Q'13	4Q'13	1Q'14	2Q'14	3Q'14	4Q'14	1Q'15	2Q'15	3Q'15
Volumes (adj. for inventory chgs)	-3.0%	-3.5%	-3.0%	-4.5%	-4.0%	-3.5%	-4.0%	-4.5%	-4.5%	-2.7%	-2.5%	-0.5%	0.0%	-1.0%
				-4.5%	-3.5%	-3.5%	-3.5%	-4.5%	-4.3%	-3.1%	-3.3%	-2.5%	-2.3%	-1.9%

Source: Company reports and RBC Capital Markets

Vapor boom appears to be fading

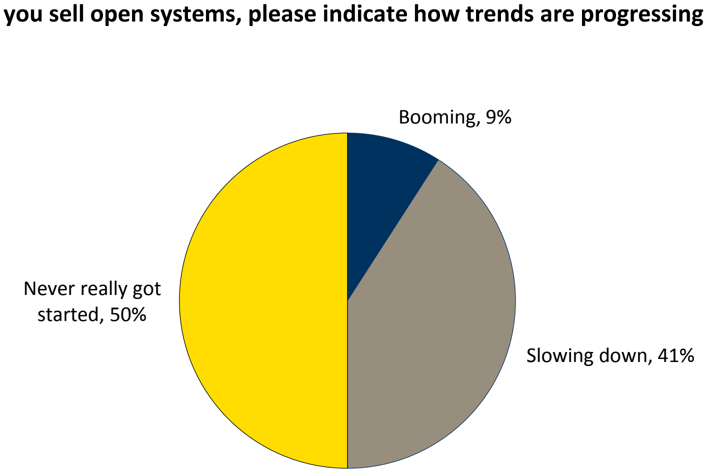
Vaporizers are the customizable form of e-cigarettes that enables users to modify the nicotine content and flavor specifications to their preference. The growing interest in vaporizers has led to the emergence of "vape shops" throughout the US, popping up in both rural and urban communities. Many vape shops are like high-end, modern coffee shops, with an element similar to wine tasting, where smokers can try and buy a variety of e-liquids with the help of professional salespeople.

In 2014, vaporizers began to significantly displace the sales of traditional "cig-a-like" e-cigarettes, driven by a stronger battery life, greater product efficacy and cost efficiency. However, we note that the vapor boom that started last year has quickly faded away and is unlikely to make a significant dent in the overall cigarette category. C-stores, which is the largest channel for tobacco, are now de-emphasizing the vapor category given poor sales of the product. This is largely due to a niche consumer group that is interested in vapor products and has a demographic that is different than the core tobacco consumer. As such, we believe vapor is more likely to remain a small sub segment of the overall tobacco industry rather than turn into a revolutionary category, at least in the near future.

Feedback we have picked up from retailers and wholesalers suggests the e-cig/vaping category continues to struggle and retailers are struggling with too much inventory on hand (which is hurting retailer ability to take on new innovation). We believe this is largely the function of too many brands in the category and brand velocity being too low. According to our latest survey work 11% of retailers are expanding their e-cigarette offerings, down from 23% in the June survey. Furthermore, feedback on Vapor's performance has been mixed, with 68% of the retailers selling vapor products though only 9% said their sales of vapor products were "booming".

Majority of the c-stores we surveyed are showing a slowdown in their vapor sales or the business never took off.

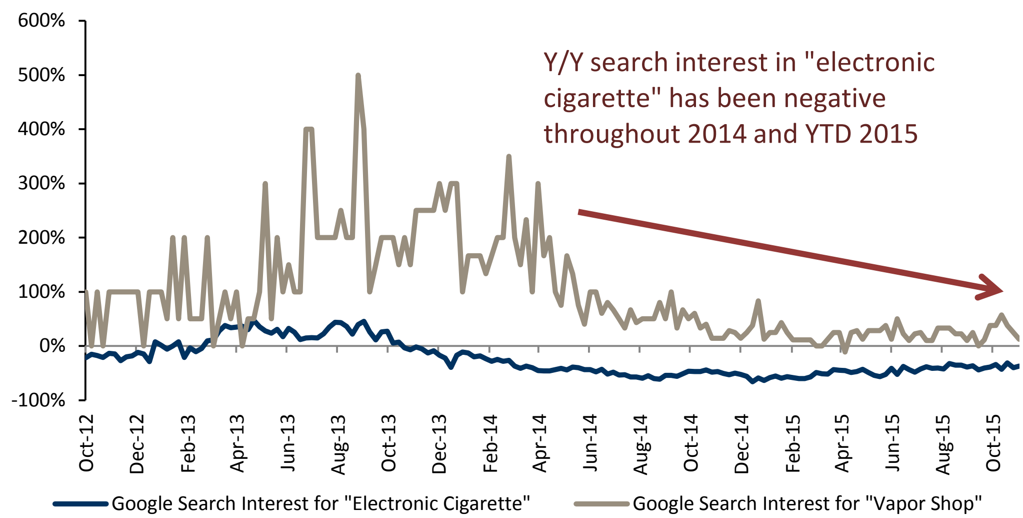
Exhibit 49: RBC Capital Markets – CSP Tobacco Retailer Survey



Source: RBC Capital Markets – CSP Tobacco Retailer Survey

Google search interest for "Electronic Cigarette" and "Vapor Shop" have lost significant steam over the past two years.

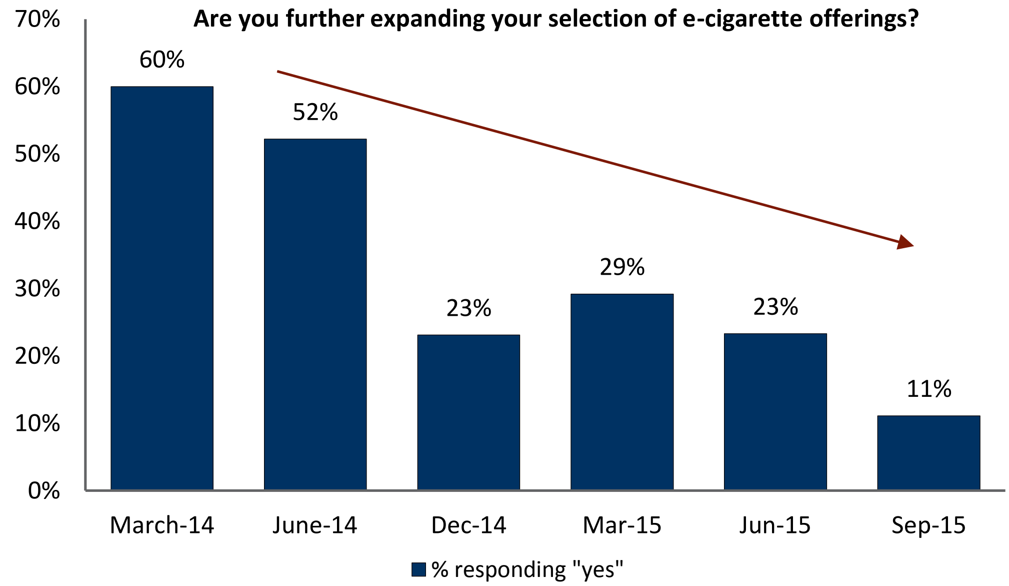
Exhibit 50: Google search interest for "electronic cigarette" and "vapor shop"



Source: Google Trends

Majority of the c-stores we surveyed are no longer expanding their selection of e-cigarettes.

Exhibit 51: RBC Capital Markets – CSP Tobacco Retailer Survey



Source: RBC Capital Markets – CSP Tobacco Retailer Survey

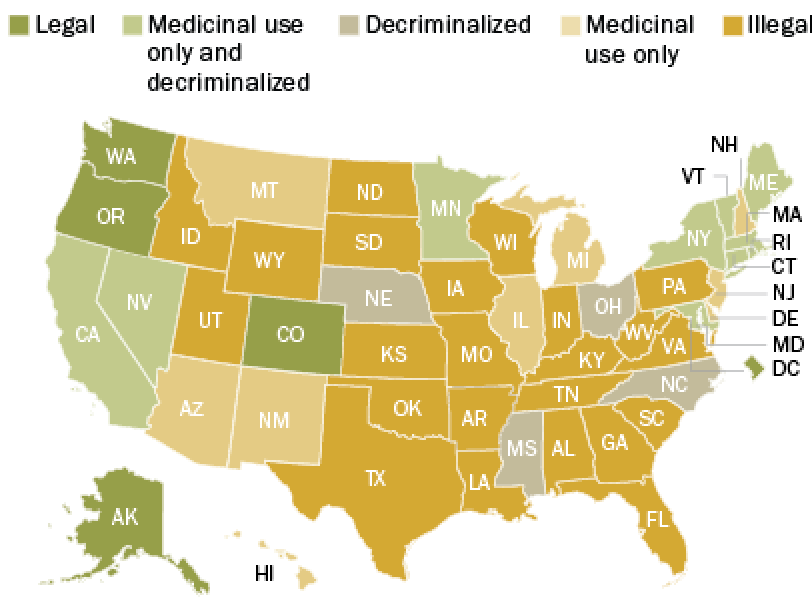
Theme #4 – Marijuana regulation

We expect to hear more about marijuana regulation in 2016 given the activity across various states to legalize (or decriminalize) use of the product. Today there are 27 states, as well as Washington DC, which have legalized marijuana in some form or have decriminalized the drug. A few additional states are slated to consider legislation in 2016.

According to a recent Gallup poll, Americans are warming up to the idea of marijuana legalization. Continuing a 46-year trend upward, 58% of Americans think marijuana should be federally legalized, up from 51% last year. This marks the third year in a row with majority support for legalization, after support initially jumped above 50% in 2013 behind legalization in Colorado and Washington state. Public opinion on marijuana has shifted rapidly in recent years, shooting significantly higher in the last decade. During the 2000 election, only 31% of respondents favored marijuana legalization, which was little changed from 28% in 1977. It is interesting to note that the rapid change in public perception of marijuana is following a similar trajectory as same-sex marriage. This year, 60% of Americans support same-sex marriage, up from 37% only 10 years ago. Furthermore, in 2005, only one state legally recognized same-sex marriage. In 2015, same-sex marriage became federally legal.

Marijuana is now legal in some form or decriminalized in 27 states and Washington, DC.

Exhibit 52: Marijuana laws by state

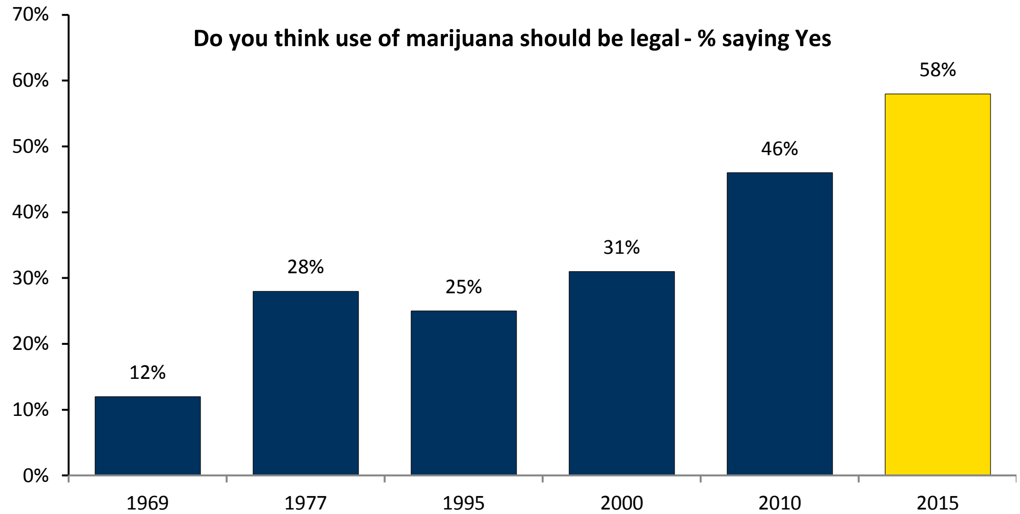


Source: PEW Research Center

For the first time ever, the majority of Americans believe marijuana should be legal—a likely critical topic for the 2016 presidential election. With this quickly changing view of marijuana across the US, we believe it is only a matter of time until investors start asking questions about how it will fit into the bigger picture. And while every tobacco company management we have spoken to on this topic has been unwilling to discuss it, we believe full federal legalization of marijuana in the US would likely lead tobacco companies to reconsider this space.

Exhibit 53: % of people saying marijuana should be legal

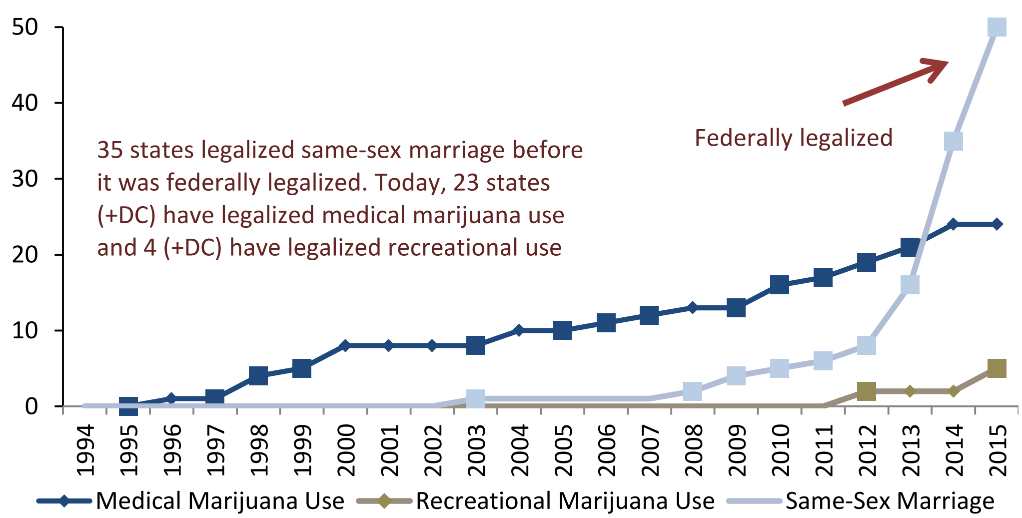
More than half of the US adult population believes that marijuana should be legal, the highest level ever.



Source: Gallup

Exhibit 54: State-level legalization of marijuana and same-sex marriage

Medical marijuana has now been legalized in 23 states (+DC) and 4 states (+DC) have legalized marijuana for recreational use.



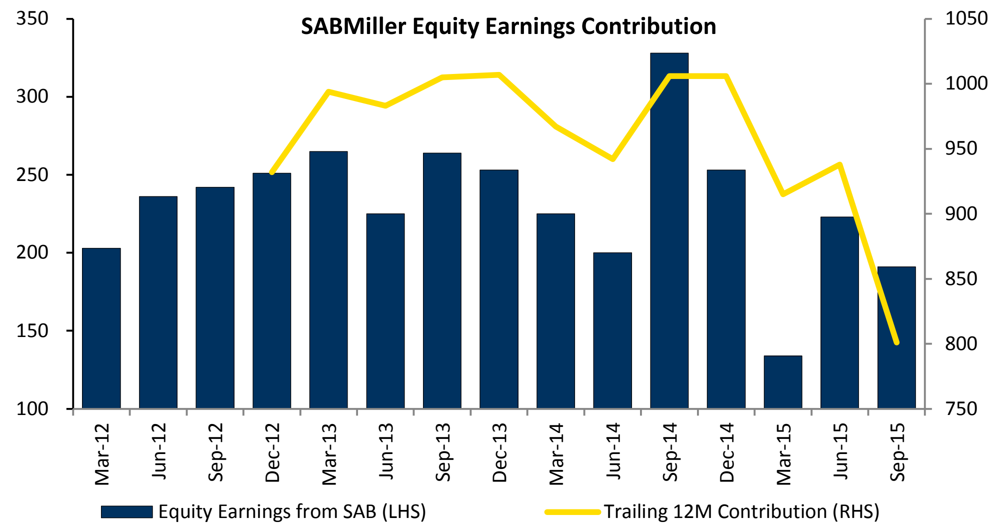
Source: procon.org and governing.com

Theme #5 – ABI/SAB implications

Altria announced it expects to receive an approximately 10.5% stake in the new, combined ABI/SABMiller business and approximately $2.5 billion in cash, subject to proration. Altria will also hold two seats on the new company's board of directors, and continue to use equity accounting, which will allow it to book its portion of NewCo's income on its income statement. The company also indicated the deal will lead to tax efficiency, though we do not have precise rates at this point.

Once a big source of contribution to MO's earnings growth, equity income from SAB has declined in recent quarters due to ongoing FX headwinds.

Exhibit 55: SABMiller equity earnings contribution



Source: FactSet

While we have not updated our estimates at this time, we point out that under the equity method of accounting, our 2019 EPS estimate (assuming all synergies are realized by then) will be boosted by 8–10% and equity income will contribute an incremental 1 pp to MO's long-term EPS growth vs. our current estimates. We also fully expect Altria's $2.5 B in cash proceeds to be used for share repurchases and have accordingly modeled $1 B in annual share repurchases through 2024. Net/net we see the ABI/SABMiller as an incremental positive for MO, though not a thesis changer. As it relates to the pricing environment, while Altria will have a tailwind to its income from this combination, we continue to expect the company to lead the industry on price realization (as long as Marlboro continues to gain modest share—which has been the case for the past few years and we expect that will continue).

Household, Personal Care key themes

The three themes/areas of dialogue that we believe will govern stock price performance in the HPC sector in 2016 (in addition to macros) are: (1) the new consumer value equation; (2) local players; and (3) the P&G effect. Our most preferred names in the sector are Energizer, Newell-Rubbermaid, Estée Lauder and Edgewell Personal Care. We remain cautious on PG and Coty.

Exhibit 56: HPC coverage snapshot

Company	Rating	Price Target	Current Price	Implied Upside	Target Multiple	Thesis	Key Topics
Jarden	Sector Perform	$60.00	$54.09	11%	18.9x	We rate Jarden shares Sector Perform with a $60 price target. We believe JAH will be acquired by NWL for $60 in consideration, which leaves only 8% upside to shares from December 15, 2015 levels. We expect the deal to be approved by shareholders and regulators. We do not expect any additional bidders for the business.	1) Impact of acquisitions 2) Weather 3) Capital allocation 4) SG&A Opportunity 5) Big box inventory management
Energizer	Outperform	$52.00	$33.83	54%	19.5x	Our thesis is simple: management has guided to low-single digit EBITDA growth, though we believe the company could generate mid-single-digit long-run EBITDA growth behind improved pricing and cost savings. We believe Energizer's 2016 guidance has some cushion to absorb any further deterioration in FX or higher costs associated with the separation from Edgewell Personal Care.	1) EPS delivery 2) Cost savings efforts 3) P&G Effect
Edgewell Personal Care	Outperform	$111.00	$75.94	46%	29.6x	We rate EPC shares Outperform mainly on the prospects of a take out. We believe a larger, multi-national suitor could use its scale and distribution network to significantly expand Schick/Wilkinson- Sword's presence globally (similar to how Unilever expanded TRESemme after acquiring Alberto-Culver).	1) Takeout 2) Wet shave competitive landscape 3) Emerging market white space expansion 4) Cost savings, particularly improved trade efficiency
Estée Lauder	Outperform	$105.00	$85.55	23%	28.7x	Through a combination of secular drivers and company specific initiatives, we forecast Estée will be able to grow its revenue and EPS by 6% and 10%+ annually over the next 10 years, almost 2x the sector average. The company has exhibited very good balance in its growth profile (growing 6%+ despite struggles for Clinique/Estee Lauder and China). On a growth adjusted basis, EL remains one of the cheapest names under our coverage.	1) Structural drivers (rising influence of women, aging population, etc) 2) Trends in China 3) Share in skin care (with particular focus on Clinique in the US) 4) Cost savings initiatives
Newell Rubbermaid	Top-Pick	$60.00	$42.15	42%	24.8x	We rate Newell Top-Pick. Given lack of overlap between Newell and Jarden, we expect the JAH acquisition will close on-time in 2Q16 and our pro-forma DCF model implies a $60 share value (38% upside). More importantly, we believe NWL could double in 5 years behind three phases: 1) deal closure, cost synergy realization (which we believe are conservative), 2) top-line synergy realization (not included in synergy guidance) and 3) Project Renewal 2.0 execution (we believe there is meaningful opportunity by leveraging some of NWL's best operating practices into JAH's businesses, there by realizing significant increase in profit per employee).	1) Jarden Integration 2) Ongoing delivery of Growth Game Plan 3) Performance of recent Jarden acquisitions
Colgate	Outperform	$71.00	$65.85	8%	23.7x	We continue to believe Colgate has an enviable business with large shares in a very profitable and growing category. However, with FX likely to deteriorate further (particular in Latin America-the company's largest business), we believe "all in" EPS could be at risk of further downside revisions. With that said, we expect Colgate to lead its mega cap peers in terms of volume growth and FX-neutral revenue growth.	1) P&G Effect 2) Cost savings upside 3) Macros 4) Potential M&A
Coty	Sector Perform	$30.00	$26.60	13%	26.8x	We rate Coty Sector Perform. While Coty's deal with P&G will transform the company into a larger player within the beauty category, we see upside from the deal limited and see significant execution risk given Coty's past record in integrating platforming changing deals.	1) Integration of Wella 2) Slowing core business 3) More M&A 4) Leadership
Church & Dwight	Sector Perform	$89.00	$83.99	6%	25.1x	While CHD shares certainly deserve to benefit from their relatively high exposure to the US consumer and limited FX risk, we believe the stock's valuation already reflects these attributes. CHD shares currently trade at 24x 2016 consensus earnings, near the high end of our coverage. Two points of concern for 2016 include: 1) the P&G Effect (will PG step up spending in US laundry now that is has streamlined its portfolio) and 2) ongoing struggles in gummy vitamins.	1) category growth for gummy vitamins 2) P&G Effect (Laundry competition) 3) New innovations 4) Capital allocation
Procter & Gamble	Sector Perform	$76.00	$78.29	-3%	18.1x	We remain on the sideline and believe PG is unlikely to see improved trends in its business unless it significantly addresses it addresses its culture and organizational design in a more meaningful way. If new CEO David Taylor wants to sustainably turn the business, we believe the near-term news will have to be negative (as we believe PG needs to make changes that will impact near-term earnings and execution).	1) Turning around beauty 2) Organization redesign 3) Closing the revenue growth gap with peers 4) Divestitures
Avon	Sector Perform	$4.00	$3.89	3%	11.8x	While recent activist news on AVP could be a reason to get bullish, we reiterate our view that EPS estimates are likely to come down (meaningfully) before they go back up. As a remidner, we have estimated that AVON needs to spend somewhere between $500 mm to $1 bn in order to: 1) streamline its IT backbone, 2) improve rep compensation, and 3) enhance brand equity.	1) Rep activity/retention 2) Intensifying competition (Brazil, Russia and Philippines) 3) Wage inflation in key markets 4) New CFO
Clorox	Sector Perform	$121.00	$126.47	-4%	23.4x	While Clorox sales and earnings growth rates appear to be inflecting upward, we believe the stock's current valuation fully reflects the company's opportunities. More specifically at 24x FY16 EPS and a PEG of 3.6, CLX shares trade at a 40% premium to our coverage average PEG 2.5 (excluding CCE and COT).	1) Input costs, gross margins 2) Category growth 3) Capital allocation 4) Competitive skirmishes
Kimberly-Clark	Outperform	$114.00	$122.65	-7%	18.6x	While we are believers in Kimberly-Clark's growth story, we feel the company is fairly valued at this time as it trades in line with its consumer staples mega-cap peers. Kimberly-Clark is a well managed company, competing in some of the faster growing global HPC categories; however, at current levels, we feel Kimberly-Clark would need to continue its beat and raise track record, which there may be some risk to over the coming years.	1) Cost savings initiatives 2) Local player competition 3) Input costs, gross margins 4) Emerging market volatility

Source: RBC Capital Markets estimates and FactSet– Note: Priced as December 14, 2015

Theme #1 – The new consumer value equation

We believe the converging forces of shifting demographics, low levels of trust (among millennials) and the reach of social media has evolved the typical consumer value equation used by most companies to make pricing, marketing and innovation decisions. The old consumer value equation largely meant price of the product divided by the benefits of the product. Today, we believe the value equation has changed to the price of the product divided by a combination of benefit and recommendation. In other words, word-of-mouth and consumer referrals are becoming increasingly important to the future trajectory of a given brand. In this regard, the size of a company's marketing budget is no longer the competitive advantage it used to be, which is why we are seeing the smaller companies make significant inroads against larger players, even in their own "wheel houses". An example of such a dynamic are small craft brewers taking share from major brewers, Sazerac (via Fireball) taking share from major spirits players, smaller cosmetics players such as Urban Decay (before being acquired by L'Oréal) getting more shelf space and smaller natural and organic food players taking share from larger food players. This changing dynamic makes product efficacy that much more important.

Exhibit 57: The transition of the "consumer value equation"

$$\text{Consumer Value Yesterday} = \frac{\text{Product Price}}{\text{Product Benefit}}$$

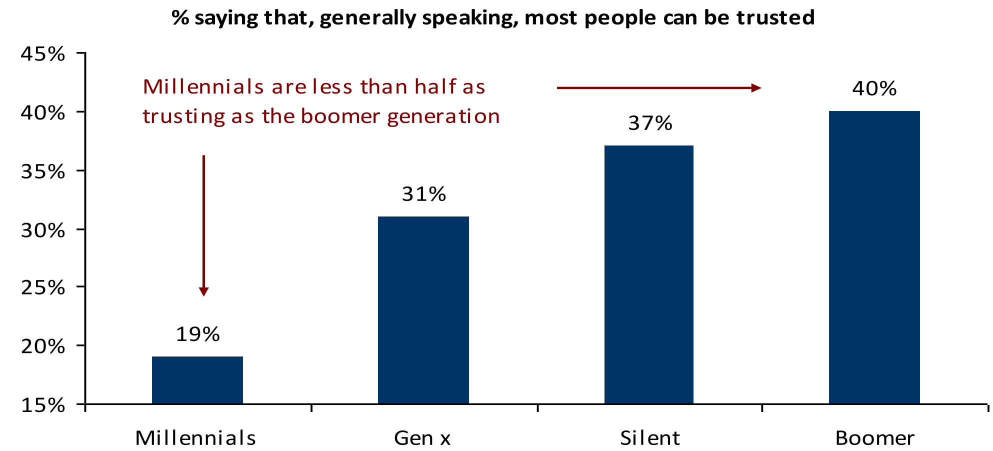
$$\Downarrow$$

$$\text{Consumer Value Today} = \frac{\text{Product Price}}{(\text{Product Benefit} + \text{Recommendation})}$$

Source: RBC Capital Markets

Exhibit 58: The newer generations of consumers are less trusting of people and organizations

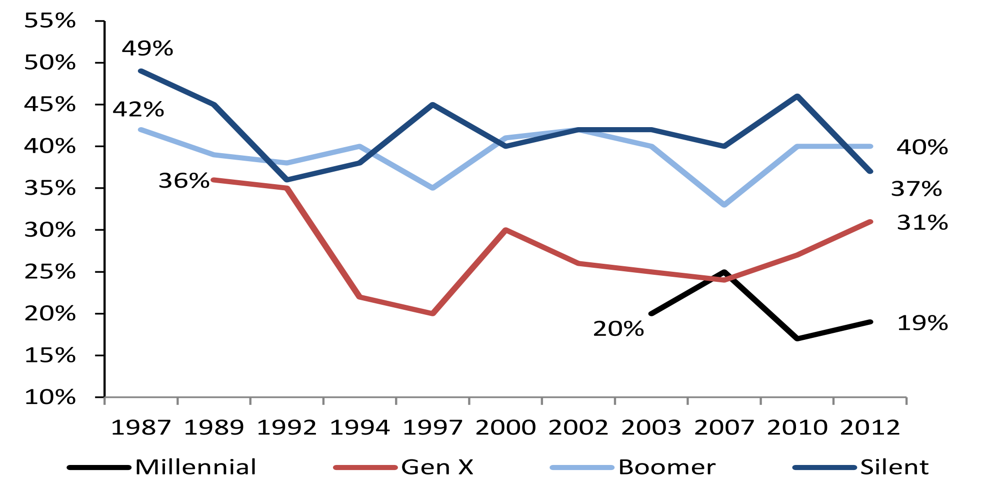
Young consumers are unlikely to listen to traditional forms of advertising such as commercials, endorsements and marketing events—alternatively, they trust only their friends and family.



Source: Pew Research

Exhibit 59: Historical % of those who trust others across generations

Trust levels have come down over time across generations.



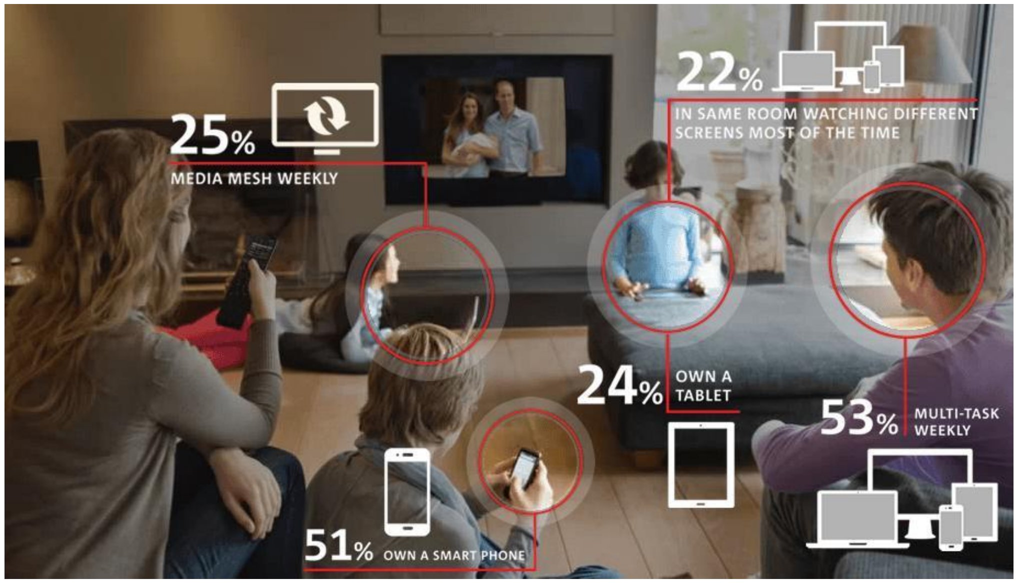
Source: Pew Research

Technology and the new "soap opera"

Leaving the consumer value equation aside, families today do not sit captive in front of the television as they did during the 1950s. Today, consumers "media mesh"—using smart phones, tablets, DVRs independently and while watching television—enabling consumers to avoid company advertising efforts.

Today's families "media mesh"—using multiple forms of media at once.

Exhibit 60: Media meshing is the new form of media consumption

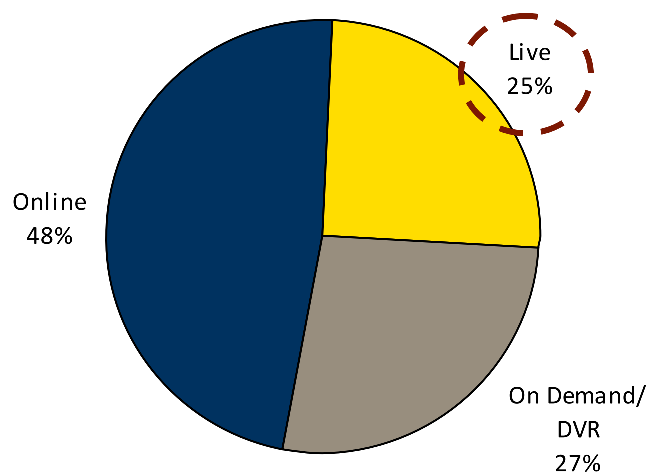


Source: iSellMobile

Today we could consider Facebook and YouTube to be the modern soap operas. 25% of TV viewing by young consumers is done live, and the Boston Consulting Group (BCG) estimates that only 26% of young consumers watch 20 or more hours of TV per week, versus 49% of older consumers.

Only 25% of TV viewing by young consumers is done live—therefore, we wonder if TV commercials are getting through to this important buying group.

Exhibit 61: New consumer media consumption breakdown

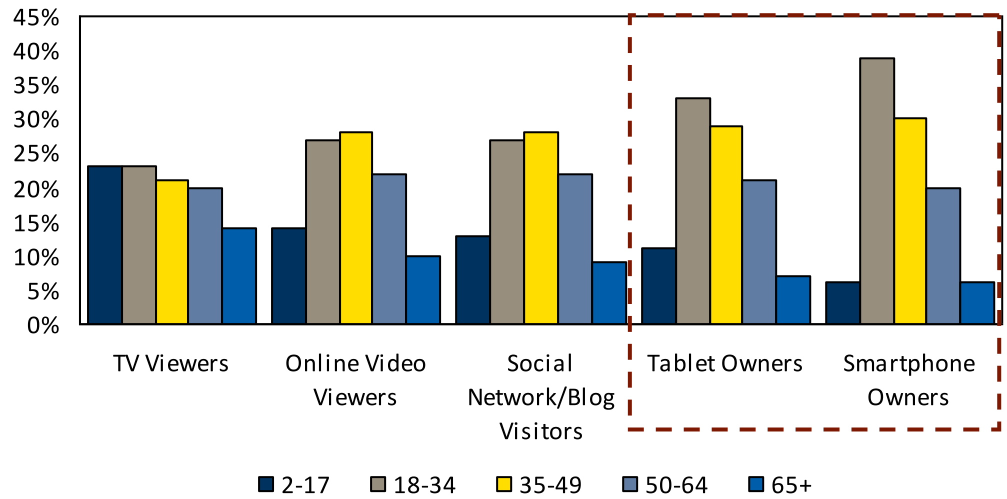


Source: iSellMobile

Furthermore, the same study has shown that consumers today are also more likely to watch TV on their computers than ever before. All of these changes in media consumption are developments major consumer staples companies will have to adapt to.

Today's consumers are consuming more media via their tablets and smart phones than television.

Exhibit 62: New consumer media consumption breakdown



Source: iSellMobile

Smart phones are also influencing how consumers shop, as 50% of young consumers surveyed reported using a mobile device to read user reviews and to research products while shopping, versus 21% of older consumers. More new consumers also tend to rate products and services on the Web compared to older consumers (60% versus 46%). Ultimately, using smart phones and tablets influences the way consumers shop—comparing price points, quickly identifying sales and using coupons.

Theme #2 – Local players

While most of the competitive focus for most of the HPC players comes down to other multinational (publicly traded) companies, we believe the battlefield for sales is becoming increasingly local. How often do you hear about Guangzhou Liby Enterprise Group from P&G when it discusses laundry competition in China? We believe the growing competitiveness of local players across categories and countries is shining a bright light on the effectiveness of organizational designs. For instance, we believe making decisions locally is becoming much more effective than those making in-market decisions more centrally. In a sense, the search for margin through scaling the business has had a direct impact on top line (due to inefficient or uninformed decision-making). After all, the manager in Brazil is probably going to make better decisions about what the Brazilian consumer wants versus a manager with global responsibilities that is based in Singapore, Geneva or the US.

Exhibit 63: Brazil local players in HPC with over 5% market share, with above-average sales growth and consistent market share gains

Subcategory	Global Brand Owner	Current Percent Share	Share Point Change from 2004	10-Year Sales Growth CAGR
Fragrances	Botica Comercial Farmacêutica Ltda	29%	5.0	20%
Laundry	Química Amparo Ltda	13%	7.6	7%
Mass Beauty	Botica Comercial Farmacêutica Ltda	12%	4.3	23%
Total Home Care	Química Amparo Ltda	11%	6.3	9%
Total Beauty	Botica Comercial Farmacêutica Ltda	10%	3.5	23%
Bath and Shower	JBS SA	9%	6.9	46%
Tissue and Hygiene	Hypermarcas SA	8%	8.2	311%
Hair Care	Niely do Brasil Industrial Ltda	7%	6.9	N/A
Premium Beauty	Puig SL	7%	6.9	N/A
Total Home Care	Bombril SA	7%	6.7	9%
Tissue and Hygiene	Mili SA	6%	3.3	28%

Source: RBC Capital Markets, Euromonitor

Exhibit 64: China local players in HPC with over 5% market share, with above-average sales growth and consistent market share gains

Subcategory	Global Brand Owner	Current Percent Share	Share Point Change from 2004	10-Year Sales Growth CAGR
Laundry	Guangzhou Liby Enterprise Group Co	16%	5.9	13%
Home Care	Guangzhou Liby Enterprise Group Co	15%	7.1	14%
Tissue and Hygiene	Hengan International Group Co Ltd	11%	6.3	19%
Oral Care	Yunnan Baiyao Group Co Ltd	10%	9.5	45%
Laundry	Guangzhou Blue Moon Co Ltd	6%	5.6	58%
Total Home Care	Guangzhou Blue Moon Co Ltd	5%	4.1	41%

Source: RBC Capital Markets, Euromonitor

Exhibit 65: India local players in HPC with over 5% market share, with above-average sales growth and consistent market share gains

Subcategory	Global Brand Owner	Current Percent Share	Share Point Change from 2004	10-Year Sales Growth CAGR
Laundry	Ghari Industries Pvt Ltd	17%	5.6	15%
Hair Care	Marico Ltd	9%	9.3	17%
Home Care	Godrej Group	8%	7.9	109%
Bath and Shower	ITC Ltd	6%	6.1	48%
Hair Care	Godrej Group	6%	1.7	25%

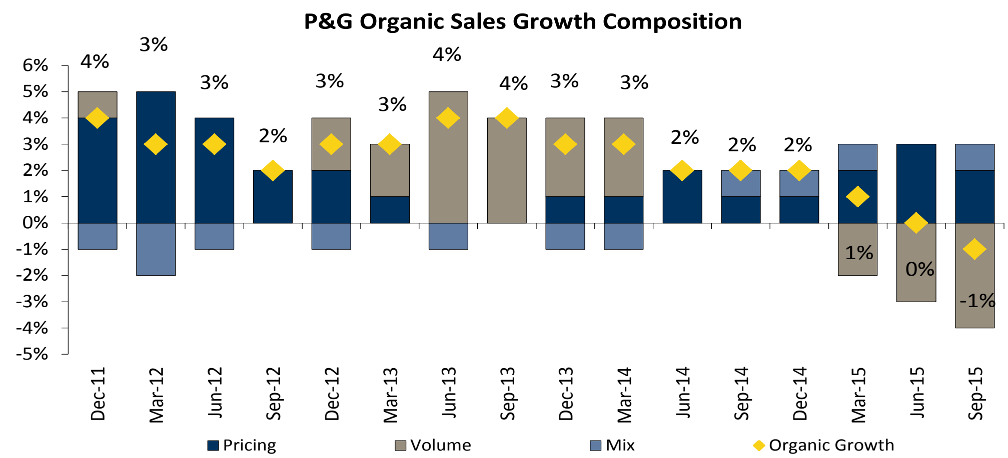
Source: RBC Capital Markets, Euromonitor

Theme #3 – P&G effect

Our long-held cautious stance on P&G has been primarily attributable to poor levels of accountability within the organization and too much central decision making that has led P&G to miss key changes in trends in many local markets--ultimately leading to poor top line and share erosion. A poor culture of risk taking has also been an area of concern.

P&G's organic growth has been driven entirely by price and mix for the past six quarters, with volumes most recently trending negative and leading to an overall organic growth deceleration.

Exhibit 66: Procter & Gamble organic growth composition



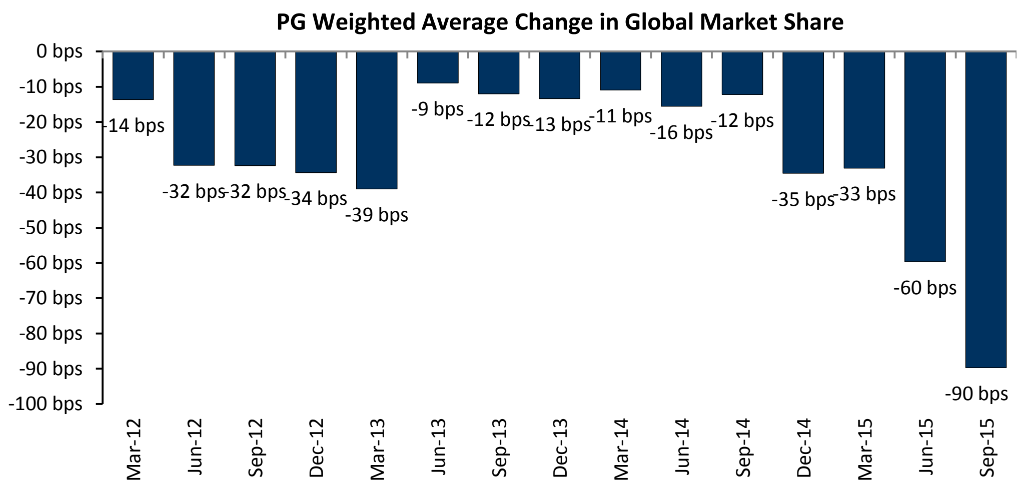
Source: RBC Capital Markets and Company documents

Exhibit 67: P&G market share trends

Market Share	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15
Beauty	-20 bps	-40 bps	-50 bps	-50 bps	-40 bps	-60 bps	-30 bps	-20 bps	-40 bps	-50 bps	-40 bps	-50 bps	-40 bps	-40 bps	-70 bps	-100 bps
Grooming	-60 bps	-10 bps	0 bps	10 bps	-10 bps	20 bps	10 bps	20 bps	10 bps	40 bps	-10 bps	0 bps	-30 bps	-30 bps	-30 bps	-130 bps
Health Care	0 bps	-20 bps	-20 bps	-40 bps	-30 bps	-40 bps	10 bps	-40 bps	-20 bps	-10 bps	30 bps	-10 bps	-10 bps	-20 bps	-50 bps	-50 bps
Fabric and Home Care	-50 bps	-20 bps	-30 bps	-30 bps	-30 bps	-40 bps	-20 bps	0 bps	10 bps	30 bps	10 bps	30 bps	-10 bps	-10 bps	-30 bps	-40 bps
Baby and Family Care	30 bps	30 bps	-40 bps	-30 bps	-50 bps	-40 bps	10 bps	-20 bps	-20 bps	-40 bps	-40 bps	-40 bps	-70 bps	-60 bps	-100 bps	-140 bps
Weighted Average	**-21 bps**	**-14 bps**	**-32 bps**	**-32 bps**	**-34 bps**	**-39 bps**	**-9 bps**	**-12 bps**	**-13 bps**	**-11 bps**	**-16 bps**	**-12 bps**	**-35 bps**	**-33 bps**	**-60 bps**	**-90 bps**

Source: Company reports and RBC Capital Markets estimates

Exhibit 68: P&G weighted average change in global market share



Source: Company reports and RBC Capital Markets estimates

Given its sheer size, the strategies of P&G have typically impacted the overall competitive landscape. For instance, when former CEO Bob McDonald decided to become more aggressive in the emerging markets at the onset of his CEO-tenure, it weighed on the margins/top line of its key competitors. We recently had the opportunity to sit down with P&G’s new CEO David Taylor. We liked what we heard. David Taylor acknowledged all of our concerns and is starting to provide more autonomy to each of the business presidents (10 businesses P&G is focusing on). The current focus is on P&G's largest geographies from a profit stand point, including the US and China. The question now becomes one of execution -- an area that we are not willing to give P&G the benefit of the doubt just yet. With that said, P&G’s refocus may not get it to top tier growth, but if the company manages to stem share losses, it could have an impact on other key HPC companies we cover.

In a series of P&G CY16 focus markets, P&G has an average 28 percentage points more share than key competitors.

Exhibit 69: P&G potential focus market/category combinations relative to key competitors in our coverage

Market	Category	P&G Market Share	Key Competitor (Market Share)	Share Percentage Point Difference Between P&G and Key Competitor
North America	Laundry Care	53%	CHD (11%)	42
North America	Oral Care	33%	CL (19%)	14
North America	Dishwashing	52%	CL (21%)	31
North America	Feminine Care	38%	EPC (25%), KMB (21%)	EPC 13, KMB 17
North America	Tissue and Hygiene	32%	KMB (24%)	8
North America	Wet Shave	68%	EPC (16%)	52
Latin America	Wet Shave	78%	EPC (5%)	73
Western Europe	Wet Shave	65%	EPC (15%)	50
Western Europe	Tissue and Hygiene	19%	KMB (8%)	11
India	Tissue and Hygiene	42%	KMB (7%)	35
Middle East and Africa	Tissue and Hygiene	24%	KMB (14%)	10
China	Tissue and Hygiene	11%	KMB (4%)	7
Average		**43%**	**15%**	**28**

Source: Euromonitor, RBC Capital Markets

However, P&G's renewed focus on businesses where it has the largest market share, will source funds from market/category combinations where P&G has less of an advantage. Key markets where P&G may reduce focus include oral care globally, outside of North America, Bath and Shower soap in Western Europe as well as diapers throughout Latin America.

We expect P&G will reduce reinvestment in key market/category combinations where it does not already have leading share positions, such as oral care in emerging markets.

Exhibit 70: P&G potential non-focus market/category combinations relative to key competitors in our coverage

Market	Category	P&G Market Share	Key Competitor (Market Share)	Share Percentage Point Difference Between P&G and Key Competitor
China	Oral Care	17%	CL (29%)	-12
Brazil	Oral Care	15%	CL (48%)	-33
India	Oral Care	5%	CL (48%)	-43
Australasia	Oral Care	15%	CL (45%)	-30
Eastern Europe	Oral Care	17%	CL (28%)	-11
Western Europe	Bath and Shower	1%	CL (13%)	-12
Latin America	Diapers	22%	KMB (43%)	-21
Average		**13%**	**36%**	**-23**

Source: Euromonitor, RBC Capital Markets

We believe P&G's likely scale-back in oral care in some markets outside of the US should have a positive impact on Colgate, who will in turn have a lower cost of voice. We could argue Energizer is also poised to benefit from P&G's refocused strategy and divestment of Duracell, which has already led to improved battery category pricing. On the flipside however, competitive intensity will likely rise for Church & Dwight, Kimberly-Clark and Edgewell as P&G reinvests in laundry detergent at home along with wet shave, tissue and hygiene globally.

Exhibit 71: P&G effect implications summary across our coverage

Company	P&G Effect Impact	Rationale
Colgate	Beneficial	We expect Colgate to be the biggest beneficiary of the P&G effect. Outside of North America, Colgate has dominant market share positions in oral care, particularly in Brazil and India where the company commands 48% market share. We see P&G refocusing on the US oral care and dish categories at the expense of global oral care and dish, which will be a competitive tailwind for
Energizer	Beneficial	We expect P&G to continue to manage Duracell rationally in very early 2016 before the business divestiture is closed with Berkshire Hathaway. Once in Berkshire's hands, we expect Duracell will continue to be a rationale competitor over the long-term.
Church & Dwight	High Risk	Church & Dwight is at most risk from the P&G Effect. We expect P&G will significantly ramp reinvestment in its home North American laundry detergent market, where P&G already commands 53% market share, nearly 5x the size of Church with 11% market share.
Kimberly-Clark	High Risk	Globally we expect P&G to step up reinvestment across Tissue and Hygiene where P&G is a share leader in both developed and emerging markets, making it tougher for Kimberly to compete. The one market exception is LatAm, where KMB commands a 43% diaper share versus P&G at only 22%.
Edgewell Personal Care	High Risk	P&G has 70% share of blades and razors in North America versus Edgewell, the next largest player, with only 16% share. P&G also has wet shave share advantages versus Edgewell in LatAm and Western Europe. Feminine Care in North America is another area where P&G will likely reinvest given P&G's 38% share versus Edgewell 25%.
Avon Products	High Risk	With a much more stream lined beauty portfolio, we expect PG to reinvest more behind Olay and Pantene--brands that compete with AVON's hair care and skin care brands.
Coty	Low Risk	P&G will renew focus on its existing business that was not sold to Coty - though there is limited overlap between P&G's remaining portfolio and Coty's business (PG more prestige, Coty more mass/salon).
Estee Lauder	Low Risk	There is limited competitive threat to Estee from P&G, though we will continue to keep an eye on P&G's APAC prestige skin care SK-II where we would expect incremental reinvestment. Though for context SK-II only has 2% of prestige beauty share in China, compared to Estee at 10%.
Clorox	Low Risk	We expect P&G to become more focused on the US (which accounts for ~85% of CLX sales) though the businesses have little category overlap, so risk is limited.
Jarden and Newell	No Overlap	Jarden and Newell do not compete with P&G.

Source: RBC Capital Markets

Beverages Key Themes

We see several sub-sector themes that will be important in 2H'15 for the beverage industry: (1) Coca-Cola's reset year; (2) the ongoing shift in consumer preferences; (3) bifurcated macros; and (4) corporate action.

Exhibit 72: Snapshot of our beverage coverage

Company	Rating	Target	Current Price	Implied Upside	Target Multiple	Thesis	Key Topics
Constellation Brands	Outperform	$165.00	$137.69	20%	26.2x	In a growth contstrained environment, we believe STZ offers investors a very unique asset with both top line growth and significant margin expansion. We believe top line will continue to be driven by 8% volume growth in the core beer business enhanced by the recent acquisition of Ballast Point. Improving price/mix in wine could provide additional upside to our estimate. On margins, we continue to believe wine margins will move higher as STZ improves its mix (to higher-end wines) and beer margins are poised to improve from the low 30's to the upper 30's in a few years.	1) Sustainability of core Beer volume growth 2) Margins in Wine & Beer 3) New growth initiatives 4) Integration of Ballast Point
Cott Corp	Outperform	$16.00	$10.36	54%	8% target FCF yield (current 13%)	Following Cott's transformative acquisition of DS Services, we believe long-run FCF growth has become more predictable (contrary to the company's history) – justifying a lower FCF yield for the name over time. Our $16 PT implies 8% FCF yield versus 12% today and 5% for our group. We believe investors are shifting their focus away from EPS/EBITDA and towards free cash flow generation.	1) Improved pricing in US CSD's 2) DS Services integration 3) Contract manufacturing momentum 4) FCF generation and growth
Monster	Outperform	$166.00	$151.91	9%	42.3x	On the back of its relationship with Coca-Cola, we believe Monster has a significant opportunity to close the gap with Red Bull International over the next 5-7 years. This makes Monster a compelling multi-year investment. However, we caution investors to be vigilant of near-term volatility as Monster is unlikely to provide a clear road map on its global roll out plans, which makes predicting near-term EPS power difficult.	1) Pace of International Expansion 2) Innovation in the US 3) Capital Allocation
Coca-Cola Co.	Outperform	$47.00	$42.45	11%	23.2x	Coca-Cola is making progress through cost savings, volume improvement, re-franchising efforts and improved pricing in the US, though macro challenges may limit upside to numbers in the coming quarters.	1) Volume acceleration 2) Re Franchising Efforts 3) Global CSD trends 4) Impact from new COO and CMO
Brown-Forman	Outperform	$109.00	$101.01	8%	28.8x	Despite the pressure from FX, Brown Forman continues to exhibit superior growth relative to the rest of consumer staples. We believe the migration of consumers into the whiskey category is still in its early innings due to broadening consumer penetration via flavored whiskeys and the growing trend of narrative-based consumption (e.g. brands under pinned by interesting narratives are the ones experiencing growth). At its current valuation, we see the stock's appreciation coming more from EPS growth than multiple expansion.	1) Global Whiskey Movement 2) Pricing Power 3) Tennessee Fire National Launch
Coca-Cola Enter	Sector Perform	$54.00	$49.73	9%	19.1x	We rate CCE Sector Perform given the run in the stock post the announced formation of Coca-Cola European Partners. Our math suggests that CCE is now fairly valued given company guidance around the deal. While there could be upside, we believe recent FX moves and the 1 year lag until the deal is completed could keep a lid on the stock in the near-term.	1) Deal closure of CEP 2) Potential upside to synergies 3) FX 4) Volume momentum
Boston Beer	Sector Perform	$220.00	$206.54	7%	27.0x	While SAM shares have sold off significantly, we remain on the sidelines. Risk to reward is more favorable here, but lack of visibility into when the on-premise channel will improve (where SAM over indexes) and innovation success (Grapefruit IPA, Nitro beer, hard root beer, etc) coupled with deteriorating trends in the core business (Boston Lager/Cider) keep us on the sidelines.	1) Craft beer category growth 2) IPA / Shandy Opportunity 3) Sustainability of Cider 4) Margin expansion?
PepsiCo	Sector Perform	$102.00	$97.95	4%	21.6x	We rate PEP shares Sector Perform. We expect modest upside to PEP shares due to likely better-than-expected fundamentals (as the company benefits from lower oil prices and the US economy improves). With that said, we do not expect to see any significant corporate action (e.g. break-up of the company).	1) KO Reset 2) Implications of management turnover 3) Next steps for Trian 4) Smart Spending initiative
Dr Pepper Snapple	Sector Perform	$90.00	$91.83	-2%	21.0x	DPS has a few initiatives that are working in its favor that could provide upside to earnings: 1) its position as the preferred distribution partner for up and coming beverage brands, 2) COGS deflation (packaging/apple juice etc) which could provide further margin benefits; 3) continued strong pricing realization, which doesn't show any signs of slowing any time soon given KO and PEP's FX headwinds are likely to carry over into 2016; and 4) execution on marketing initiatives, which are targeting growing demographics (Hispanics/sports/EDM). With that said, at 21x NTM P/E, DPS is already one of the most expensive stocks in consumer staples and we struggle to see the stock rallying significantly from current valuation levels.	1) Volume growth 2) RCI progression 3) M&A?

Source: RBC Capital Markets estimates and FactSet – Note: Priced as December 14, 2015

Theme #1 – Changing consumer preferences

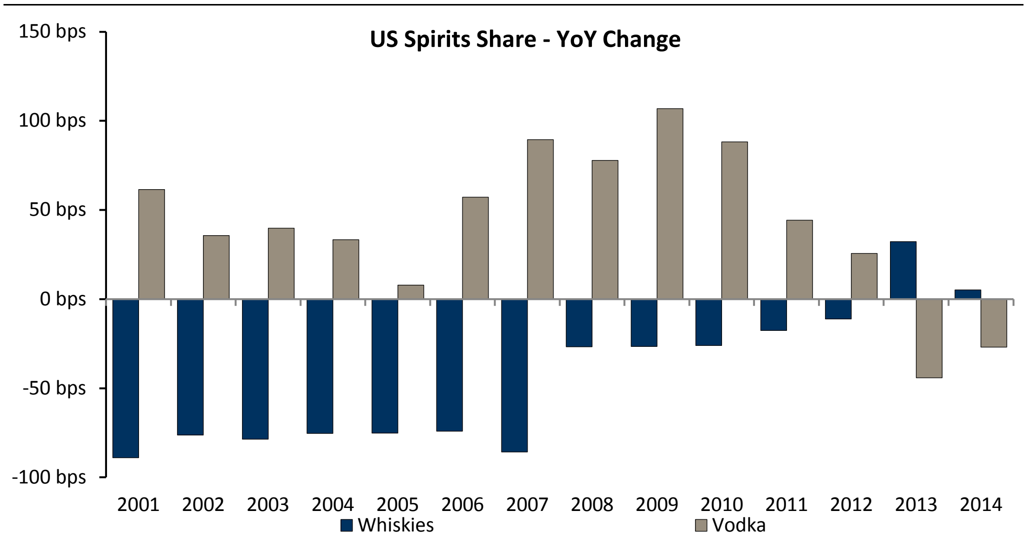
Perhaps more so than the other sectors we cover (Tobacco and HPC), consumer tastes have experienced significant change in the beverage industry. Below, we provide four conclusions based on our analyses.

- **Brown spirits are in** – movement away from vodka benefits whiskey and flavors open the door to new consumers. High-end tequila is also experiencing above-sector average growth;
- **Domestic premium beers continue to bleed share to craft beer, Mexican imports and flavored beers** – The increase in the legal drinking age of Hispanic and millennial consumers is having a profound impact on beer consumption via changing taste palettes (more sweet and more flavor);
- **Premiumization will continue** – the most expensive segments are growing the fastest;
- **Demand high for functionality** – coffee and energy drinks growing the fastest.

Brown spirits are in

2016 should prove to be another year of strong momentum for brown spirits. The whiskey category continues to see a renaissance. Not only is whiskey taking share in the US, but also it is gaining acceptance in the core vodka markets of Eastern Europe. Part of the path to growth is the introduction of flavored whiskies that open the category to incremental consumers, particularly females and younger legal-drinking age consumers. We are still in the early stages of the whiskey flavor proliferation, with flavored products representing just 5% of total whiskey but 27% of total spirits. Unlike vodka, where flavor innovation was rapid and overwhelming, natural barriers to entry (specifically aging requirements) allow the industry leaders largely to dictate the pace of flavor innovation. Importantly, Brown-Forman has been careful to protect their core products as they extend into flavors.

Exhibit 73: Annual change in volume market share for US spirits



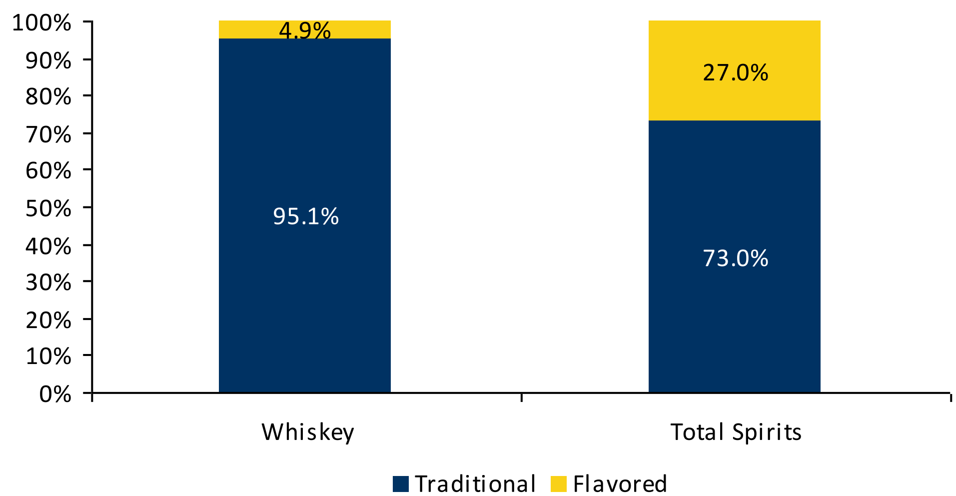
Source: Euromonitor

Exhibit 74: Annual change in volume market share for global spirits

Source: Euromonitor

Exhibit 75: Percentage of category from flavored products – whiskey just beginning

Flavors as a percentage of whiskey is far smaller than flavors as a percentage of total spirits.

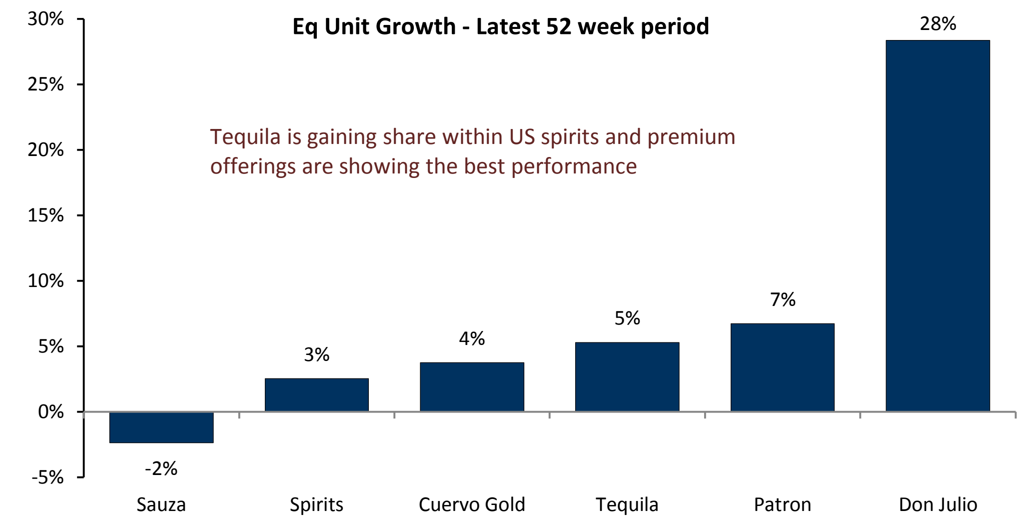


Source: Nielsen, DISCUS and RBC Capital Markets estimates

And we expect tequila to have a solid year—especially with more interest in this category by leading players such as Constellation Brands (through its purchase of Casa Noble tequila). The tequila sub-segment is outperforming spirits. Within tequila, premium products, where Casa Noble plays, are performing the best.

Exhibit 76: Nielsen volume growth (y-axis) and avg EQ price (x-axis), last 12 weeks

Tequila is doing better than total spirits, and premium offerings are performing the best.



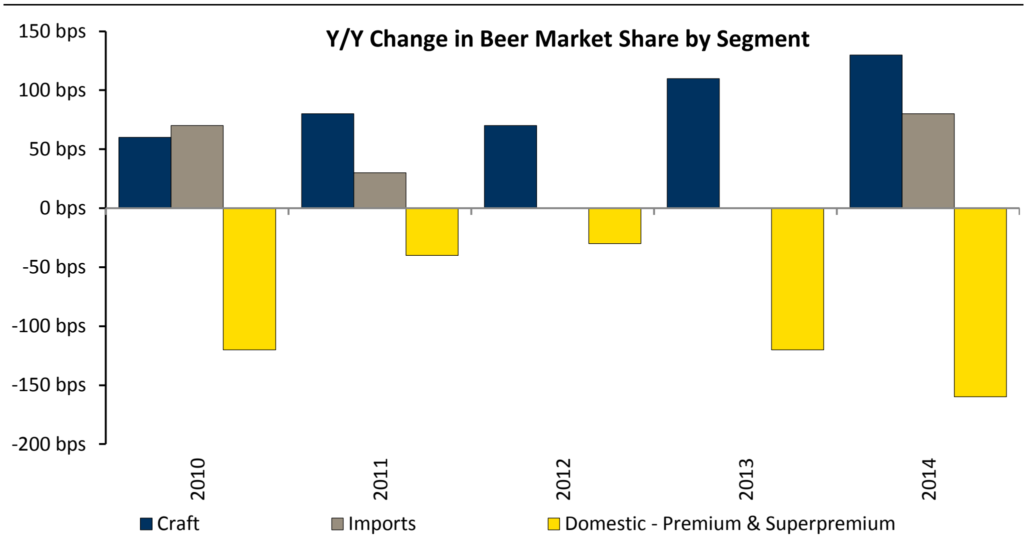
Source: Nielsen

Domestic premium beers continue to bleed share to craft beer, Mexican imports and flavored beer

We believe shifting demographics and new age brand building have altered consumer preferences across the beer industry. While the overall beer category has seen some resurgence as of late (likely due to improving macros), we are not expecting share losses of the domestic premium beers at the hands of craft, flavored beer and Mexican imports to reverse anytime soon.

Exhibit 77: Y/Y dollar sales market share changes – Domestic premium leaking to craft and Mexican imports

Craft and Mexican imports have been the primary gainers of domestic premiums lost market share.

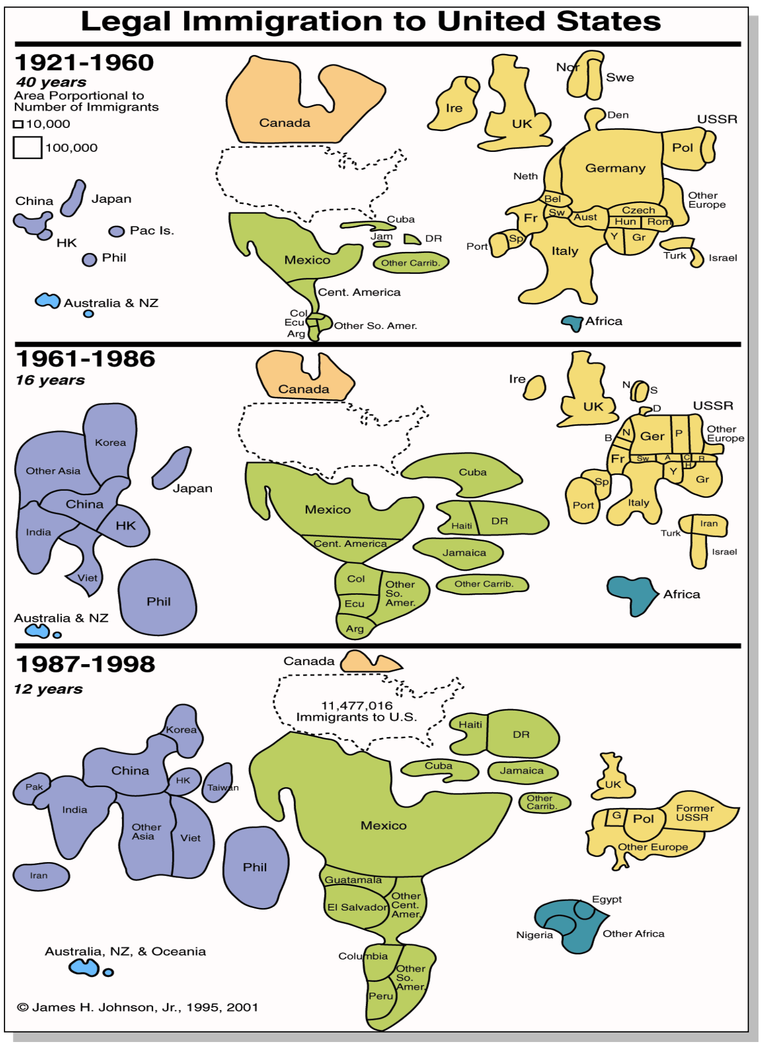


Source: Beer Marketer's INSIGHTS

Multiculturalism is upon us

Over the past 50 years, Hispanic share of the total US population has increased by nearly 400%, accounting for 17.1% today up from 3.5% in 1960, and shows no signs of slowing. According to the latest projections from the US Census Bureau (2014), Hispanic share of the US population is expected to reach 28.6% by 2060. Interestingly, during that same time period we have seen a notable influx of immigration from Hispanic regions. Between 1921 and 1960, the majority of persons legally immigrating to the US came from Europe or Canada. The dialogue is now very different as most immigration stems from countries of Spanish-speaking (particularly Mexico) and Asian descent. We note that 72% of children born to intermarried parents in the US are considered Hispanic, which compares to about 40% a decade ago and attests to an overall societal shift.

Exhibit 78: Legal Immigration to United States

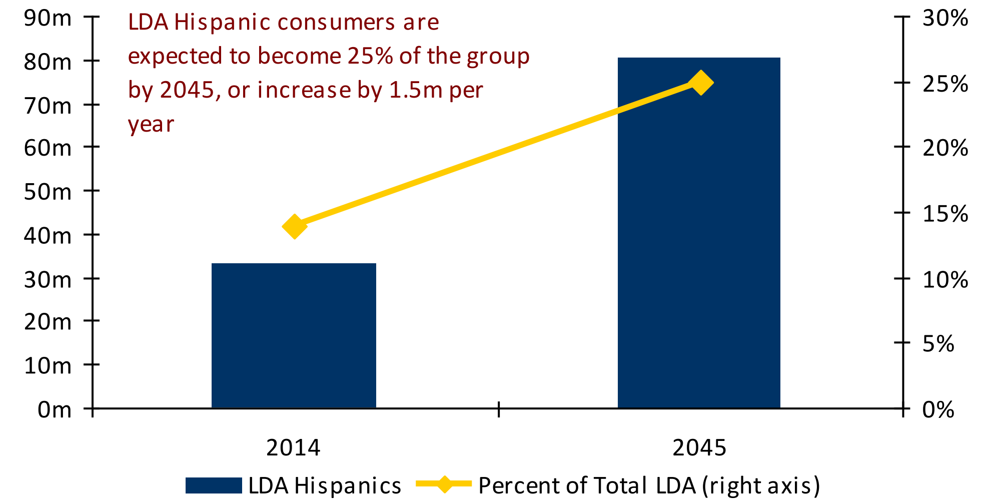


Source: James H. Johnson. Jr. and RBC Capital Markets estimates

At present, the Hispanic consumer is the single fastest-growing demographic in the US. More importantly, Hispanics reaching legal-drinking age (LDA) over the next few years will likely provide an ongoing tailwind for brands like Modelo Especial and Corona. Based on government data, there are currently 33MM LDA Hispanic consumers, representing 14% of the population. This is expected to increase to 25% by 2045. We estimate that would be an incremental 47MM LDA Hispanic consumers, or 1.5MM incremental consumers per year.

Demographic tailwind from growing Hispanic population.

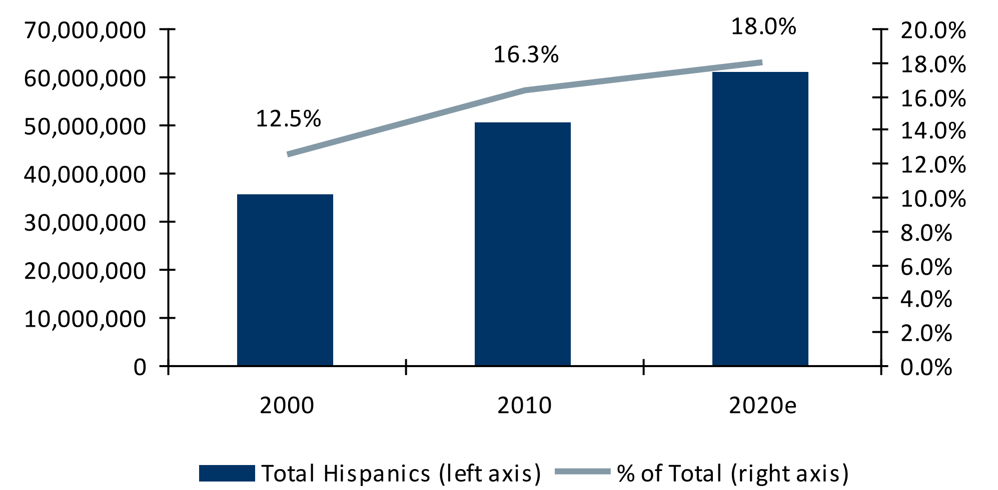
Exhibit 79: Hispanic population growth and percentage of US population favors Crown's portfolio



Source: Census Bureau, Technomic Special Trends in Adult Beverages and RBC Capital Markets estimates

According to the US Census Bureau, by 2020 an estimated 18% of the US population will be Hispanic. That number has grown from 12.5% in 2000 and 16.3% in 2010. We believe this demographic tailwind will favor Constellation's beer portfolio. The anticipated 10MM+ additional Hispanics are expected to represent about one-third of the population growth in the 10 years from 2010 to 2020.

Exhibit 80: Hispanic population growth and percentage of US population favors Crown's portfolio.

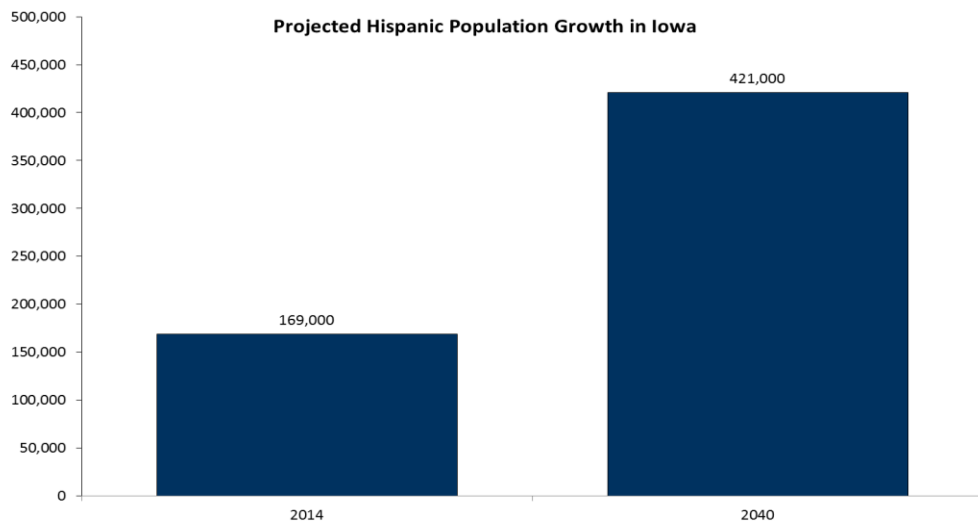


Source: US Census Bureau, RBC Capital Markets estimates

Seeing the big picture on changing consumer taste profiles

Diving deeper into US Hispanic population growth, we point out this quickly growing demographic is not limited in its growth to urban centers but is growing throughout the nation. For example, Iowa's Hispanic population is projected to more than double by 2040.

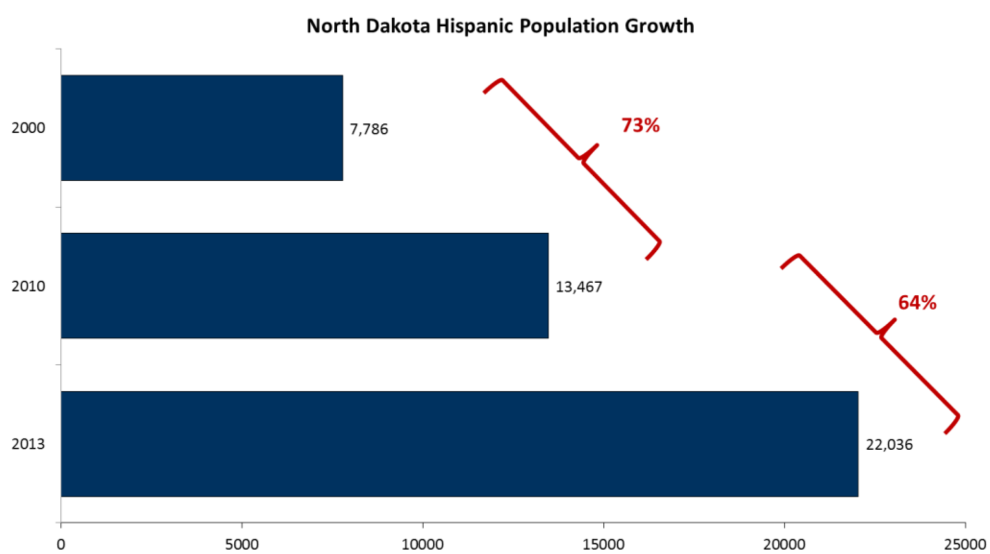
Exhibit 81: Projected Hispanic population growth in Iowa



Source: US Census Bureau, RBC Capital Markets estimates

We also point out that the North Dakota Hispanic population grew by over 60% between 2010 and 2013 according to PEW Research Center data. Similar growth rates can also be found for Hispanics in Nebraska, Kansas and Idaho.

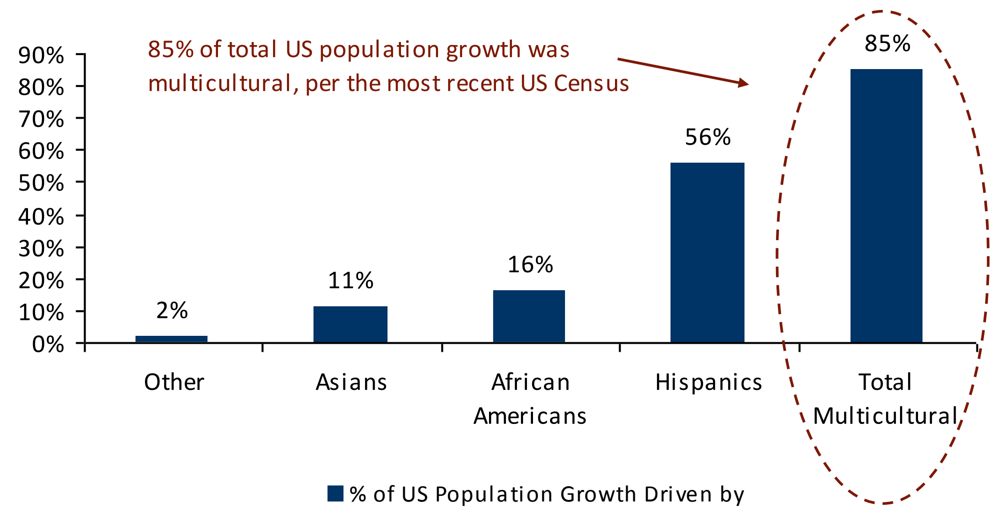
Exhibit 82: North Dakota Hispanic population growth



Source: US Census Bureau, RBC Capital Markets estimates

As the Hispanic population grows throughout the US, what is particularly interesting is that Hispanics among other demographics are marrying between one another—leading "multiculturals" to be the fastest-growing demographic group.

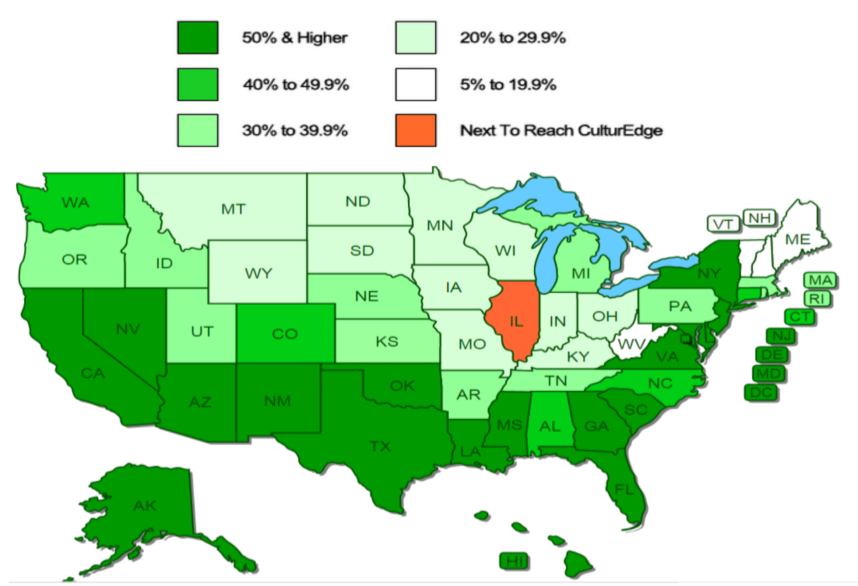
Exhibit 83: US population growth by demographic group



Source: US Census Bureau, RBC Capital Markets estimates

And consistent with the previous mentioned observations on Hispanic growth, multicultural growth is also pervasive. According to Ethnifacts, today more than half of US states have a population comprised of 30% or more mutliculturals. Per the image below, Illinois is the next state to have more than 50% of its population be multicultural and thus is "next to reach CulturEdge."

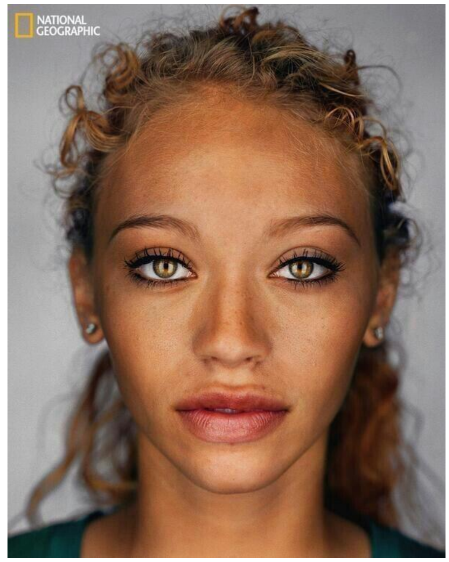
Exhibit 84: Multiculturals as a % of total population



Source: US Census Bureau, RBC Capital Markets estimates, Ethnifacts

With the fast and widespread rise of multiculturals throughout the US, National Geographic expects the average American will look like the woman below—a clear blend of features across different demographic groups.

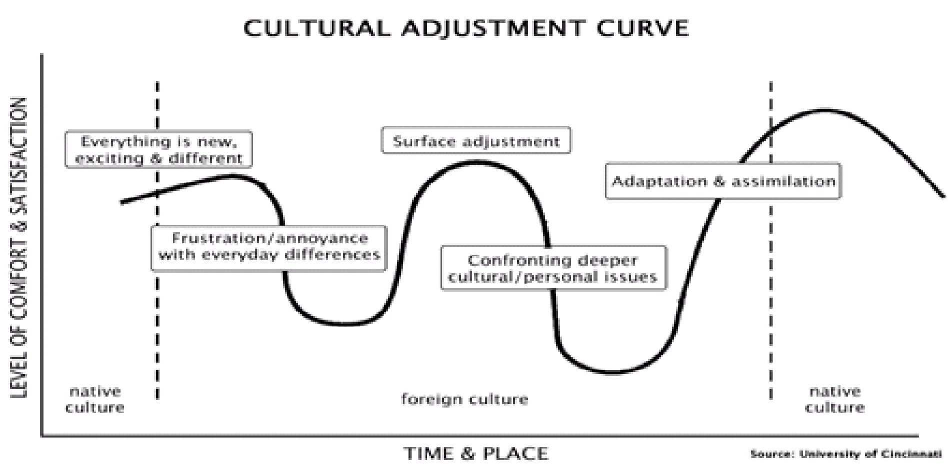
Exhibit 85: An image of what National Geographic expects the average American to look like by 2050



Source: National Geographic

Importantly, Hispanic or multicultural influence is not limited to immediate families, but can spread throughout communities, and all groups of people. More simply put, different demographic groups are quickly adopting the traits and consumption habits of other demographic groups (mainly Hispanics).

Exhibit 86: University of Cincinnati cultural adjustment curve



Source: US Census Bureau, RBC Capital Markets estimates

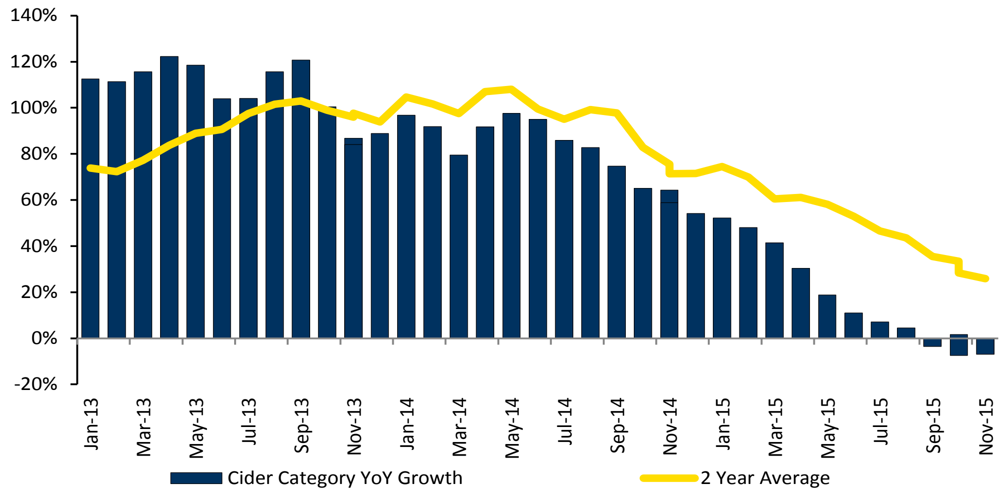
This trend of influence by Hispanics and multiculturals is not only bolstering the growth of Mexican import beer, but expanding the American consumer's taste palette (more sweet, more flavor). This in turn is why innovation is so critical in the beverage category and most recently has driven a resurgence in the flavored beer category, though at the expense of cider.

Cider growth sours with flavored beer on the rise

Cider has slowed meaningfully to start off 2015, with category growth now trending negative in the past three scanner data updates. We believe a multitude of factors are contributing to cider's slowdown, including an increased base for the category, and increased competition from cider alternatives such as flavored beer. Given cider's importance to Boston Beer, we see the slowdown in the category as a potential negative for SAM's growth going forward.

Cider's growth has slowed meaningfully.

Exhibit 87: Cider category growth

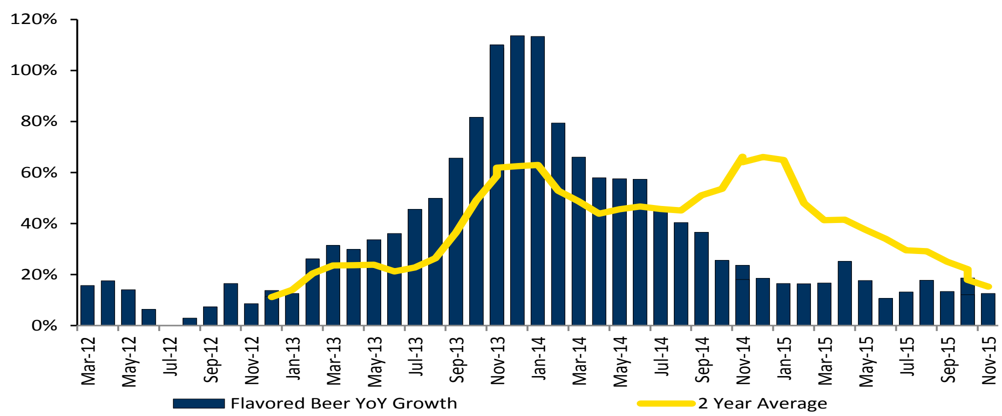


Source: Nielsen

Recent launches of hard root beer (which has accounted for an estimated 0.04% of total beer/malt volumes in recent months) have contributed to flavored beer growth.

Competition from flavored beer likely played a role in cider's slowdown.

Exhibit 88: Flavored beer growth



Source:Nielsen

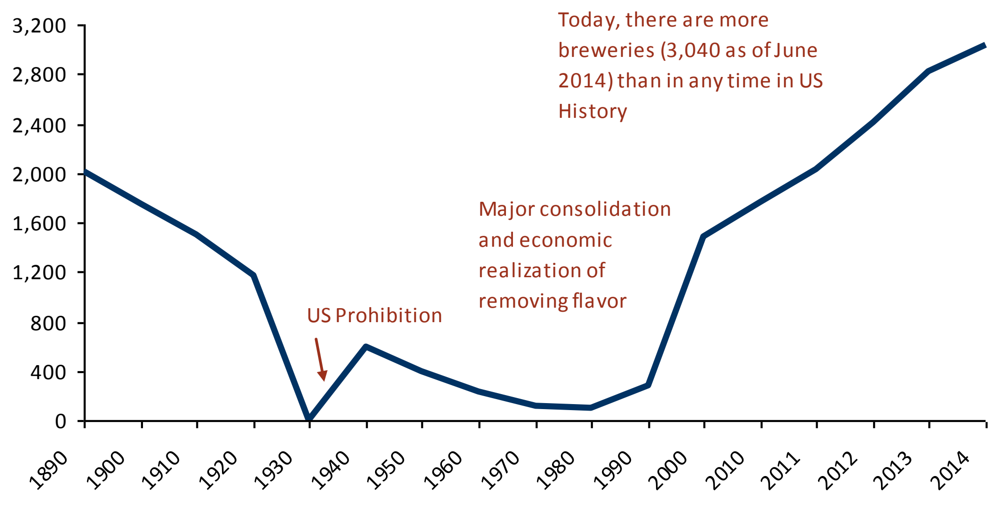
Brewery madness

No segment displays the power of "Big is bad" as remarkably as craft beer. The category has grown a robust 10–15% as the overall beer category has declined four of the past five years. Of note, ABI and MillerCoors have lost 17MM bbls and Miller Lite has lost 20% of its volume over the last five years (as per Beer Marketer's INSIGHTS). We believe this trend continues and the value proposition of craft beer (unique high quality at a reasonable price) will only improve.

According to the Brewer's Association, in 2014, there were 3,040 breweries in the United States. This is more breweries than at any time in history. Impressively, the expansion has occurred in the face of moderately declining beer category.

More breweries in the US than at any time in history.

Exhibit 89: Breweries in the US



Source: Brewer's Association

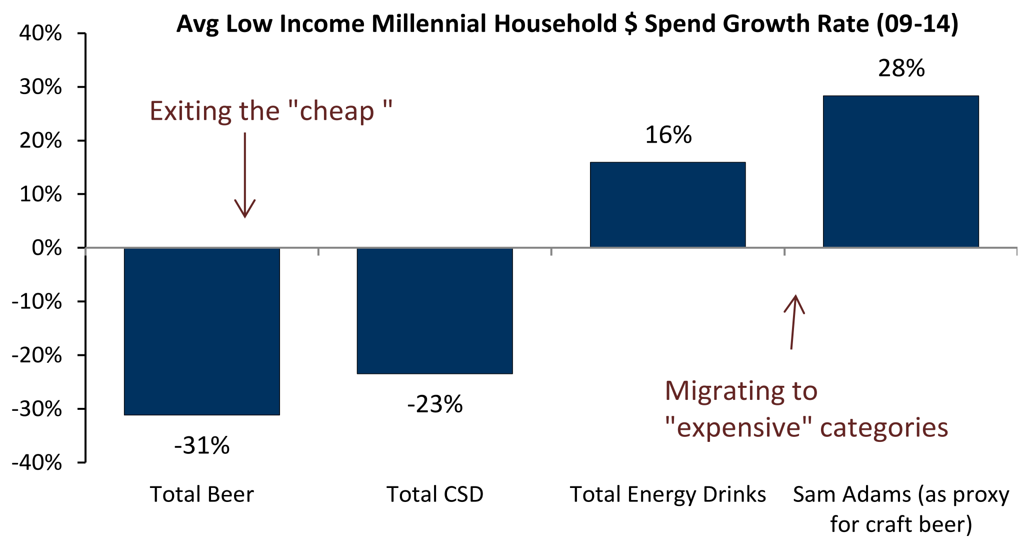
While some have called this phenomenon a "bubble", we believe craft beer's share of total beer and number of breweries will continue to grow rapidly. Vermont, Oregon, and Montana, which have on average about one brewery for every 20,000 people, saw brewery growth rates far above the national average. Additionally, while absolute brewery count is at an all-time high, there is only one brewery per ~80,000 people today, compared to one brewery per 30,000 people in 1890. The movement to more local is just beginning, in our view.

Premiumization continues

Consumers, particularly in beverage alcohol and CSDs, are migrating toward the more expensive offerings within the respective categories. In spirits, the last 10 years have seen 160% growth of the super-premium segment but 9% growth of the value segment.

Low income millennials are on migrating from cheap beer/CSDs and moving to energy drinks/craft beer.

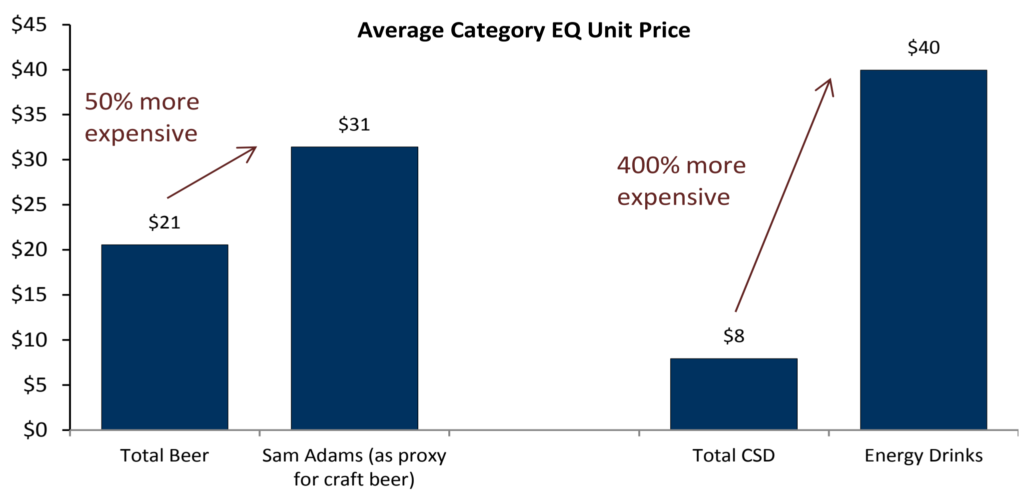
Exhibit 90: Average Low Income Millennial Household Dollar Spend Growth Rate (09-14)



Source: DISCUS, RBC Capital Markets estimates

The average equal unit price for Sam Adams (a proxy for craft beer) is 50% more expensive than the beer category. This compares to energy drinks, which is 400% more expensive than the CSD category.

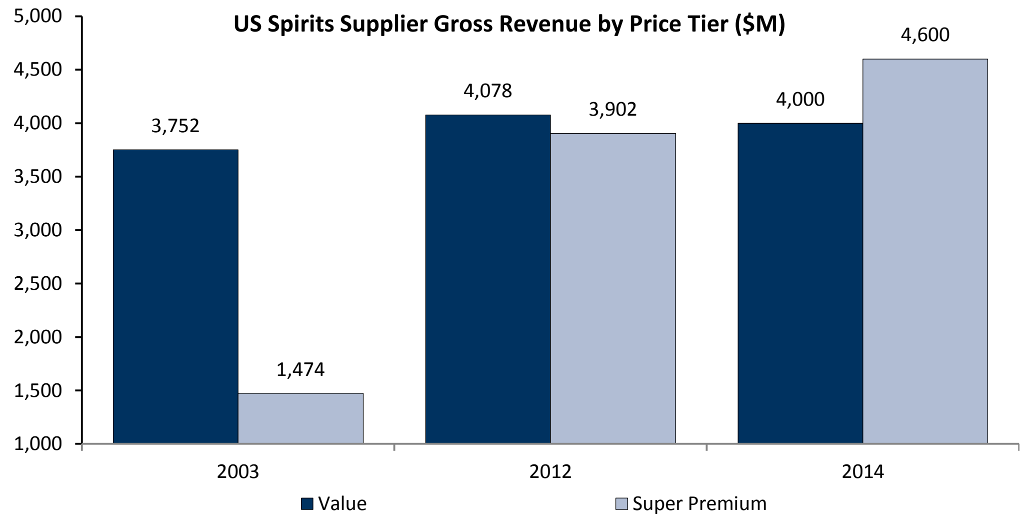
Exhibit 91: Average Category Equal Unit Price



Source: DISCUS, RBC Capital Markets estimates

In spirits, the super-premium segment is outgrowing the value segment.

Exhibit 92: US Spirits Supplier Gross Revenue by Price Tier ($M)

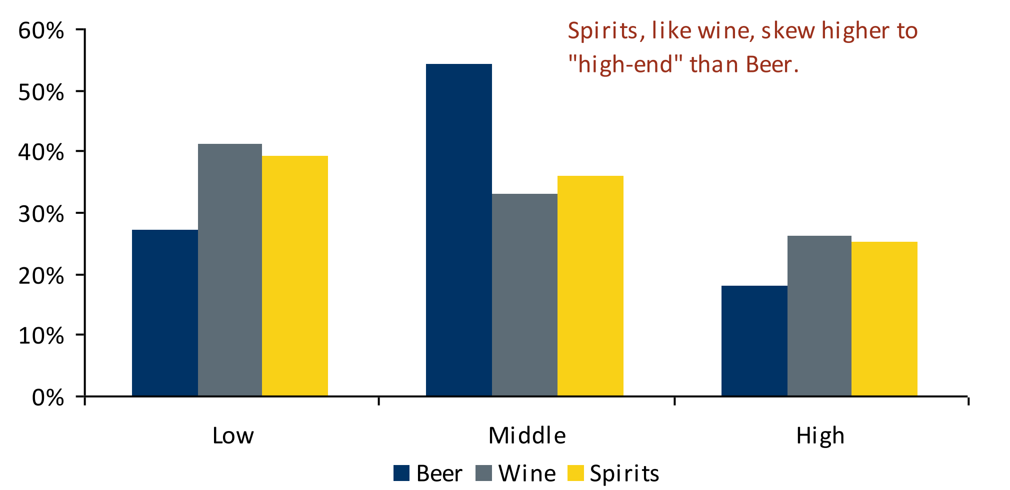


Source: DISCUS, RBC Capital Markets estimates

Wine and spirits have already captured a larger portion of the high-end market than beer. This suggests craft beer and imports, which are generally priced above domestic premium offerings have more room to enjoy outsized growth.

Spirits skew higher to premium pricing than beer.

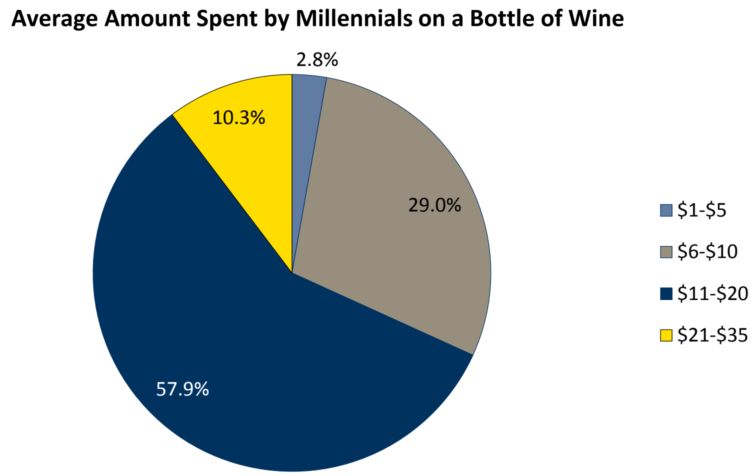
Exhibit 93: Price tier skew across US beverage alcohol categories (2014)



Source: Beer Institute, RBC Capital Markets estimates

Exhibit 94: Average amount spent by millennials on a bottle of wine

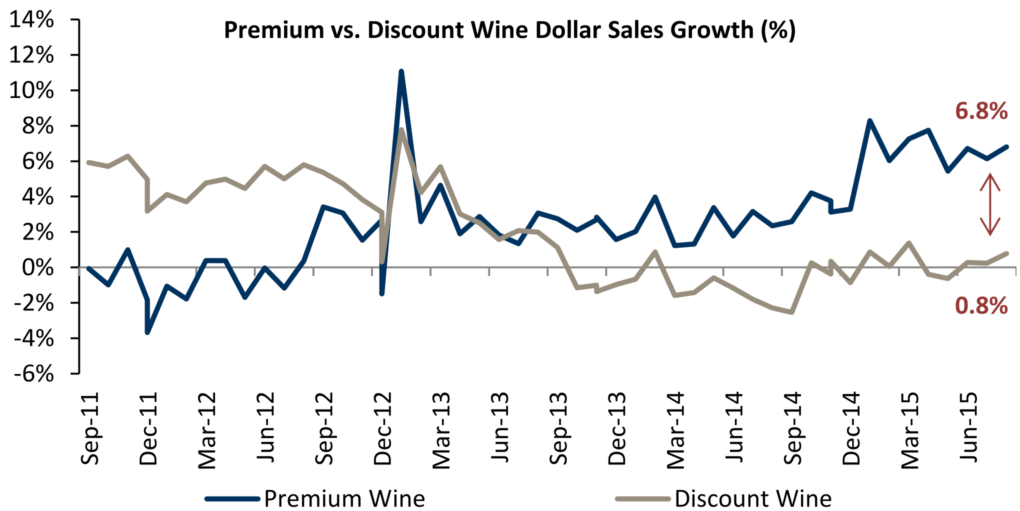
More than half of millennials buy bottles of wine priced over $10 on average.



Source: Financial Services Wine Symposium

Exhibit 95: Dollar sales growth of premium and discount wine

Since 2012, premium wine (>$10 per bottle) has outpaced discount wine (<$10 per bottle).

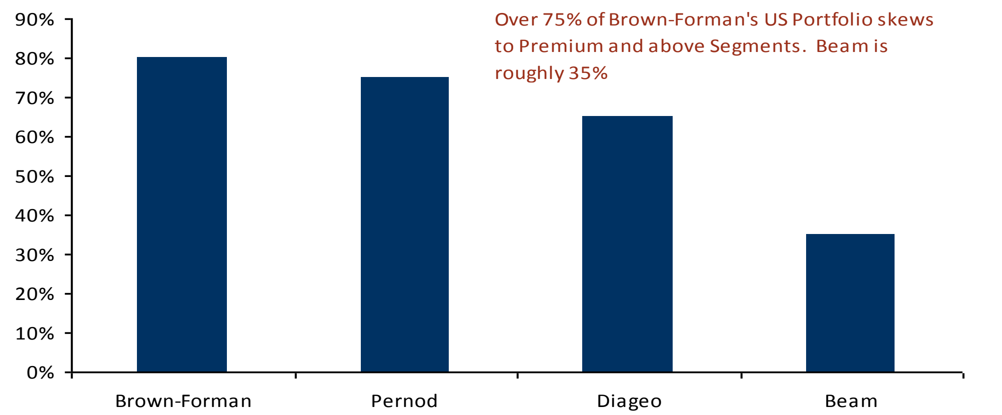


Source: Financial Services Wine Symposium

Within the spirits category, Brown-Forman skews more to the premium and above segments than its competitors do. This portfolio skew should benefit Brown-Forman, as the premiumization of the category continued in 2015.

Brown-Forman's portfolio skews more premium than its competitors.

Exhibit 96: % of the portfolio in the premium and above categories (>$20/750ml) – Brown-Forman most indexed



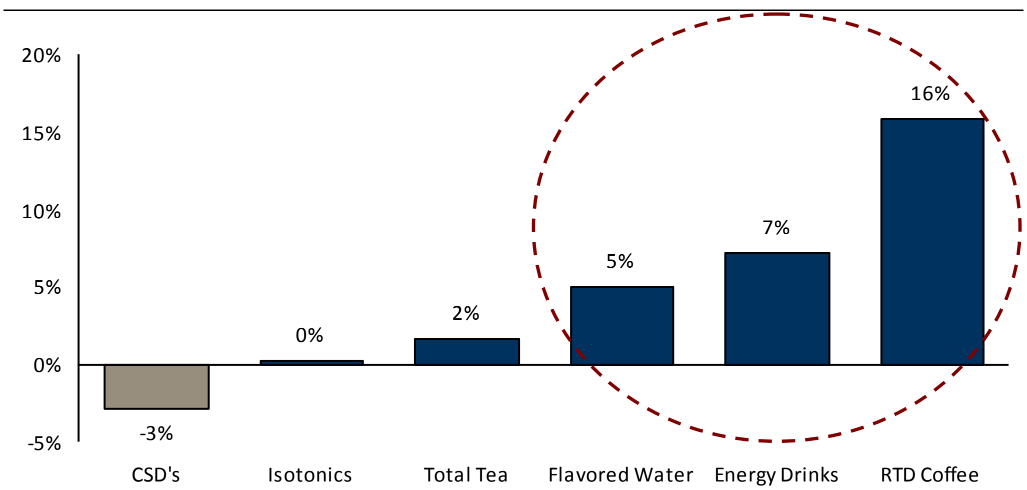
Source: Company reports, Nielsen AOC

Even within ABI's and MillerCoors' portfolios, the value segment is underperforming. Over the last 52 weeks, ABI unit sales are down -1% in Nielsen, but Natural Light/Ice and Busch/Busch Light are both down ~6%. Similarly, MillerCoors' unit sales are down 2%, but Keystone Light is down 7% and Miller High Life is down close to 3%.

Demand for functionality and refreshment continues

Over recent history, the fastest growing beverage categories remain ready-to-drink (RTD) coffee and energy drinks. Looking forward to 2016, we would expect these trends to continue, particularly given lower gas price tailwinds as both energy drinks and RTD coffee over index to convenience stores.

Exhibit 97: Beverage category growth rates



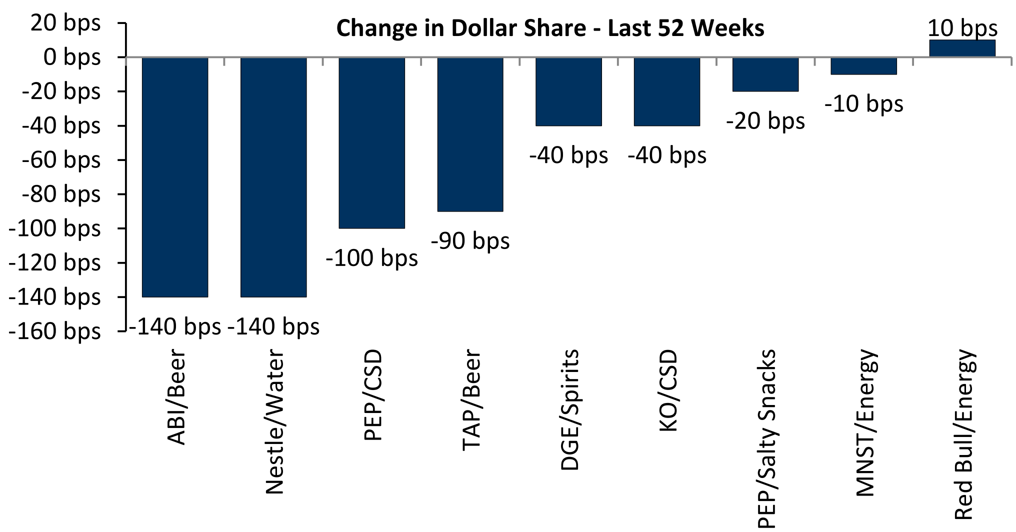
Source: Company reports, Nielsen AOC

Theme #2 – Big brands vs. small brands

We looked across our largest segments within the US Beverage industry and found that the largest segment players (>20% market share) are losing dollar share to smaller competitors. With the exception of Red Bull in energy drinks, all the biggest players lost market share: Diageo in spirits, PepsiCo in salty snacks and carbonated soft drinks, Coca-Cola in carbonated beverages, ABI and MillerCoors (TAP) in beer, and Nestle in bottled water.

Except for Red Bull in energy drinks, companies with a 20% or greater share of their category are share donors.

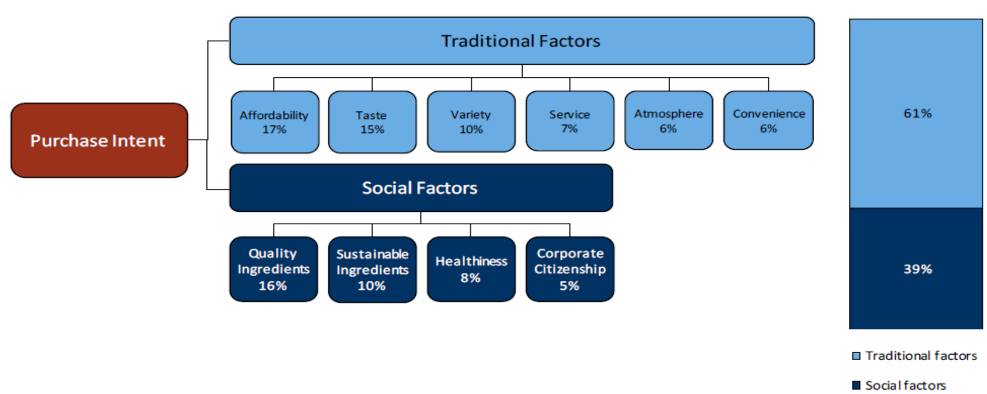
Exhibit 98: Dollar share performance for largest brands in beverage categories



Source: Nielsen and RBC Capital Markets estimates

Today consumers consider more than just the brand name of a product when shopping. Mission measurement found there are over 10 independent factors consumers look for when purchasing a product.

Exhibit 99: Purchase intent drivers



Source: Mission Measurement, RBC Capital Markets

Big is not an excuse

As we look across the broader consumer space, we find many reminders that big brands can grow through share gains. Nike, Marlboro, Starbucks, Apple and even McDonalds as of late are each names that come to mind as big brands who are outperforming peers.

Nike for example, has done a terrific job of being relevant, building a culture among consumers through sponsored events and aggressively pursuing and signing the best athletes in the world as brand ambassadors. This deliberate brand building strategy and investment in relevancy led Nike to gain 400 bps of apparel market share in 2013 along with another 100 bps of footwear share—gains that come despite Nike having significantly more market share than the next closest competitor in each category.

Since 2013, Nike gained 400 bps and 100 bps of apparel and footwear market share.

Exhibit 100: Nike sales by segment

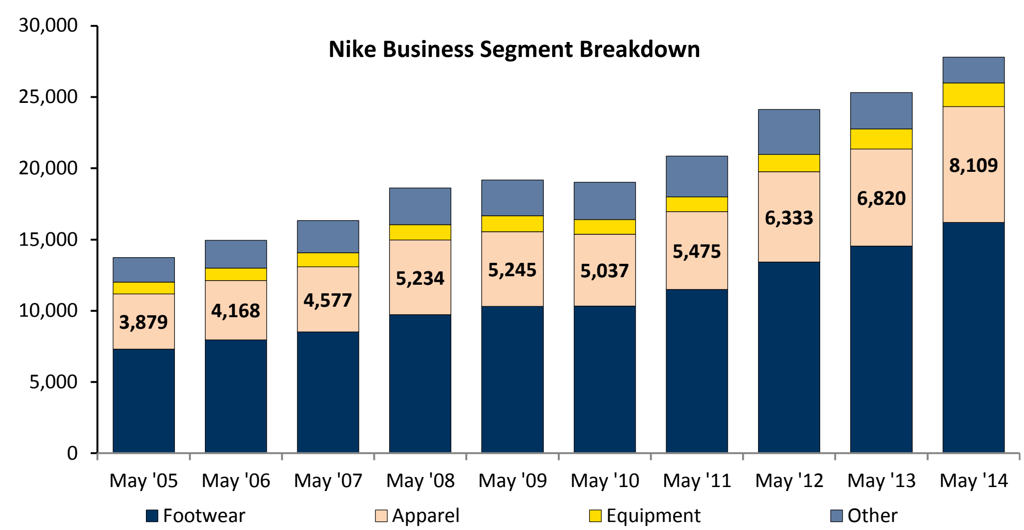
US Sports Apparel Market Share			US Sports Footwear Market Share		
Brand	2013	Most Recent	Brand	2013	Most Recent
Nike	**27%**	**31%**	**Nike**	**45%**	**46%**
Under Armour	14%	16%	Adidas	8%	6%
The North Face	6%	7%	Asics	4%	4%
Adidas	8%	6%	Sketchers	3%	4%

Source: SportsOne Source, 2014 data

Just like Coca-Cola, Pepsi, Budweiser, Coors, Smirnoff (Diageo) and Monster, the Nike brand transcends geographies (even categories) and has consistently grown each year since 2005 despite FX pressure and weather issues along the way.

Despite FX, macro and weather issues cited by consumer and retail companies, Nike has consistently delivered annual sales growth, balanced across segments.

Exhibit 101: Nike annual sales by segment

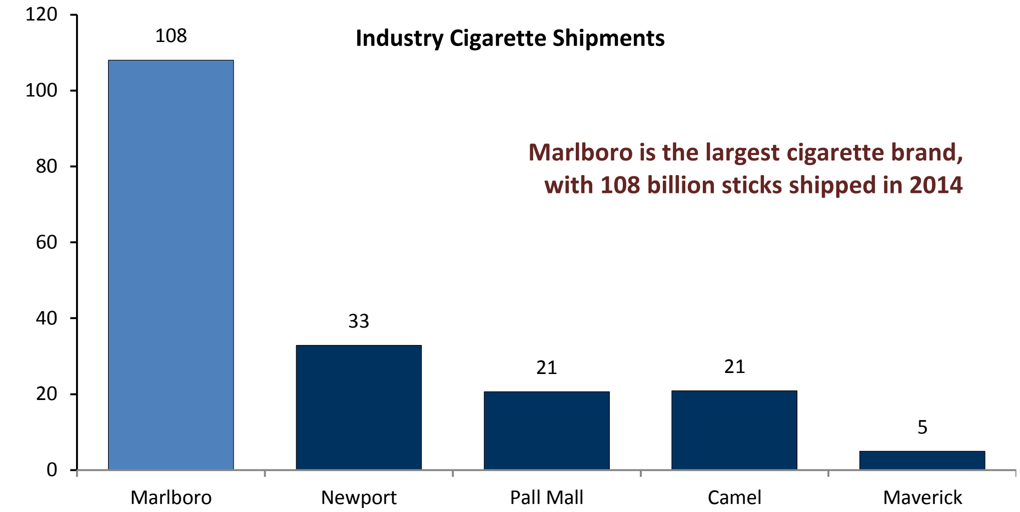


Source: Company filings

Marlboro is another example of a mega brand that continues to do very well, despite being the largest cigarette brand and 3x the size of its next largest competitor Newport.

Exhibit 102: Industry cigarette shipments by brand

Marlboro is the largest cigarette brand, more than 3x the next largest brand Newport.

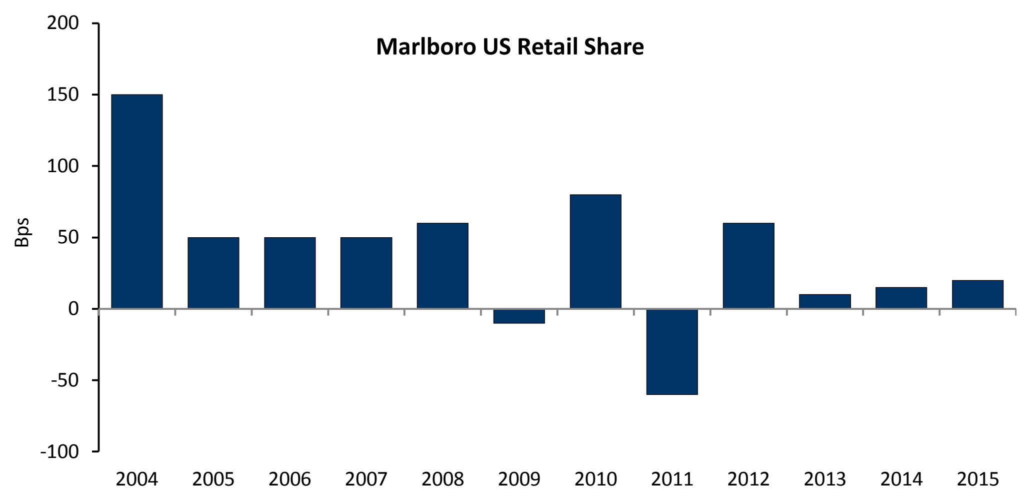


Source: Company reports

Marlboro has delivered consistent share gains, increasing share in every year but two since 2004. To achieve this feat, Altria management has invested significantly in forms of legal consumer engagement (including events for consumers like Nike). Marlboro product quality is excellent, which leads to recommendations as well as employing a very tactical pricing strategy.

Exhibit 103: Marlboro US retail share annual change

Marlboro has delivered 40 bps of average annual share gains over the past decade.



Source: Company reports

In our view, there are four key factors that drive brand building (regardless of brand size) and sustainable growth over time.

Exhibit 104: Consumer brand growth formula

Product Efficacy/Quality

+

Consumer Relevance

+

Consumer Engagement

+

Recommendation

Source: RBC Capital Markets

Theme #3 – Distribution changes

In 2016, we expect a series of distribution-related changes in the industry to impact fundamentals. Namely, these include Coca-Cola's refranchising, Monster's transition to Coca-Cola distributors nationally, as well as distributor shifts among the biggest brands in beer, wine and spirits.

Coca-Cola refranchising

We believe poor execution is one of Coca-Cola's largest issues and refranchising of the system will be a leading catalyst in accelerating Coca-Cola volume growth. From discussions with our contacts, we learned the areas that have re-franchised for six months or more have seen a significant improvement in volume (between 500–1,000 bps). About 60% of the volume improvement came from limiting out-of-stocks, the rest was due to better merchandising and improved relationships with owners of up-and-down street stores. Just this past October, the company signed non-binding letters of intent on additional distribution territories in seven states—bringing the total amount of US volumes now transitioned to 30%. Coca-Cola is also taking more of a partnership approach with its bottlers. Over the summer, we learned Coca-Cola had a global meeting with its top 20 bottlers in Italy. Based on our fieldwork, the meeting was very positive and productive. When Coke cut marketing support several years ago (to offset FX headwinds), bottlers cut back their own support (in the form of scaled-back feet on the street and cooler placements—which are key drivers of volume). At the meeting in Italy, Coke management made it very clear that brand support was here to stay and they would like the bottlers to step up their own support (mainly cooler placements).

Monster global distributor transition

Monster is underway in transitioning its distribution to Coca-Cola bottlers worldwide. The company completed the transition in Germany where it's already beginning to see improvement and has reached an agreement with Coca-Cola Hellenic Group that will be applied across 28 countries serviced by them for Coca-Cola (already being distributed by the

Hellenic Group in 14 countries). Recall that Monster's international business is about the tenth the size of Red Bull International. Additionally, with the help of The Coca-Cola Company, Monster is gearing up to launch in China.

Wine and Spirits distribution changes

For context in 2002, Brown Forman and Bacardi entered into a distribution alliance and Remy was included in 2007. The point of this alliance is to create "synthetic" scale with distributors. All three companies had very narrow portfolios by themselves, but together could rival the breadth of portfolios form Diageo and Constellation Brands. Based on discussions with distributors, we understand that Bacardi is now looking to break from the alliance (they have recently put their distribution rights up for bid—no verdict yet). We believe the implications of Bacardi breaking from the alliance could actually be positive for Brown-Forman. A retailer that carries Bacardi, Jack Daniels and Remy and loses Bacardi, will probably put more emphasis and focus on Jack Daniels, etc. to help make up the lost Bacardi volume.

ABI's new incentive for performance program

At a recent meeting with its US distributors, ABI announced an updated incentive for performance program for its distributors. Depending on the scale of volume a distributor sells, A-B will pay certain percentage of the wholesaler's minimum cents-per-case marketing spend. Here is how the program works.

A+ Wholesalers: A-B will pay 75% of cost per carton (CPC) if a distributor sells 98% or above of A-B products by volume. That number gets bumped to 100% if the wholesaler achieves an Ambassadors of Excellence (AOE) score greater than 850 (an in-house quality program. For this calculation, Craft Brew Alliance are counted as A-B, as well as Constellation Brands, at least until June 30, 2016. Another exception: If non-AB brands are small local crafts (ie up to 15k barrels and/or only sold in one state), then the distributor can still qualify as an A+ wholesaler.

A Wholesalers: A-B will pay 50% of CPC spend (75% if AOE) if a distributor sells equal or greater than 95% A-B volume, and/or if the distributor adds a separate sales force.

B Wholesalers: A-B will pay 10% of CPC (35% if AOE) if the distributor sells 90% A-B volume, and/or they add an incremental sales force.

C Wholesalers: If a distributor sells less than 90% A-B products, they can get A-B to pay 25% of the CPC marketing spend if they are in AOE.

To qualify for these incentives, a distributor cannot sell beer outside their A-B footprint.

These programs (if they are allowed to go through), could hinder the proliferation of new craft brands. Something to keep a watchful eye on in 2016.

Detailed perspective on our focus names

On the following pages, we provide some more detail for our focus names. In conjunction with this Playbook report, we have published separate reports on Newell Rubbermaid and Constellation Brands.

Cott Corp.

Following Cott's transformative acquisition of DS Services, we believe long-run FCF growth has become more predictable (contrary to the company's history) – justifying a lower FCF yield for the name over time. Our $16 PT implies 8% FCF yield versus 12% today and 5% for our group. We believe investors are shifting their focus away from EPS/EBITDA and towards free cash flow generation.

As we wrote in our 2013 Sector Perform initiation, Cott was a victim of circumstance: 1) 40% of its business was in the growth challenged/competitive carbonated soft drink category, 2) large customers had a disproportionate influence on Cott's P/L, 3) the company's thin margin structure made it susceptible to input cost fluctuations, thereby creating volatility in its cash flow stream and 4) efforts to ramp its contract manufacturing business fell short of expectations.

However, over the past 12 months Cott has made/ undergone significant change that has substantially improved its prospects:

1) the acquisition of DS Services not only diversified the company's business away from CSD's and Coca-Cola/ PepsiCo competition, but it also creates stability and opportunity for Cott's free cash flow profile as well as a platform for future, growth/ margin accretive tuck-in acquisitions,

2) the company's EBITDA is now less exposed to the volatility of juice input costs and

3) Cott inserted new leadership into the US business, which has led to an acceleration in its contract manufacturing revenue stream. We believe all of these changes will translate into significantly better FCF growth than we had previously modeled.

4) the company continues to further diversify its business, completing three tuck-in HOD water businesses in the US and just announced the $40 M acquisition of Aquaterra, the largest HOD water business in Canada.

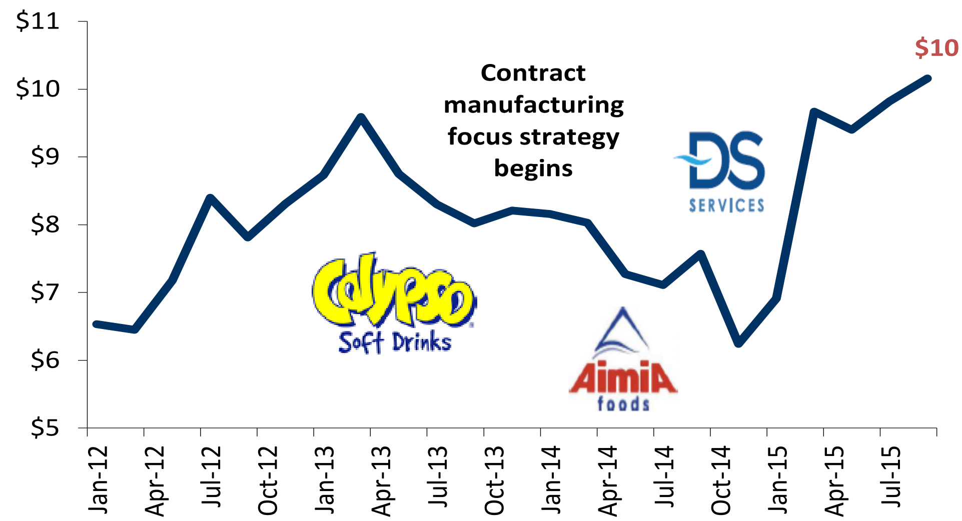
We believe all of these changes will translate into significantly better FCF growth than we had previously anticipated. In fact, we believe Cott can grow free cash flow by an 18% CAGR between 2016-2018 and mid-single digits thereafter.

The Diversification Drive from Within Finally Paying Off

Due to its struggles in its legacy core business (US private label beverages), Cott has deliberately focused on diversifying its business over past 3-years. The company purchased Calypso (United Kingdom soft drinks with foodservice presence including schools) for $12 M in June 2013, Aimia foods (United Kingdom hot chocolate, coffee, malt drinks, creamers/whiteners and cereals) for $139 M in May 2014 and DS Services (home/office deliver water/coffee) for $1.25 B in December 2014. Also in 2014 management announced they would be stepping up their allocation of resources behind growing the company's contract manufacturing business, with the three-year goal of 50 M to 80 M serving equivalent cases by 2017 (up from 20 M). Today, Cott is a very different company than just 3 years ago. In terms of channel, Cott's private label business was reduced from 81% of sales in FY12 to ~49% of sales today. Also as it relates to product, CSDs now only account for 19% of Cott sales versus 41% in 2012.

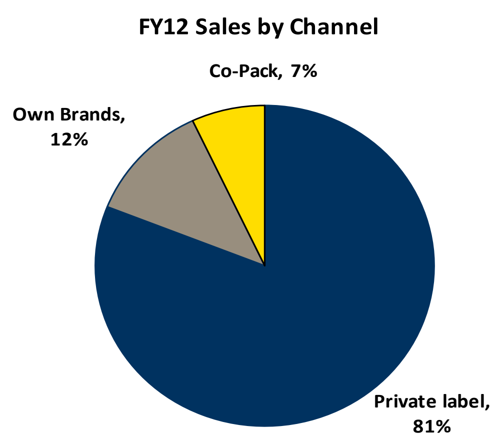
Cott has made a series of acquisitions and initiatives to diversify away from its core, private label CSD business, though shares have been volatile along the way. However, we believe Cott's $1.25 B acquisition of DS Services in December 2014 is transformative and shares will continue to move higher from current levels.

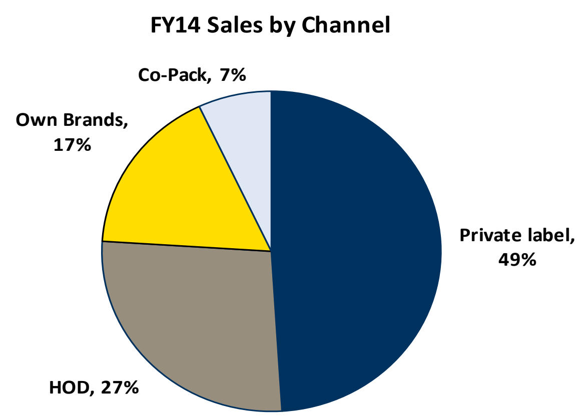
Exhibit 105: COT share price and diversification acquisitions/initiatives



Source: Company reports and RBC Capital Markets estimates

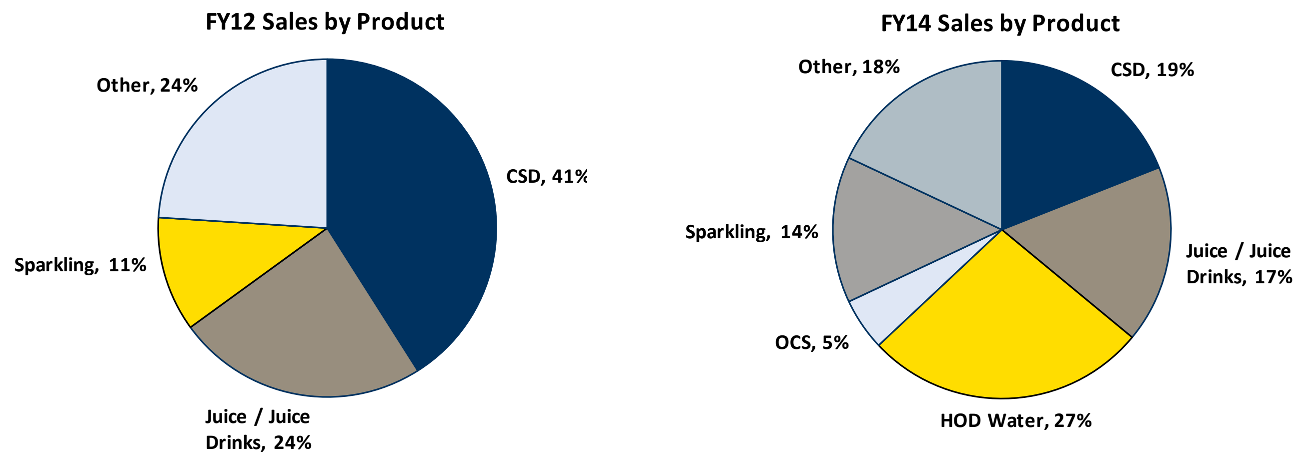
Exhibit 106: Cott channel sales breakdown transition





Source: Company reports and RBC Capital Markets estimates

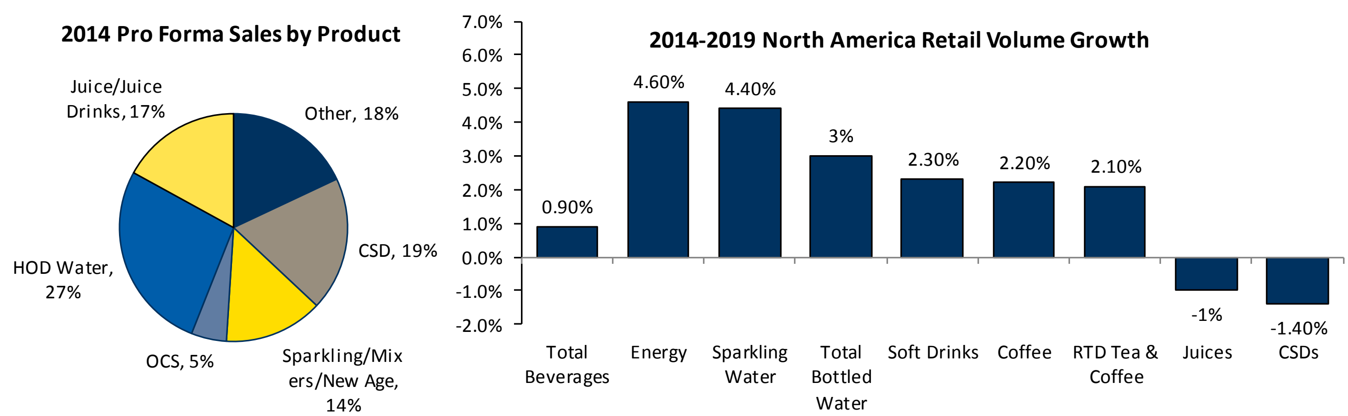
Exhibit 107: Cott product sales transition



Source: Company reports and RBC Capital Markets estimates

This change in Cott's sales exposure by product, not only diversifies the business away from the contracting and volatile CSD and juice categories, but also increases Cott's exposure to faster growing categories including energy drinks (where the company has had some recent contract wins), sparkling water and coffee. We note today Cott generates 75% of its EBITDA from growing categories notably HOD water, sparkling water, Office Coffee Service, and energy drinks, among others.

Exhibit 108: Cott sales breakdown by product along with projected product growth rates

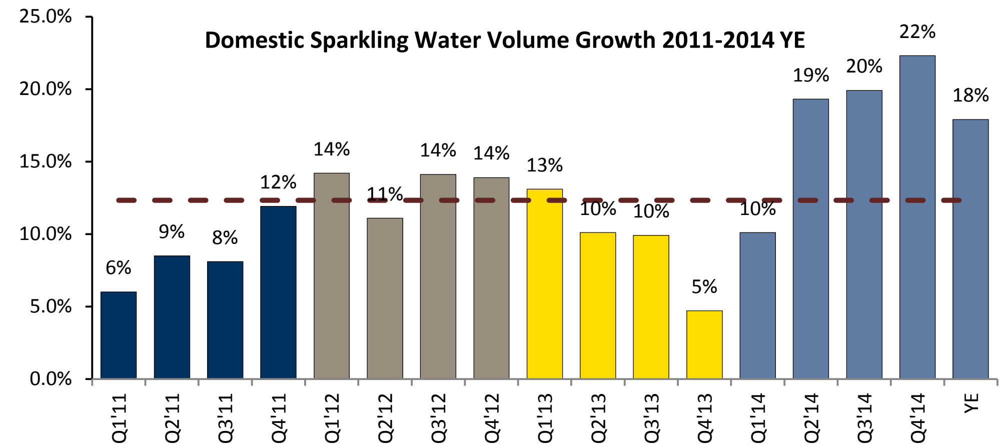


Source: Cott Corporation, RBC Capital Markets

Sparkling water is one category in particular where management is focusing resources, and as a percent of sales has increased from 11% in 2012 to 14% today. Sparkling water has averaged strong 12% growth over the past four years and has accelerated as of late, growing 18% in 2014.

Sparkling water has become a focus category for Cott, which growing at double-digit rates is able to help offset declines in CSDs and juice

Exhibit 109: DS Services customer acquisition cost index



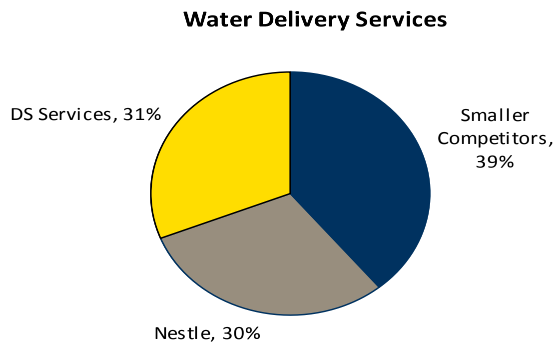
Source: Cott Corporation and RBC Capital Markets

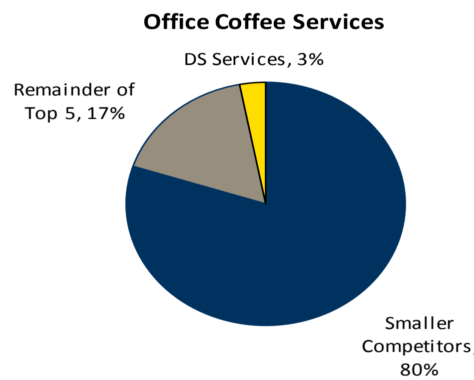
Simply due to changes in business mix (primarily driven by the DS Services acquisition), we believe Cott's EBITDA and free cash flow profile has taken step-function change improvement.

DS Services offers diversification and growth opportunities

Unlike CSDs where Cott competes against the likes of Coca-Cola, PepsiCo and Dr. Pepper, DS Services is a leader in the Home Office Delivery (HOD) water and coffee categories. More specifically DS Services is the largest HOD water player in the US with access to ~90% of US households and 31% market share, followed by Nestle with 30% market share and the remaining HOD water category comprised of 3,000 regional players (which leaves plenty of opportunity for Cott to take share). For HOD coffee, DS Services is a top five player with the top five making up only 20% of the market—leaving further opportunity to consolidate a fragmented market. This competitive positioning is in stark contrast to Cott's legacy private label business. Within the DS Services business, Cott has more pricing power and is playing from a position of strength. The fragmented nature of DS Services categories also leaves a long runway for small tuck-in acquisitions.

Exhibit 110: Water and office coffee delivery service competitive landscape

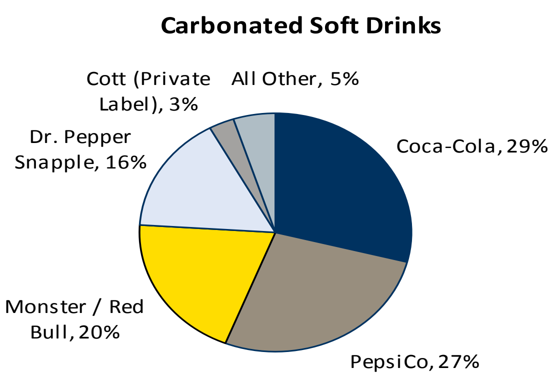


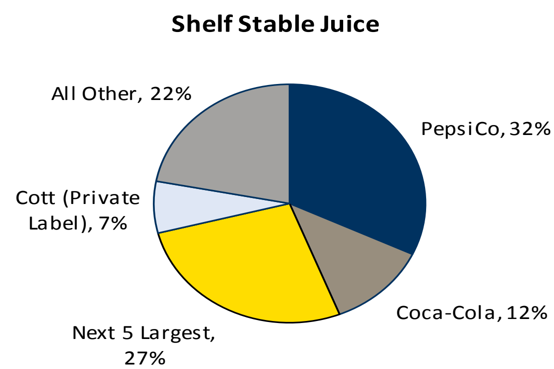


Source: Cott Corporation, RBC Capital Markets

DS Services opportunity for expanding its Competitive Advantage Period (which we discuss in today's 2015 Investment Playbook) and consolidation is much higher than the traditional Cott business. In the carbonated soft drink and shelf stable juice categories (where traditional Cott competes) only 5% and 22% of each category respectively is occupied by small players, with Coca-Cola and PepsiCo combining for at least 40% share of each category alone.

Exhibit 111: Traditional Cott business competitive landscape

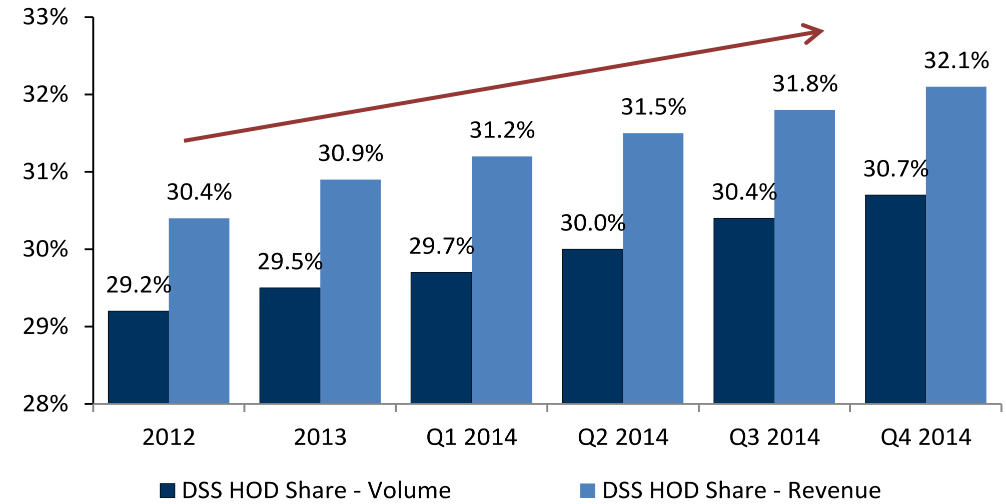




Source: Nielsen, RBC Capital Markets

Customer growth coupled with strong pricing has led DS Services to outpace the broader HOD category leading to consistent share gains

Exhibit 112: DS Services HOD volume and revenue market shares



Source: Cott Corporation and RBC Capital Markets

Long runway for accretive tuck-in DS Services acquisitions

Looking forward, we expect tuck-in HOD water and coffee businesses to be a key component of the DS Services growth story. Just this past quarter management mentioned they acquired two HOD water businesses that together generate $9 M in revenues, add over 20,000 new customers to DS Services network and generate $3-$4 M in EBITDA – a level of return that combined with synergies makes the deals near-term accretive. Each year, Cott will look to spend $10 - $20 M on these types of deals, often in different US geographies allowing for easy absorption into the DS Services system without stretching capacity. We point out these deals are the most cash flow accretive way for Cott to grow the DS Services business, as traditional methods of advertising and acquiring customers have proven to be c.30% more expensive. We also believe the runway for Cott to make these acquisitions stretches beyond the next few years given 40% and 80% of the water delivery and coffee delivery markets are made up of fragmented small, local competitors.

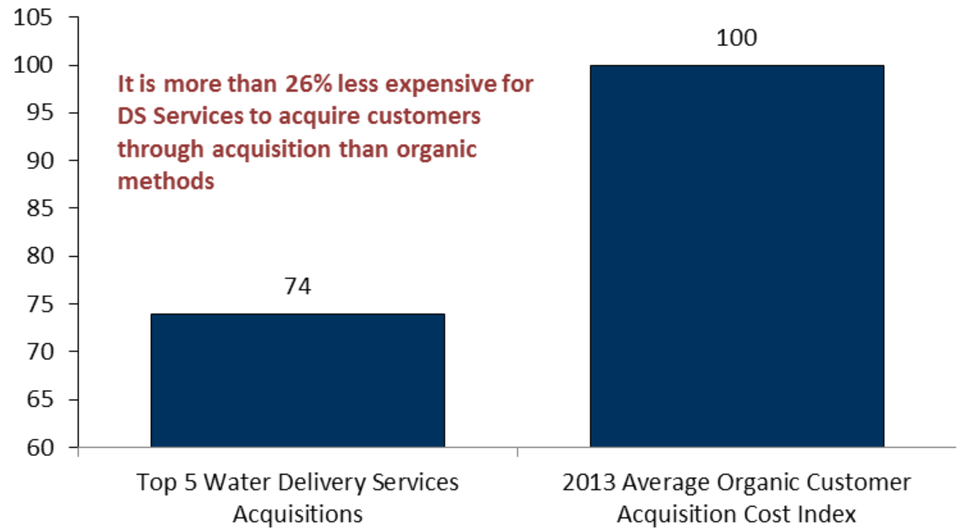
Exhibit 113: DS Services tuck-in acquisition history

	2007	2008	2009	2010	2011	2012	2013	2014	Average
Number of Acquisitions	5	4	4	7	7	5	9	7	6
Cash Paid	28.0	8.1	14.7	33.6	13.9	74.6	7.5	4.0	23.1
Average EBITDA Multiple Paid by DS Including Synergies	**2.8x**	**2.0x**	**2.4x**	**3.2x**	**2.8x**	**3.4x**	**2.4x**	**2.8x**	**2.7x**

Source: Company report

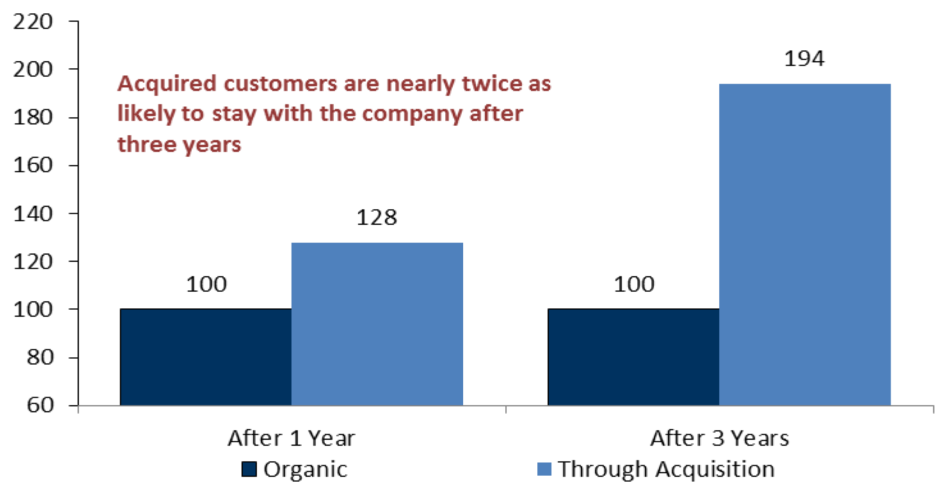
Acquiring customers is the most cost efficient way for Cott to grow its DS Services business

Exhibit 114: DS Services customer acquisition cost index



Source: Cott Corporation and RBC Capital Markets

Exhibit 115: DS Services customer retention rates



Source: Cott Corporation and RBC Capital Markets

Aquaterra acquisition?

Last week on December 8th, Cott announced it has entered a definitive agreement to acquire Aquaterra, Canada's largest home and office water delivery business, for $47 M - which we note is greater than the $10-$20 M Cott planned to spend each year on HOD tuck-in acquisitions. Through the acquisition Cott will acquire 70,000 HOD water customers (compared to the 1.5 M water delivery customers Cott has today). Cott paid 0.8x sales for the business and the year 3 post synergy adjusted EBITDA multiple is expected to be in the mid 5x range and the cash on cash IRR in the mid-teens. The deal is expected to close January 2016, be accretive to free cash flow in the first year and will be funded using Cott's asset based lending facility.

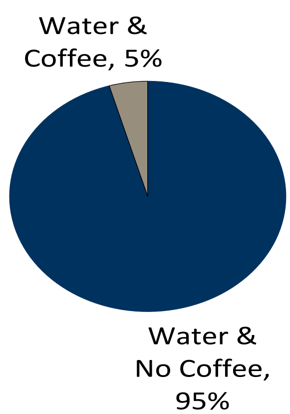
Strategically, the Aquaterra acquisition now provides the company with a platform to acquire smaller HOD businesses in Canada, as the company has done this past year in the US. This is a key positive in that Cott's acquisition strategy is focused on acquiring HOD businesses in different geographies (preventing shock to the system if tuck-in acquisitions are made too soon and too geographically close to one another). In our view, another potential acquisition Cott could make down the road in Canada is Van Houtte (one of Canada's largest HOD coffee businesses) as it would provide cross-selling synergies and further diversify Cott's category base in the region. Lastly, and importantly, this deal is accretive to FCF in year one which is our focus for the name.

DS Services has an inherent growth opportunity through cost selling

Over the next 10 years, we believe DS can compound EBITDA at a mid-single digit rate. Part of this growth will be driven by the natural progression of category growth and share opportunities (discussed previously). However, we believe another supporting pillar of growth is the company's inherent opportunity to cross sell water and coffee (among other products) across its customer base. Presently, only 5% of DS Services water customers buy its coffee services. Cott has already made some progress in this cross selling opportunity and increased its percent of customer base purchasing both water and coffee from 4.3% in 2013 to 4.5% today (a 1,700-customer difference). However, we expect this rate to accelerate following DS Services launch of the Aquacafe which offers both water and coffee to customers in one unit.

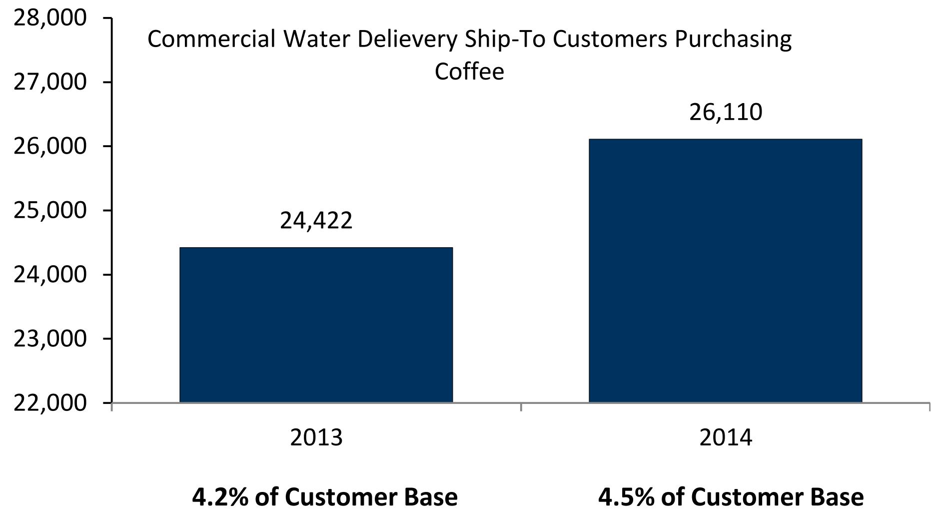
Exhibit 116:DS Services water to coffee cross selling opportunity

Following the rollout of DS Services Aquacafe innovation, there is a meaningful opportunity for DS to offer coffee services to existing water customers



Source: Cott Corporation and RBC Capital Markets

Exhibit 117: DS Services expansion of water/coffee customer base



Source: Cott Corporation and RBC Capital Markets

The changing profile of Cott's margin structure/opportunity

Cott's new and diversified business model leads to better gross and operating margin stability with expansion opportunity looking forward. Putting aside that DS Services is a higher margin business when compared to Cott's legacy private label business, the company will see margin relief from reducing exposure to juice cost of goods (which have proven to be extremely volatile over the past few years). While Cott management has not provided specific COGS detail, we estimate that the juice business now accounts for 17% of revenues and only ~8% of operating profits today.

We also believe the company will be able to execute on its stated DS Services synergy and new "War on Waste" cost savings efforts, each expected to be $30 M through 2017. On DS Services synergies, the company has already realized $3 M to date as the new business leverages Cott's existing back office infrastructure and scale as it relates to procurement items. On the company's $30 M cost savings objective we expect the company to work with its retail partners to save on packaging and other related costs.

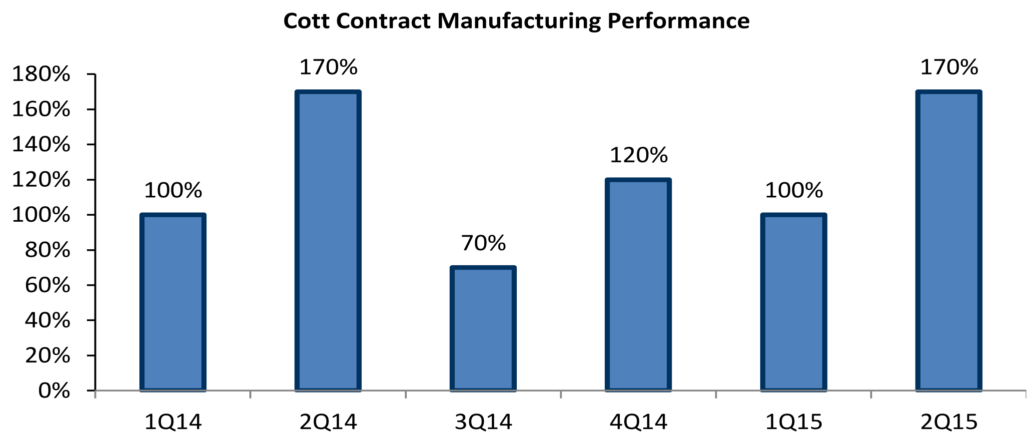
Based on these factors, we conservatively estimate Cott can deliver modest EBIT margin expansion, expecting the company to reach 6% EBIT margins by 2025, only 200 bps higher than the company's 4% EBIT margins today.

Expanding the contract manufacturing revenue stream

Over the past year, Cott management has stepped up its pursuit of high FCF contract wins – with the ultimate goal of contract manufacturing reaching 20% of traditional Cott sales compared to 11% today and only 4% a few years ago. The advantages of Cott's co-pack strategy include: 1) stable margin contribution with limited commodity exposure as brand owners normally supply ingredients and packaging materials, 2) gross margins consistent with Cott historical rates, 3) capitalizes on outsourcing trends by brand owners and 4) increased capacity utilization. Encouragingly, Cott has a lot of momentum in this business, averaging 120% growth each quarter since the beginning of 2014, with recent wins in Ready-to-drink teas, hot fill drinks, shelf-stable juice, ready-to-drink alcohol cans, energy drinks and CSD food service.

Since the beginning of 2014, contract-manufacturing growth has averaged 120% each quarter

Exhibit 118: Contract manufacturing growth since 2014

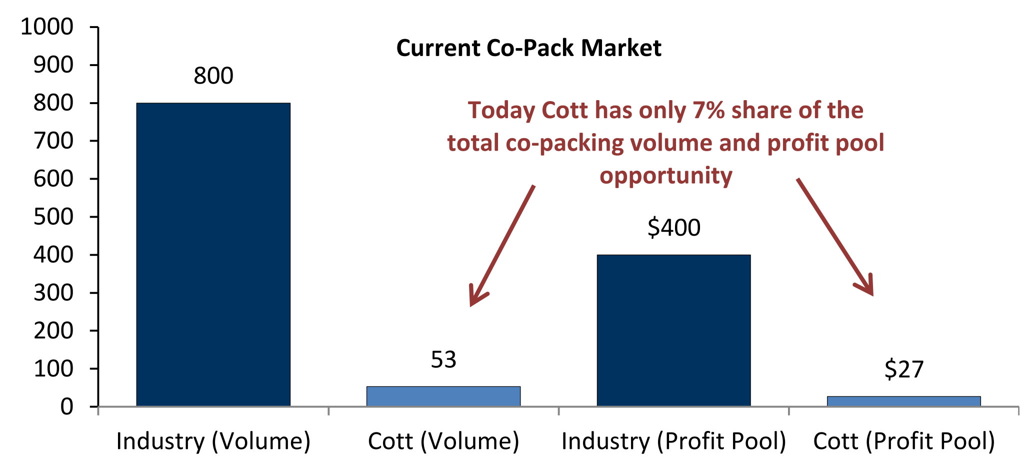


Source: Cott Corporation

To credit for much of Cott's recent contract manufacturing success is North America Business Unit President Steve Kitching who had previously successfully expanded the business in the United Kingdom. Under Mr. Kitching's leadership, we are encouraged Cott can maintain its momentum in this business and point out that the company has only 7% share of the co-packing volume and profit pool.

Cott has substantial room to grow in terms of contract manufacturing growth, currently with only 7% share of the co-pack market profit pool and volumes

Exhibit 119: Contract manufacturing volume and profit pool



Source: Cott Corporation

Addressing UK concerns

The most popular concern among investors is performance in the company's UK business, which drove the entire company to miss consensus expectations across the P&L, due largely in part to weather. We note though the company's core traditional Cott business in the UK/Europe accounts for only 9% of EBITDA and that is working to improve the business through SG&A reductions (headcount already under way), a warehouse savings initiative, and the addition of a "high-speed rainbow pack line", which should help to win business among hard discounters. We also know from our conversations with management that they are not interested in selling the UK business at this time given improvements under way (a decision we support) but would consider a JV that could lower the businesses cost basis.

Quantifying the implications of Cott's changes

We are ok with Cott compromising near-term EPS (to fund the DS deal) to create medium/ long-term EBITDA and FCF stability/growth. Our model now assumes Cott can grow its FCF by an 18% CAGR during 2016-2018 (versus 13% previously) driven by: 1) 24 pp from core DS Services EBITDA growth, 2) 2 pp from cost savings and synergies, and 3) 5 pp from deleverage, offset by 13 pp from capex.

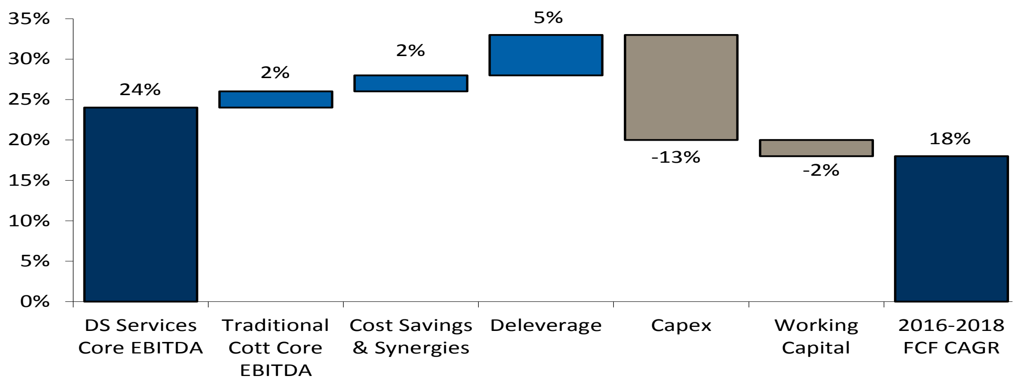
EPS implications

Due to Cott's increased leverage from 3x to 5x net debt to EBITDA, we project COT EPS to fall 60% in 2015, only to rebound at 50% CAGR over the following three years through 2018 as the company delevers, while benefitting from cost savings and synergies. Through 2025 behind consistent low-single-digit top-line and operating income growth, along with deleverage we believe Cott can deliver high-single-digit annual EPS growth.

Breaking down the drivers of Cott's 18% free cash flow growth

A closer look at our bridge to 18% FCF growth in 2016-2018 shows that consistent with Cott's new strategy, DS Services will drive the majority of FCF growth for the company growing EBITDA at a 5% rate (cross selling, pricing and acquisitions) versus the traditional Cott business growing EBITDA 1% driven by contract manufacturing growth. Deleverage which plays an important role over the next few years through 2017. On cost savings and synergies, we assume Cott will be able to slightly exceed its targets by 2018 and model a combined $60 M benefit over 2016, 2017 and 2018 accordingly. Capex remains a flat $117 M of 4% of sales over the three years, an appropriate level per our discussions with management. Lastly, we have modeled working capital as a slight headwind to FCF due in part to Cott's ramp up in contract manufacturing which has higher working capital requirements. For example in contract manufacturing, Cott will harvest fruit seasonally, process and store for months before placing in a finished good.

Exhibit 120: Bridge to 18% 2016-2018 FCF CAGR



Source: Cott Corporation and RBC Capital Markets

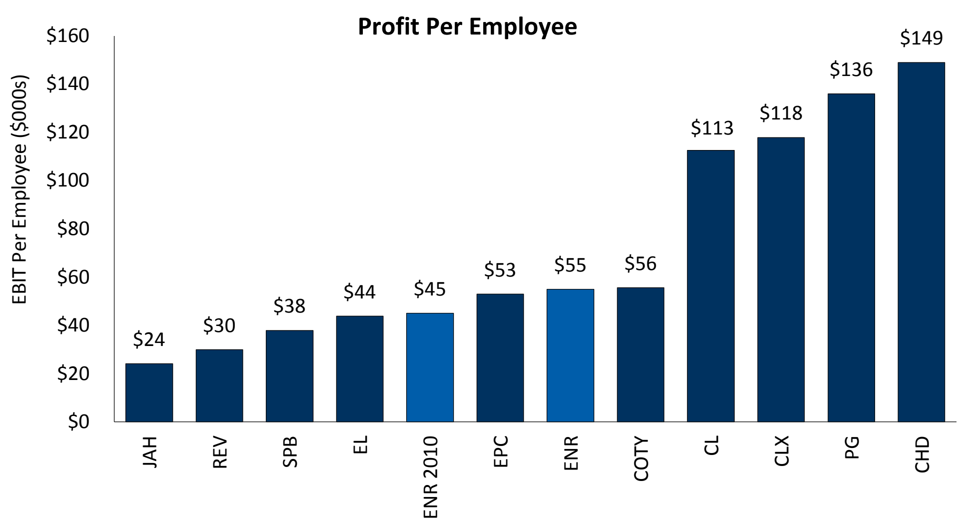
Energizer Holdings

Our thesis is simple: management has guided to low-single digit EBITDA growth, though we believe the company could generate mid-single-digit long-run EBITDA growth behind improved pricing and cost savings. We believe Energizer's 2016 guidance has some cushion to absorb any further deterioration in FX or higher costs associated with the separation from Edgewell Personal Care. However, we expect trading to remain choppy over the next few months due to volatility around quarterly results. We advise investors to consider any pullbacks in ENR as an opportunity to build positions. $53 price target, 55% implied upside.

Expecting cost savings upside from here

We calculate Energizer's EBIT per employee of about $55K. While this is significantly better than $45K in 2010 (prior to the implementation of "Project Transformers"), it is still significantly below other US consumer staples companies. We believe Energizer has the opportunity to continue reducing costs through: (1) trade spending optimization (via improved trade analytics and new agreements with retailers), (2) supply chain efficiencies (via outsourcing more manufacturing), and (3) further SG&A productivity.

Exhibit 121: Energizer profit per employee



Source: RBC Capital Markets estimates

If Energizer were to achieve profit per employee of $80,000, while maintaining its current 5,100 employee base that would imply EBIT of $410 M or 50% upside from the $275 M in 2015 EBIT. We believe trade spending efficiency alone could be up to a $100 M opportunity for Energizer and note that achieving this level of savings could lead to sustainable 5% EBIT growth alone over the next five years.

Higher pricing to drive higher EBITDA

Looking out longer term, we believe the battery profit pool is poised to improve following Berkshire Hathaway's acquisition of Duracell, as we believe Berkshire is likely to emphasize cash over volume. We note Duracell was the most promoted brand in the battery category under P&G's ownership, leading Duracell (and the category) to have lower profit margins than when P&G acquired Gillette in 2004. Under Berkshire Hathaway, we expect the focus to shift from growing top-line to growing profits. We note that since Berkshire took official ownership of Duracell, promotional activity has subsided industry wide.

Duracell joins the Marmon Group

Duracell will join Berkshire Hathaway's Marmon Group, and a new Berkshire Hathaway executive will be appointed to run Duracell (press reports suggest it will be Angelo Pantaleo – a senior executive at the Marmon Group. Marmon's current CEO is Frank Ptak). We note by way of background that Marmon is a diversified industrial company, composed of more than 100 subsidiaries, acquired by Berkshire from the Pritzker family. Based on our analysis of Berkshire Hathaway's annual report, Marmon has been a key source of earnings generation for Berkshire.

Expect Duracell to be more profit focused under Marmon’s watch

Consistent with Warren Buffett's management style, he leaves complete autonomy to business managers on decision making, who in Marmon's case is Frank Ptak (though as referenced earlier, Angelo Pantaleo could be likely to directly oversee Duracell). Mr. Ptak joined Marmon in 2006, after a 30-year career at Illinois Tool Works where he last served as Vice Chairman. Prior to ITW, Ptak worked for five years at Sara Lee, holding roles including Assistant to the Chairman. Warren Buffett speaks very highly of Ptak in letters to shareholders, particularly in his 2009 letter, when Marmon sales were down 27% but Ptak received praise from Buffett for record margin achievement and cost-conscious management. We note Pantaleo is likely manufacturing-oriented, having spent over 10 years at DuPont prior to joining Marmon, and if recent press reports bear out, we would expect him to be very focused on Duracell's cost and capacity rationalization opportunities and less so on retail execution/promotions.

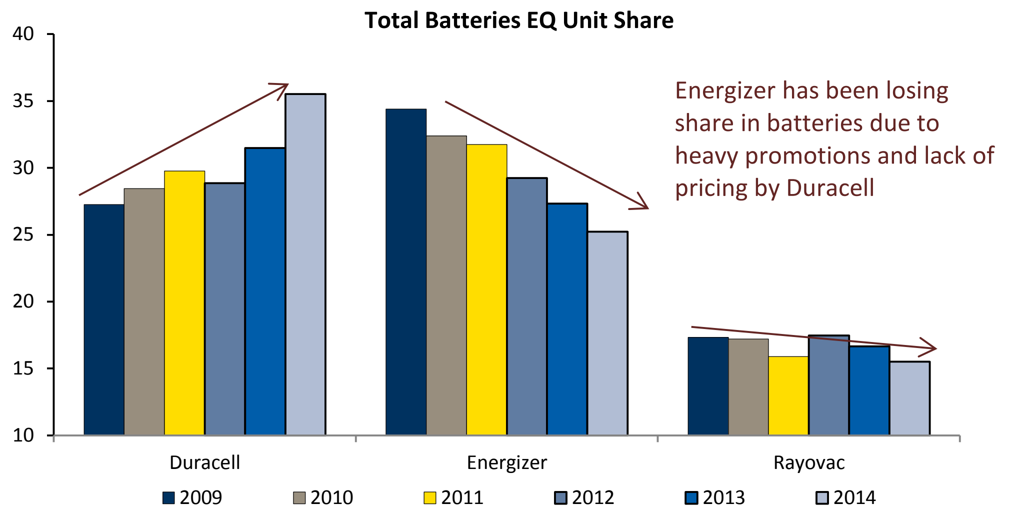
Existing State of Batteries Difficult for Energizer

The battery category has been declining for a few years and has historically been one of the most promoted categories in all of HPC; however, ENR’s business has underperformed the category largely due to a difficult competitive environment and large distribution losses at key customers.

Since 2009, ENR’s share of the category is down from 35% to nearly 25%, while Duracell has increased from around 27% to 30%. During this time, Duracell has been the highest promoted branded player and one of the most promoted brands within P&G’s entire portfolio. Duracell also has not followed Energizer and Rayovac on price increases since 2009 (based on scanner data), with its average EQ unit price today down vs. 2009, while Energizer and Rayovac are up significantly.

Energizer has been losing share in batteries due to heavy promotions and lack of pricing by Duracell

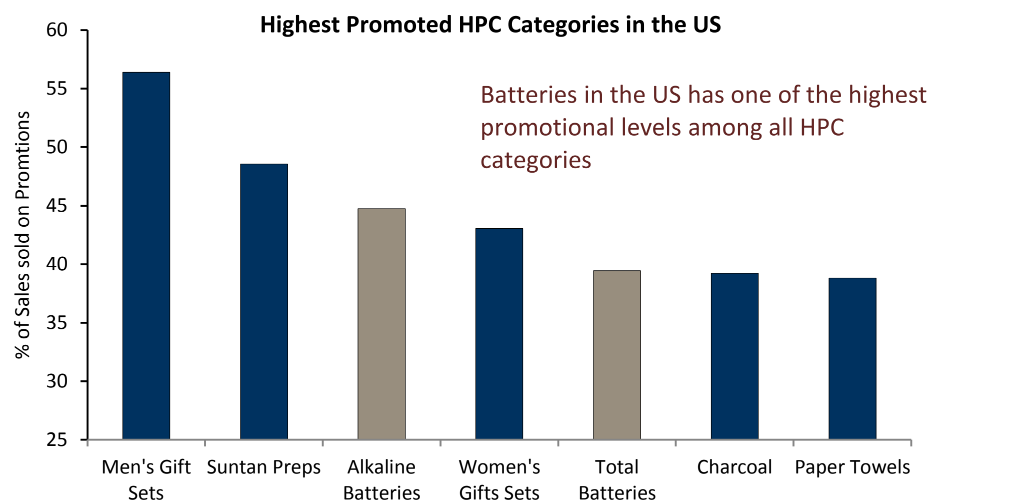
Exhibit 122: Total batteries EQ unit share (%)



Source: Nielsen

Batteries in the US has one of the highest promotional levels among all HPC categories

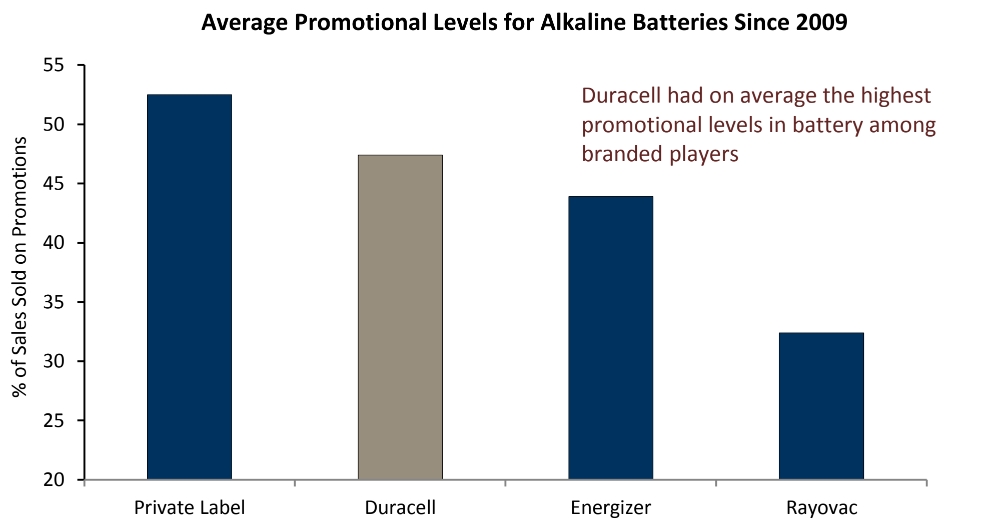
Exhibit 123: Highest promoted HPC categories in the US



Source: Nielsen

Duracell had on average the highest promotional levels in battery among branded players

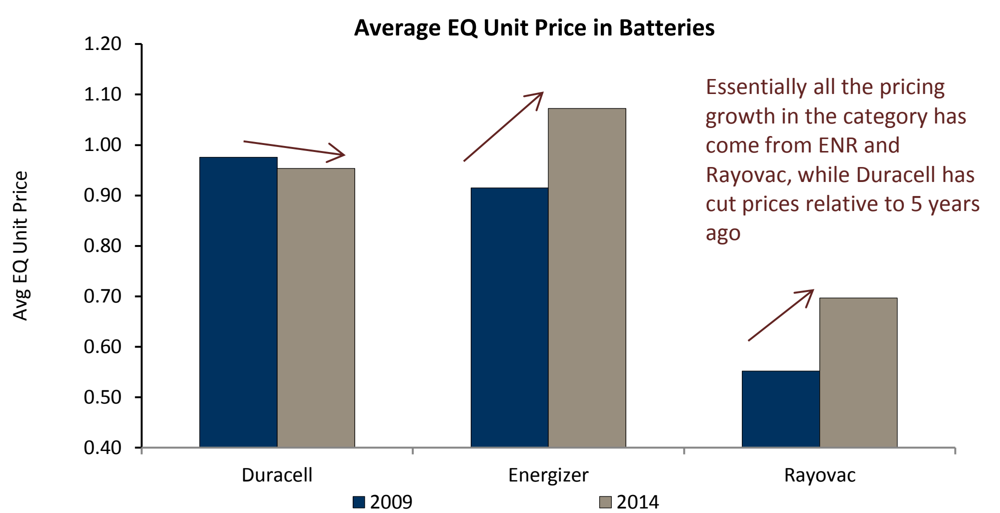
Exhibit 124: Average promotional levels for alkaline batteries since 2009



Source: Nielsen

Essentially all the pricing growth in the category has come from ENR and Rayovac, while Duracell has cut prices relative to 5 years ago based on scanner data

Exhibit 125: Average EQ unit price in batteries



Source: Nielsen

Duracell currently has operating margins of roughly 18% – lower than the level when Gillette was acquired in 2004 and when Gillette acquired Duracell in 1996 from KKR – an interesting observation given the significant restructurings that have occurred in P&G's portfolio since 2004. We believe the depressed margins are a direct result of increased promotional spending by Duracell over the past few years as P&G was dressing the asset up for a potential sale.

Expecting competitive environment to become more rational

While Duracell has been the more promotional player in the battery category in recent years, we note that this was not always the case and the company had a different strategic approach prior to being acquired by P&G. Under Jim Kilts leadership in 2003 (when Warren Buffet was on the board of Gillette as well), Duracell's strategy was to "maintain dollar share while generating industry-leading margins".

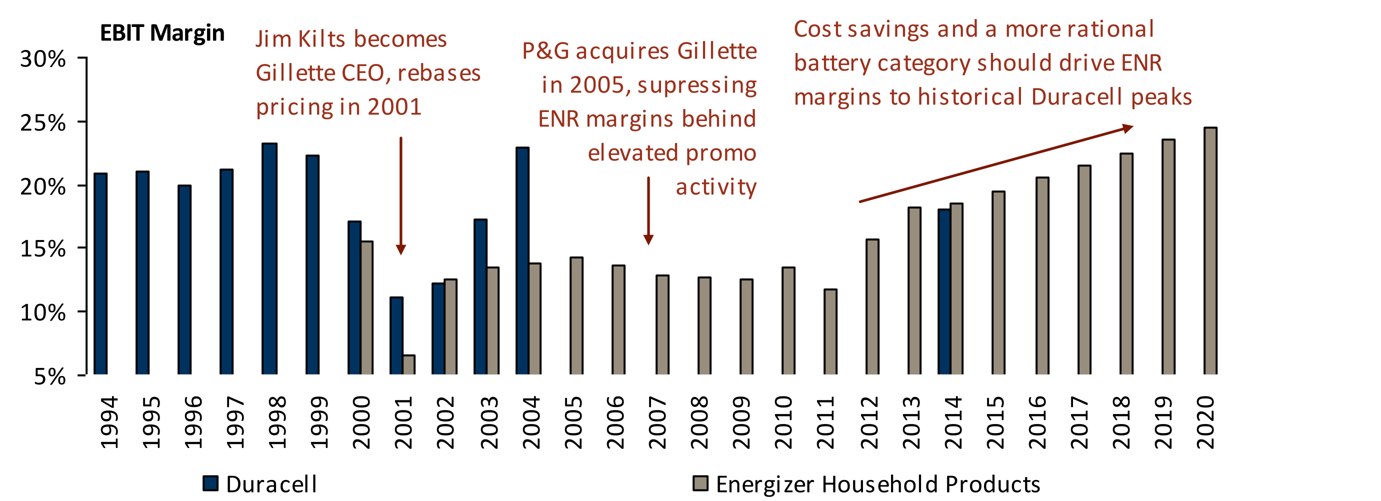
From Gillette's 2003 10-K:

The Company's objective for Duracell is to <u>maintain dollar share while generating industry-leading margins.</u> Growth in the segment is driven by increases in unit volume. The battery industry has been intensely competitive for several years, leading to a deflationary pricing environment and a reduction in category value. In an effort to counter this trend, Duracell announced a price-deal realignment program in North America early in 2003, which resulted in price reductions, <u>partially offset by reduced promotional activity and the elimination of free cell giveaway programs.</u> To date, the program has been successful, as the Company has been <u>able to hold market share while significantly increasing the profitability of the business</u>.

Berkshire Strategically Focused on Growing Book Value vs. Sales

We think it is interesting to note the differences in how performance is measured at Berkshire Hathaway vs. P&G (from an investor perspective). Berkshire Hathaway's stock performance is linked to the company's growth in its book value per share, not on revenues or share of its various businesses. On the other hand, one of the most important metrics watched by investors for P&G is organic growth across its portfolio – leading to the majority of the focus within the company falling on share and volume performance. We believe the distinction on how the two companies view value creation for shareholders provides further support to our view of BRK refocusing Duracell's attention on profits and cash flow.

Exhibit 126: Duracell Historical EBIT Margins

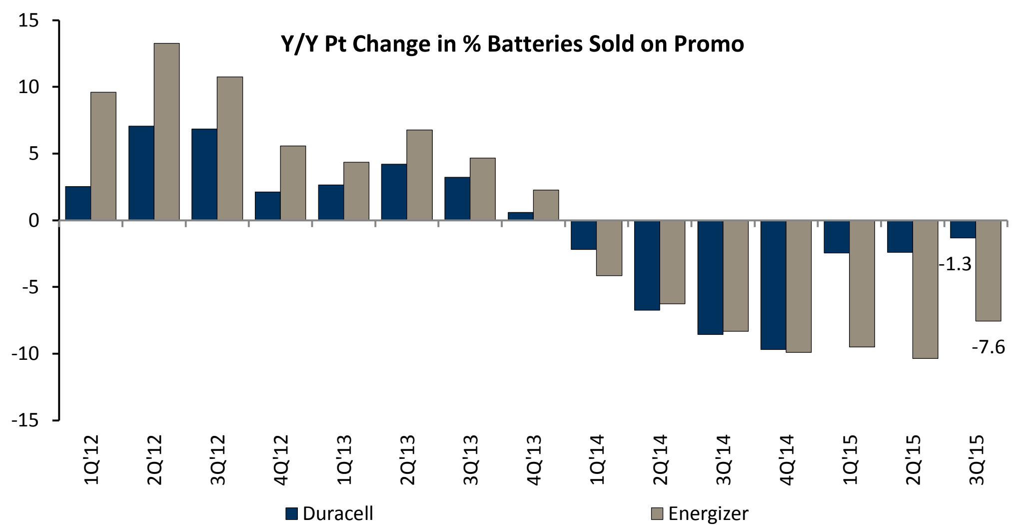


Note: Historical Energizer Adjusted EBIT margins assume Corporate/Other expense and R&D at 5% and 2% of sales respectively (consistent with 2012 levels per Energizer Form 10).
Source: Company reports and RBC Capital Markets estimates.

Already beginning to see the difference

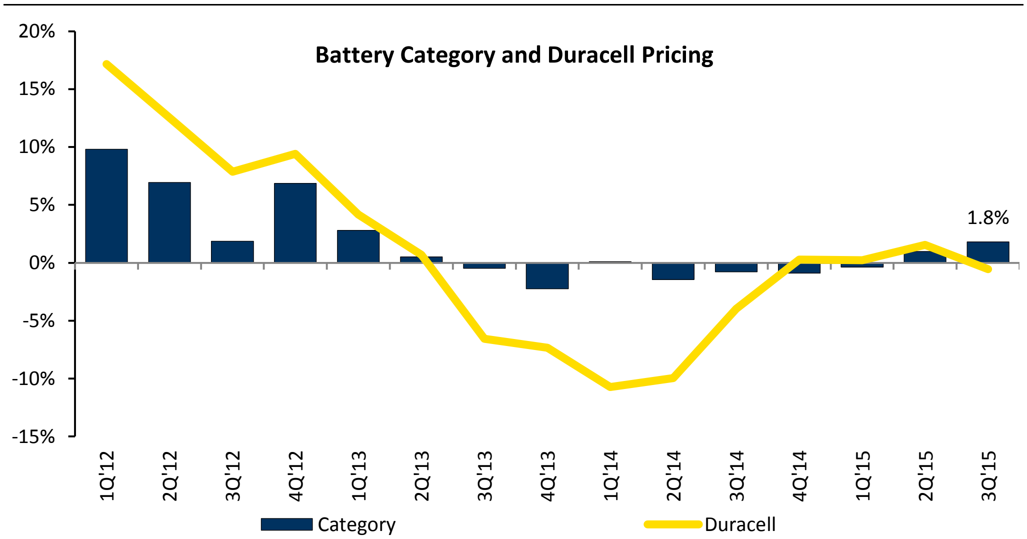
So far this year, we have already seen both Duracell and Energizer pull back on promotional levels as well increase list pricing. In fact, battery category-wide pricing is already trending +1%. We see this as just the beginning set of data points for a category that should consistently improve pricing by at least a point each quarter.

Exhibit 127: Duracell and Energizer battery promotions



Source: Nielsen

Exhibit 128: Battery category and Duracell pricing



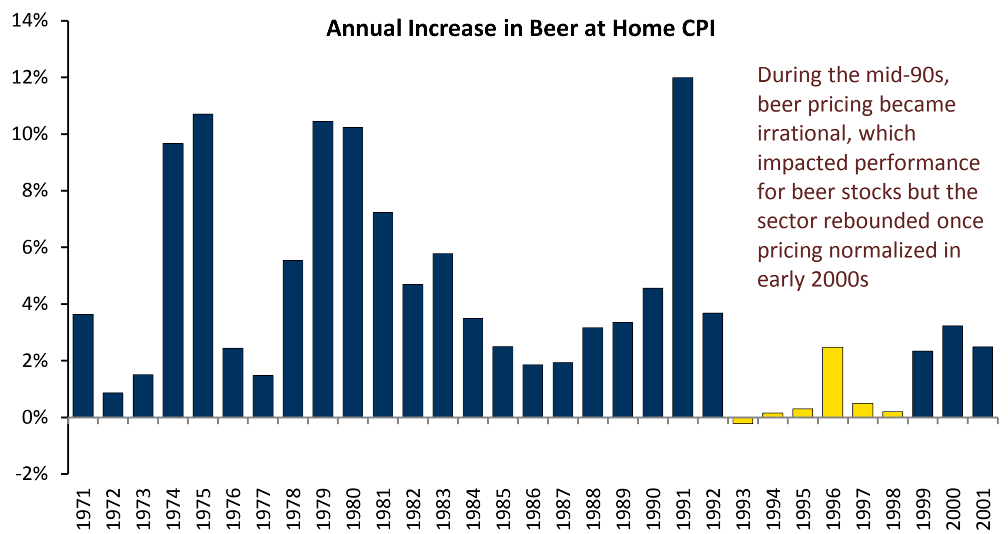
Source: Nielsen

Catching a Pricing Story Before it starts

We note that, generally speaking, sector pricing improvement stories lead to improved performance for consumer staples stocks. We point to two specific examples that illustrate this phenomenon: 1) beer in the 1990s and 2) tobacco three years ago. In the mid 1990s, after years of 2-4% pricing annually, pricing realization in the beer industry slowed significantly behind increased promotional activity in the category. During this time period, Anheuser-Busch, the leading brewer at the time, saw its stock languish relative to the S&P 500. However, following improved pricing in the early 2000s, the stock resumed its rally, rising as much as 200% relative to the S&P in the ensuing years. We saw a similar dynamic play through in the tobacco industry in 2012. Tobacco has historically been one of the best performing sectors in the S&P 500, outperforming the broader market every year in the decade leading up to 2012. However, in 2012, Altria significantly stepped up promotional activity, which reduced the sectors average price realization. As such, tobacco stocks recorded their first underperforming year since the heavy litigation period in the early 2000s. Once pricing rebounded in 2014, tobacco stocks resumed their outperformance.

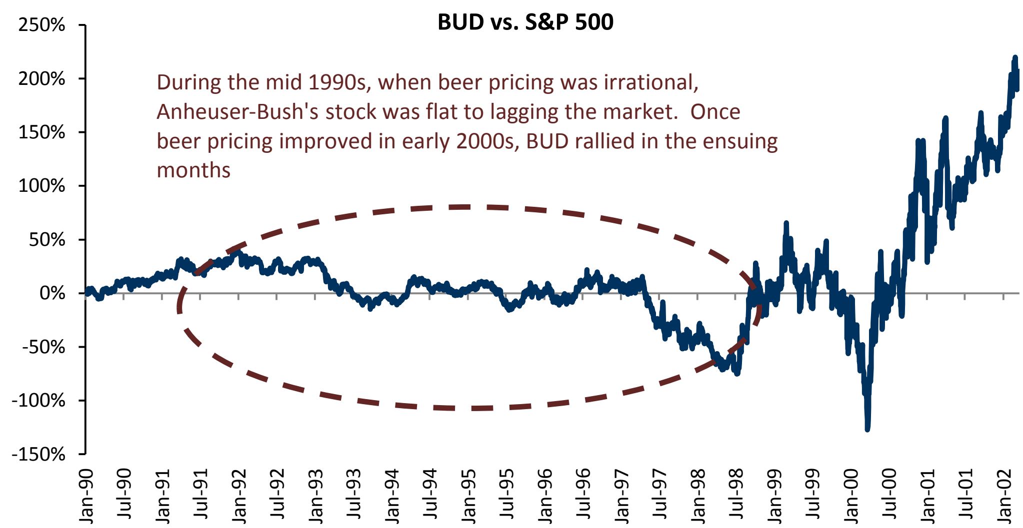
We note ENR presents investors a unique pricing story that is likely to see category price realization accelerate for the next few years.

Exhibit 129: Annual Increase in Beer at Home CPI



Source: BLS

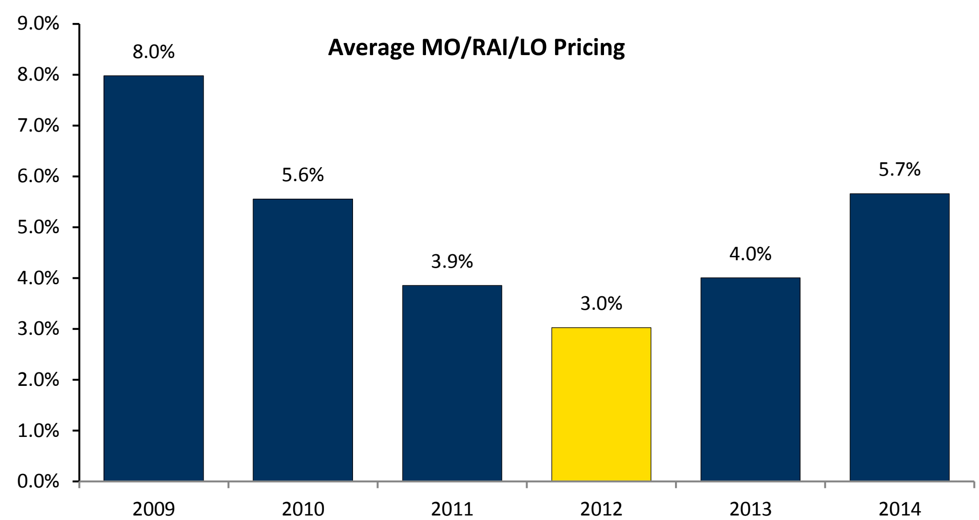
Exhibit 130: BUD vs S&P 500



Source: FactSet

Exhibit 131: Average MO/RAI/LO Pricing

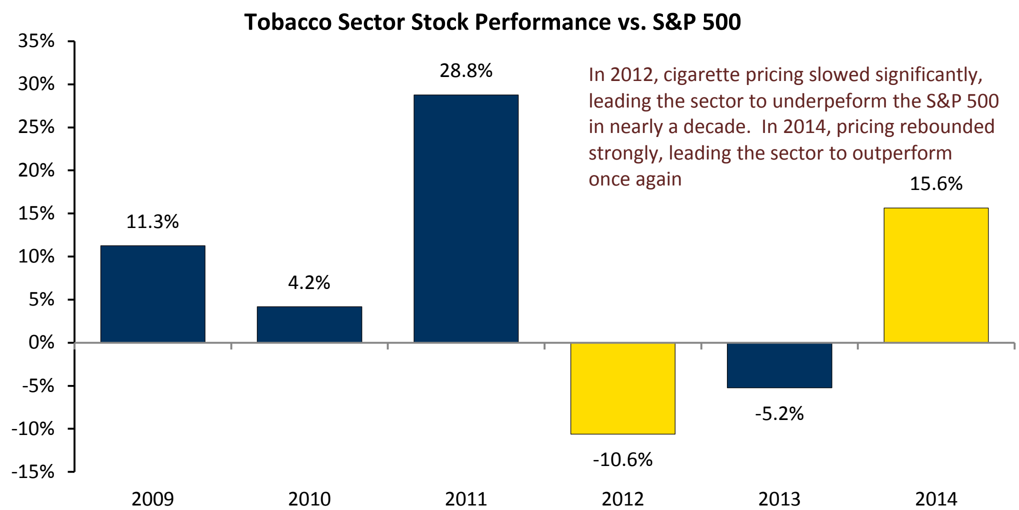
Cigarette price realization slowed significantly in 2012 after Altria stepped up promotional support behind Marlboro



Source: RBC Capital Markets

In 2012, cigarette pricing slowed significantly, leading the sector to underperform the S&P 500 for the first time in nearly a decade. In 2014, pricing rebounded strongly, leading the sector to outperform once again

Exhibit 132: Tobacco Sector Stock Performance vs. S&P 500

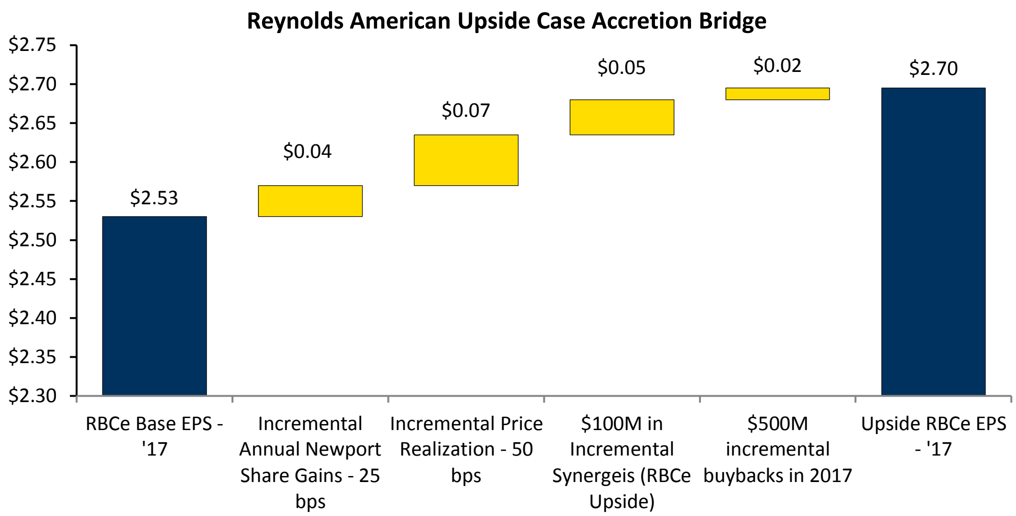


Source: FactSet

Reynolds American

We rate Reynolds American outperform and believe there is room for EPS upside to current consensus estimates. With cost synergies opportunities well understood, the biggest opportunity for RAI from here is revenue synergies, which are difficult to model and not fully appreciated. The potential for revenue synergies was apparent this past quarter, with Newport trends accelerating while being under the RAI system for only a few months.

Exhibit 133: RAI upside case accretion bridge



Source: RBC Capital Markets Estimates

Exhibit 134: EPS accretion sensitivity

EPS accretion sensitivity – incremental upside needed to achieve an additional 1% in EPS accretion

Incremental Upside Needed to Achieve 1% in EPS Accretion	
Cost Synergies - Run rate	$50M
Deleverage (debt repayment)	$500M
Cigarette Share Gains	10 bps
Price Realization	15 bps
Cumulative Buybacks	$500M

Source: RBC Capital Markets Estimates

The opportunity for revenue synergies

While value creation on the cost side is clear and quantifiable, we believe RAI will be able to realize meaningful synergies on the revenue side as well. We see revenue synergies being realized through incremental share gains for the Newport franchise (and potentially for Camel as well).

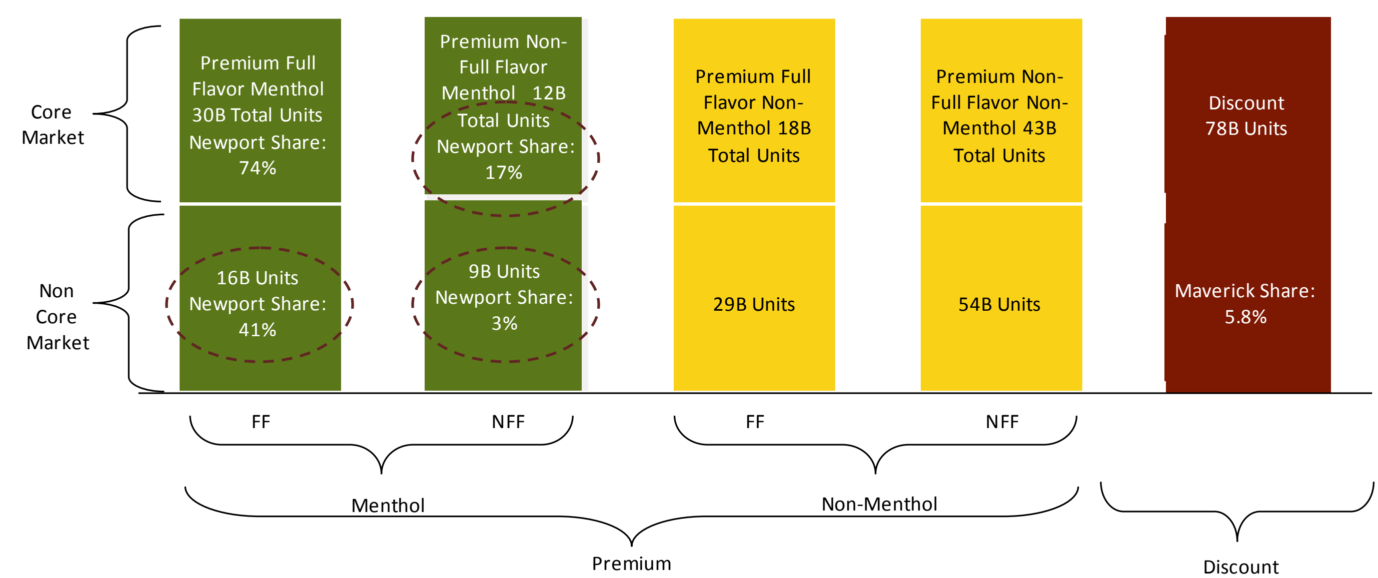
Incremental share gain opportunity

Historically, we note that Newport has gained 30 bps of share primarily through growing its base in its core markets – but the brands performance has been hindered in certain markets due to not being party to merchandising agreements. In fact, Lorillard cites its lack of retail contracts as a risk to its business in its 10K.

"We believe our ability to compete even more effectively has been restrained in some marketing areas as a result of retail merchandising contracts offered by Philip Morris and RJR Tobacco which limit the retail shelf space available to our brands. As a result, in some retail locations we are limited in competitively supporting our promotional programs, which may constrain sales." – Lorillard's 2013 10K, page 7

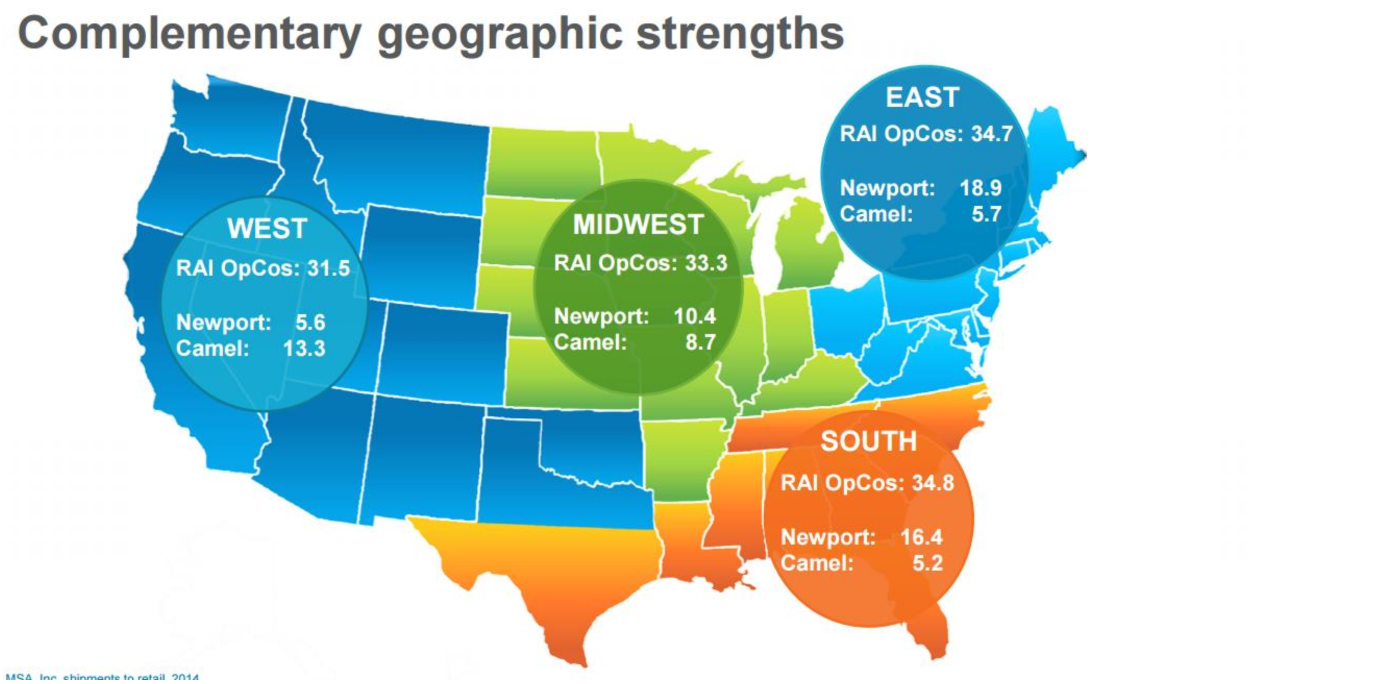
Newport's share in its core full flavor menthol markets is close to 74%, but its share in non-core markets is 41% and even lower in the non-full flavor menthol segment. We believe that as part of a merchandising agreement under Reynolds' umbrella, Newport will be able to leverage Reynolds's expertise in the western half of the country and expand its share in its non-core market as well as expand its positioning in non-full flavor premium menthol. We believe Newport menthol could gain as much 25 bps of incremental annual share through the next decade.

Exhibit 135: Newport's positioning in its core and non-core markets – Newport has significant expansion opportunities in its non-core markets and in non-full flavor menthol



Source: Lorillard (based on 2012 shipments)

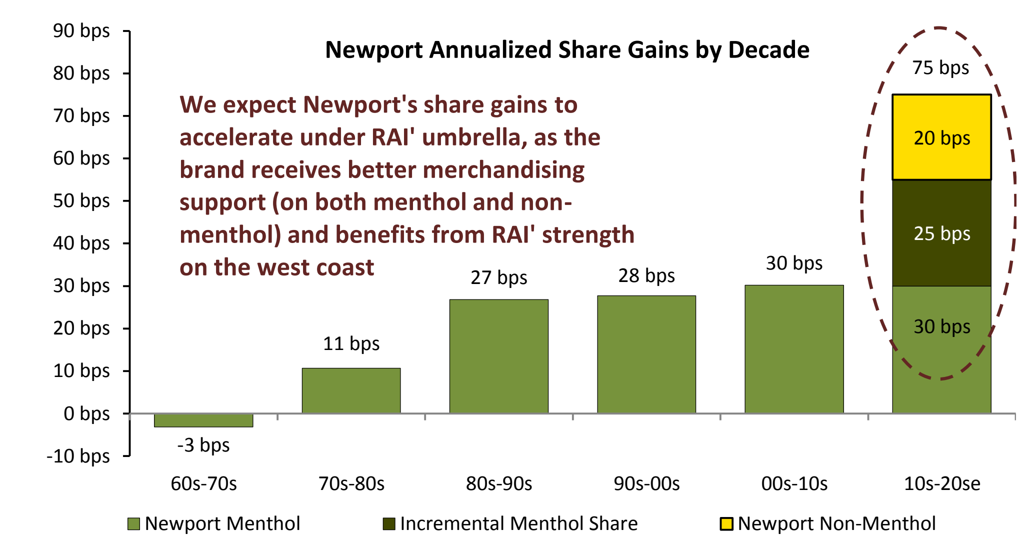
Exhibit 136: As part of Reynolds' merchandising contracts, Newport can leverage RAI's strength on the west coast to position the brand better west of the Mississippi



Source: Reynolds American

We believe Newport's exclusion from merchandising agreements at retail has limited the brand's expansion potential, and believe Newport menthol can accelerate share gains by as much as 25 bps by getting better shelf spacing

Exhibit 137: Newport Annualized Share Gains by Decade

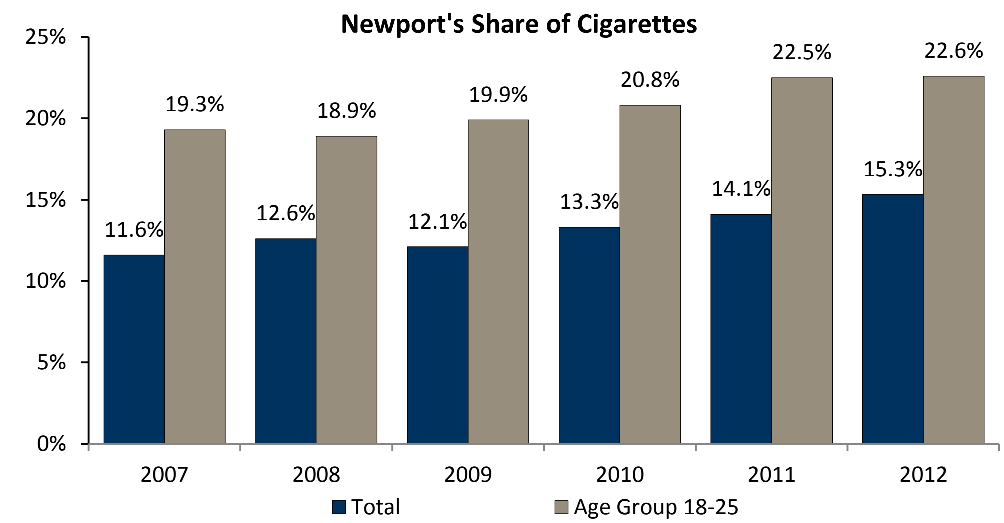


Source: RBC Capital Markets Estimates – Note: historical share based on shipments to wholesale

Furthermore, Newport currently has a large gap between its share for smokers age group 18-25 (23.6%) and legal smokers of all ages (15.6%). If Newport is to close this gap over the next 10 years and move its share closer to its share among younger demographics, the brand can realize annualized share gains of 75 bps.

Newport's share for age group 18-25 today is 23%, vs. 15% across all age groups. Newport closing this gap over the next 10 years equates to annual share gains of ~75 bps

Exhibit 138: Newport's share of cigarettes



Source: Lorillard

We note that Reynolds also picked up an addition 50,000 urban retailers in core Newport markets. As such, there is opportunity to enhance Camel, Pall Mall and NAS distribution as well.

A Quick Word on RAI's "EDLP" Program

RAI's EDLP (Every Day Low Price) program essentially provides retailers incentive dollars on Camel for making Pall Mall the lowest priced cigarette in the store. Currently, only about 60% of retailers are on the EDLP program (mostly in high share Camel markets). However, by inserting Newport into the program, Reynolds is likely to get broader participation (in key East Coast markets--where Newport has high share). Not only will this help Pall Mall's momentum (which has been struggling of late), but should also help Camel and Newport's volume momentum since retailers usually take the incentive funds to discount these brands (to drive traffic). RAI said it expects EDLP participation to increase to 70% through linking the program with Newport.

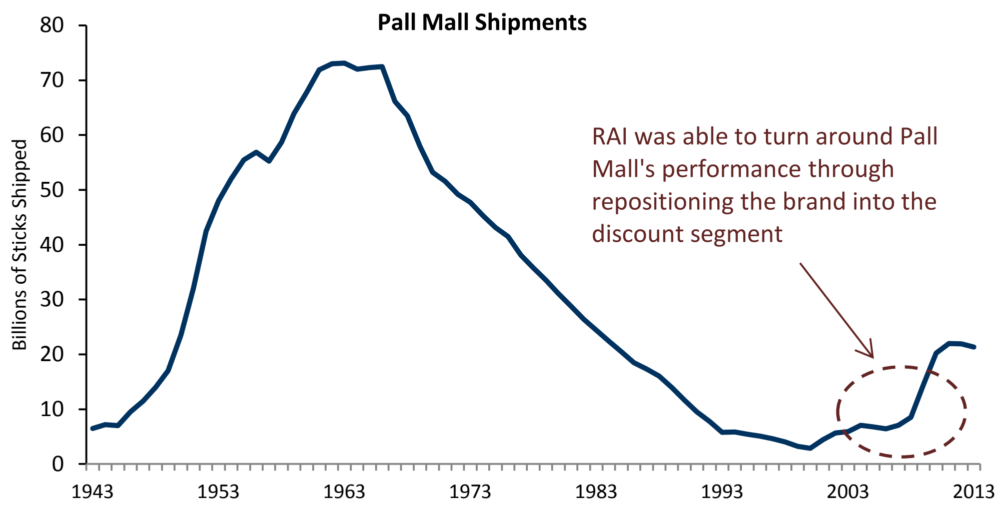
Implications of ITG's investment back into Winston

ITG recently communicated that it will step up investments behind the brands it acquired from RAI (Winston/Kool, etc) in an effort to stabilize the brand's performance, which is consistent with the strategy the company announced when it acquired the brands. We have fielded a lot investor questions on whether Imperial's move will disrupt the overall pricing environment. We do not believe that will be the case. We do not believe Winston/Kool will be able to source meaningful share from the core brands of MO and RAI to elicit a significant promotional response. Importantly, the promotions vary by state (ranging from $0.02/pack to $1/pack on Winston). We remind investors that RAI pursued a similar strategy with Pall Mall in 2009, with Pall Mall gaining significant share for a 4 year period. Throughout this time period, the pricing environment for cigarettes remained more or less normalized.

The Pall Mall Case Study

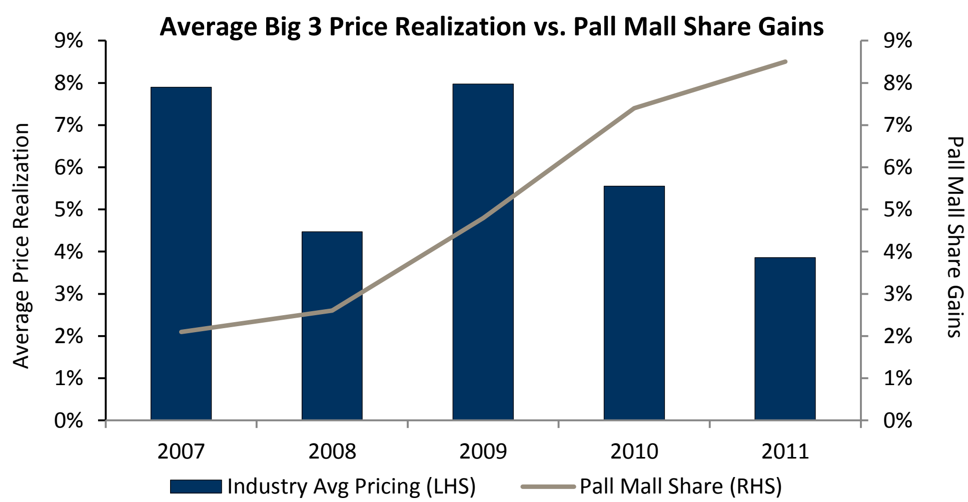
Pall Mall for years had been in a declining trajectory, similar to Winston today, but RAI was able to rejuvenate the brand through rebranding and increased investments. And while Pall Mall's price came down as part of its repositioning, it did not affect the overall pricing environment.

Exhibit 139: Pall Mall's Historical Shipment Volumes



Source: RBC Capital Markets

Exhibit 140: Average big 3 price realization vs. Pall Mall share gains

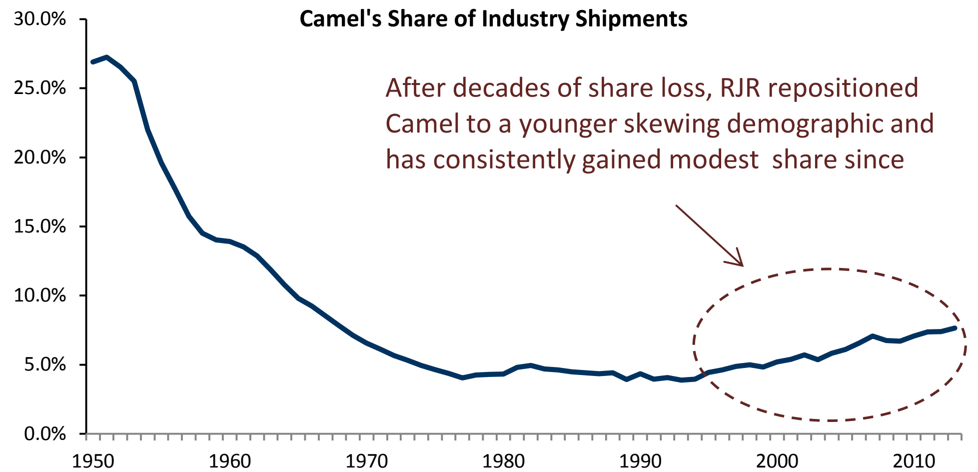


Source: RBC Capital Markets Estimates – Note: historical share based on shipments to wholesale

The Camel Case Study

RAI has been gaining share on the Camel brand for more than a decade, by repositioning the brand towards younger skewing demographics. In fact, Camel's menthol styles were one of the lowest priced menthol cigarettes on the market, and sold at a lower price point to both Marlboro and Newport. However, during this protracted period the tobacco industry continued to realize 3-4%+ pricing on average.

Exhibit 141: Reynolds was able to turn around Camel due to better focus and non-priced based investments

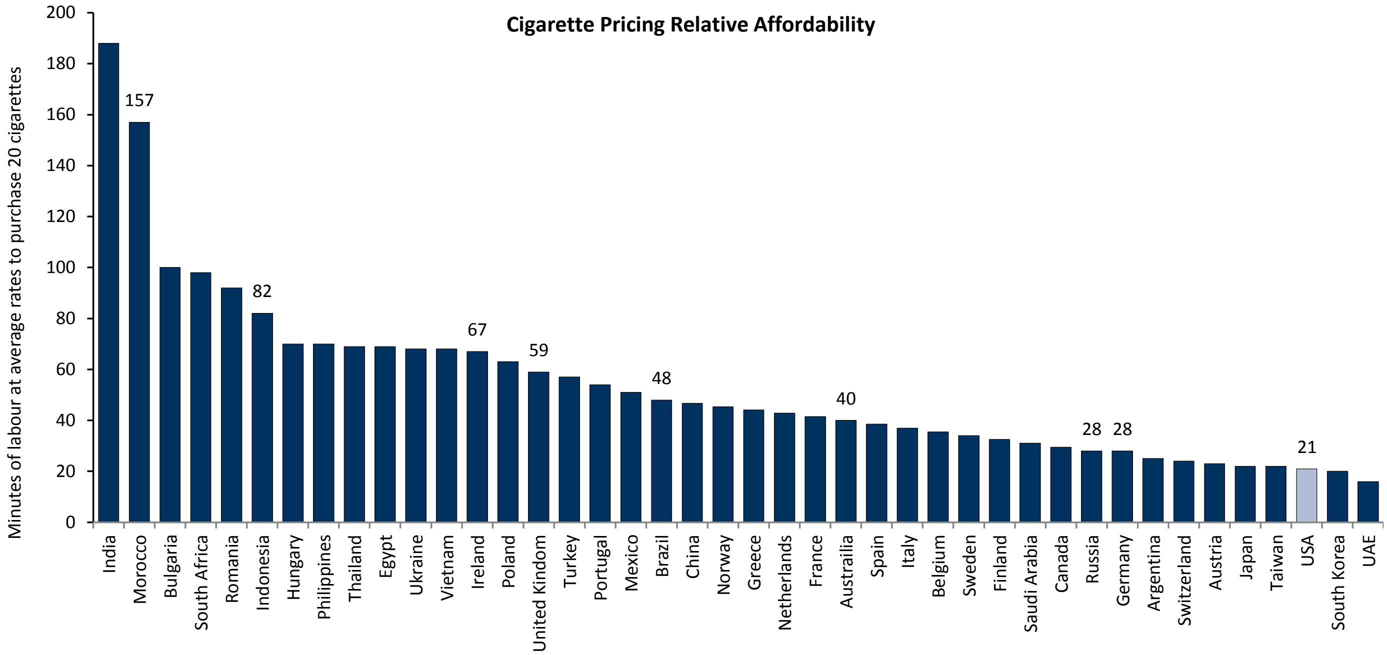


Source: RBC Capital Markets

Imperial believes the US has lots of pricing opportunity

Imperial management has been very clear that they believe the US market possesses significant pricing opportunity. We highly doubt Imperial spent $7bn to become bigger in the US cigarette market--only to degrade the profit pool. In a study done by ITG, cigarette affordability provides the industry with significant pricing ability for the foreseeable future. The US is one of the most affordably priced cigarette markets globally, as measured by the minutes of labor required to purchase a pack of cigarettes. Cigarette affordability in the US is very favorable even when comparing to emerging markets such as Brazil and Indonesia.

Exhibit 142: Cigarette pricing relative affordability – Cigarette pricing in US has significant runway

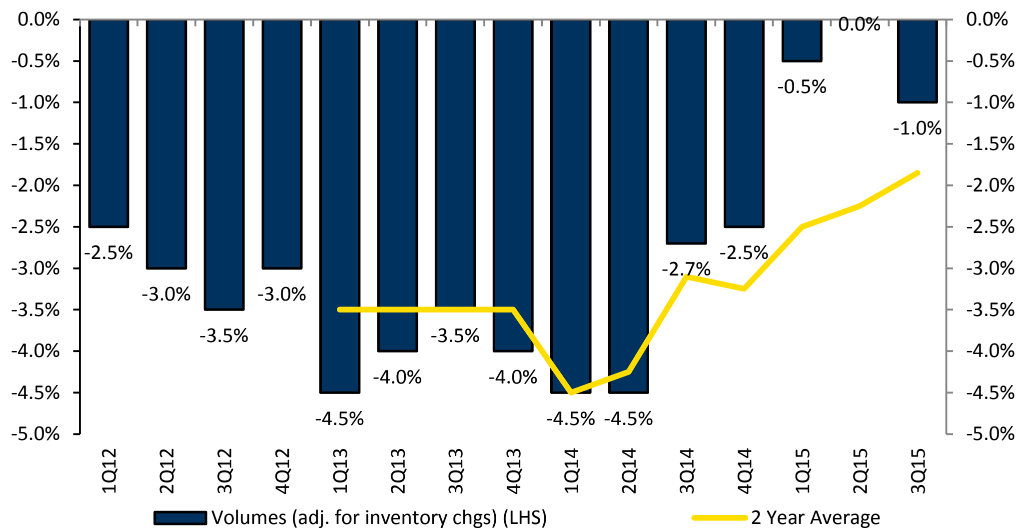


Source: RBC Capital Markets

Volume Trend Outlook for 2016 and Beyond

So far in 2015, cigarette volumes have performed well above historical trends, declining only -0.5% YTD. However, we do not expect the recent momentum to carry into 2016 and we are cautioning investors to keep expectations in check. We do not believe the cigarette category is in a new normal, where volumes will decline -1% to -2% annually. Rather, we view 2015 as a positive anomaly that benefited from: 1) lower gas prices combined with wage inflation for low income consumer consumers, 2) retailers decision to reduce ecig/vape inventory in favor of premium branded cigarettes and 3) consumer migration away from untracked nicotine alternatives (roll-your-own, little cigars, etc) and back into premium branded cigarettes. Our current expectation is for cigarette industry volume declines to return to down 2-4% in 2016 and we believe RAI will use the same expectation in their 2016 guidance.

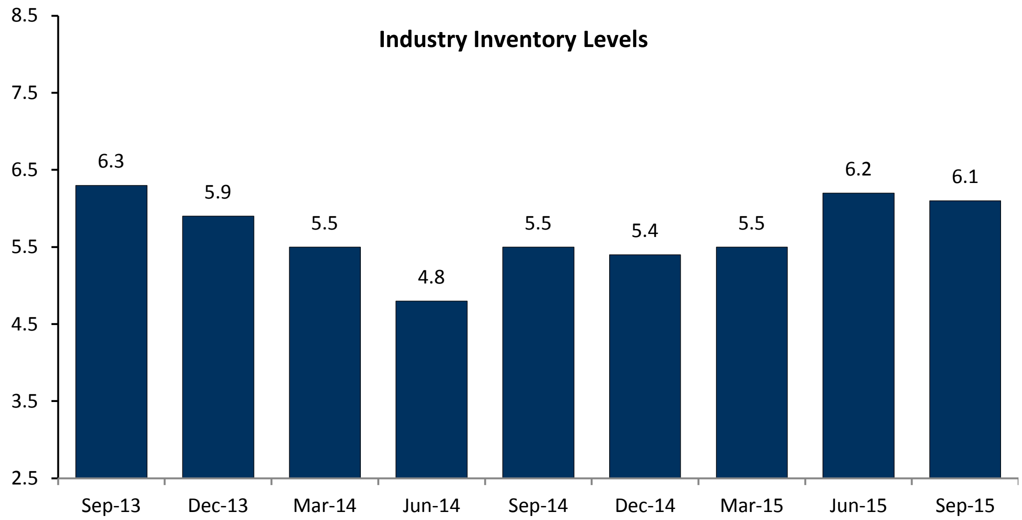
Exhibit 143: Cigarette industry volumes have benefitted from a cocktail of macro factors



Source: RBC Capital Markets

Importantly, we believe the entire cigarette industry will face “tougher” compares moving into 2016 mainly due to inventory inflation (as retailers increased inventories of cigarettes in 2015 after de-stocking in 2014 due to giving more space to e-cigarettes).

Exhibit 144: Industry inventory levels have been elevated in recent quarters – we expect inventory levels to stabilize/moderate in 2016



Source: RBC Capital Markets

RAI has many levers to overcome "NPM Cliff"

In 2012, RAI reached an agreement with various states over disputes over past MSA payments, referred to as the NPM settlements. As part of the settlement, RAI receives credits towards future MSA payments, which the company elected to apply to MSA payments from 2012-2017. These credits equated to $307M in 2014 and $261M in 2013, and will equate to roughly $280M this year. In 2017, the original credits received in 2012 will expire, serving as a headwind of above $250M to 2017 EPS.

We have received questions from many investors in regards to the upcoming "NPM cliff" in 2017, which could lead to a significant slowdown in EPS growth. We believe RAI has several levers it can pull to help mitigate the "NPM Cliff". These levers include:

1) Future NPM settlements – RAI is still in arbitration proceedings with 27 states over past MSA payments and any settlements reached with these states will likely lead to further NPM benefits.

2) E-cigarette spending – RAI has been spending a significant amount of money behind its e-cigarette venture. The "All other" segment, which houses RAI's e-cig operations, reported a loss of -$234M on revenue of $263M last year, and we estimate the company will report a loss of $143M on revenues of $366M this year. RAI has significant flexibility to scale back spending on its e-cig operations to offset the NPM headwinds

3) De-leveraging/ Share buybacks: RAI has said it will not repurchase any shares until it is able to de-lever to its desired debt/EBITDA ratio of 1.5x – 2.5x. With the sale of Santa Fe International, we expect RAI to de-lever to 2.5x next year, enabling the company to begin re-purchasing shares in 2017

We note that RAI recently reached a settlement over NPM disputes in NY State, which offsets roughly $90M of the $250M+ headwind faced in 2017.

Estee Lauder Companies

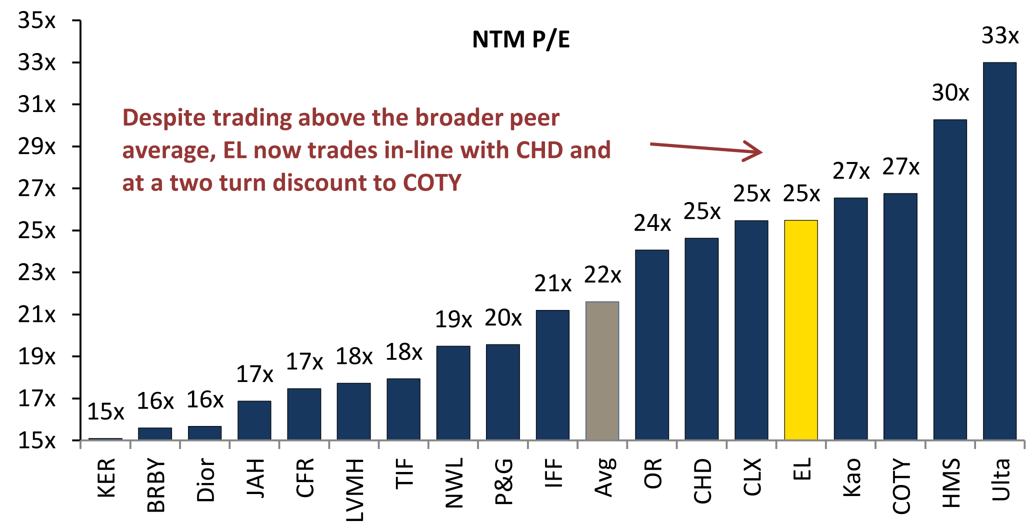
Through a combination of secular drivers and company specific initiatives, we forecast Estée will be able to grow its revenue and EPS by 6% and 10%+ annually over the next 10 years, almost 2x the sector average. The company has exhibited very good balance in its growth profile (growing 6%+ despite struggles for Clinique/Estee Lauder and China). On a growth adjusted basis, EL remains one of the cheapest names under our coverage.

DCF aside, Estee's valuation is compelling on a P/E and PEG basis

EL shares trade at 25x NTM EPS estimate, the same valuation as CHD and cheaper than COTY at 27x – despite both names growing constant currency top-line low-single-digits, versus EL at mid to high-single-digit levels. As it relates to bottom line growth, we believe Estee is on track to grow EPS at a 13% CAGR over the next three years, leading the stock to trade at a 1.9 PEG, cheaper than peers at 2.9 and most notably COTY and PG at 5.1 and 4.8 respectively.

While EL trades at a premium to peers, the stock now trades in-line with CHD and at a two turn discount to COTY – both of which are only growing organic top-line low-single-digits

Exhibit 145: NTM P/E valuation for EL and peers

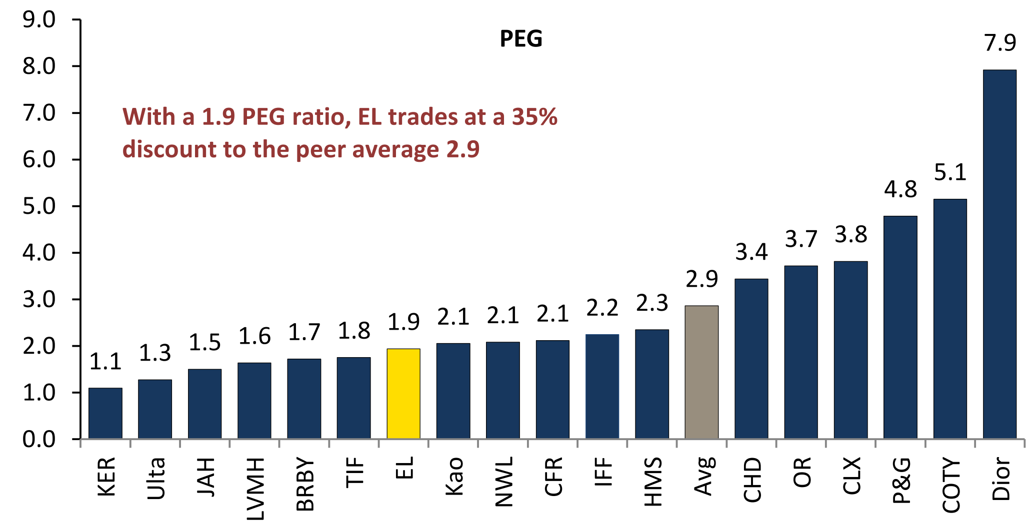


Source: FactSet, RBC Capital Markets. Priced as of 12/9/15

EL's P/E premium to peers is justified given top-line as the company's 6-8% constant currency top-line guidance exceeds our coverage average 3% forward constant currency top-line guidance.

Exhibit 146: PEG valuation for EL and peers

Adjusted for bottom-line growth, EL continues to trade at a discount to peers



Source: FactSet, RBC Capital Markets. Priced as of 12/09/15

Breaking down Estee's margin opportunity from here

Estee's three year margin guidance implies 30-40 bps of constant currency annual margin expansion looking forward. However, we believe 70 bps of annual margin expansion is more appropriate over the next 10-years. Our analysis suggests pricing/channel mix and operating leverage could add an incremental 40 bps and 25 bps respectively beyond management's guided targets, partially offset by incremental reinvestment. A positive turn in FX over the years would suggest even more margin upside.

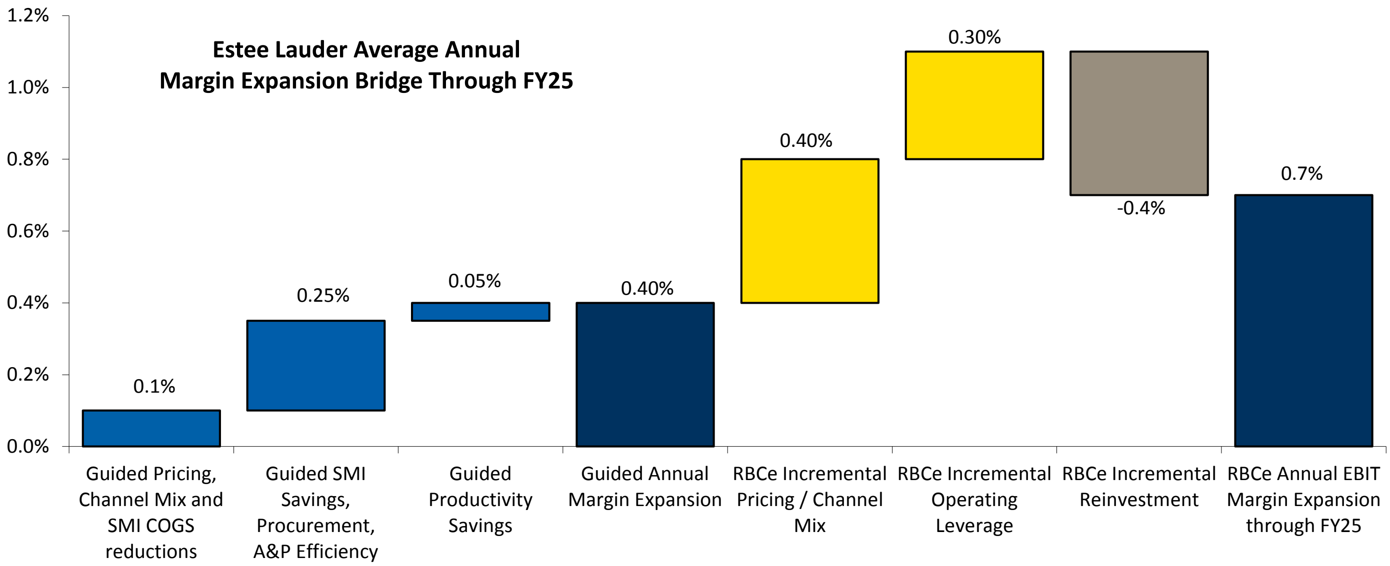
Exhibit 147: Annual and long-term implied guidance from Estee Lauder's target "cumulative 90 – 130 bps of constant currency margin expansion through FY18"

	Implied Annual Guidance	Implied 10-Year Guidance
Estee Lauder FY18, 3-Year Margin Guidance	"Cumulative 90-130 bps"	300 - 430 bps
Implied Average Annual Margin Expansion	30-43 bps, we assume 40 bps	400 bps
Pricing, Channel Mix and SMI driven COGS reductions	"1/4 of total" or 10 bps	100 bps
SMI Savings, Procurement and A&P Efficiency	"2/3 of total" or 25 bps	250 bps
Productivity Savings	"Remainder" or 5 bps	50 bps

Source: Company commentary, RBC Capital Markets estimates

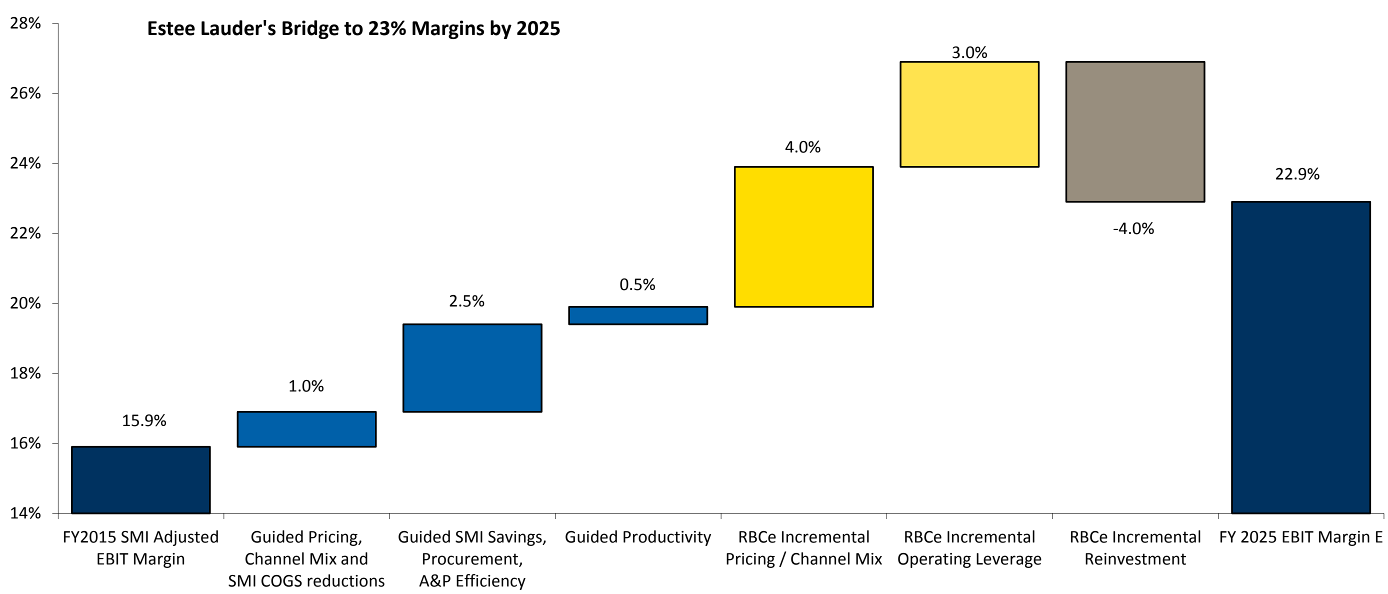
In the chart below, we bridge Estee Lauder's current SMI adjusted margins to our 23% FY15 estimate by breaking down Estee's implied 10-year margin expansion guidance per the prior table (in blue), along with the incremental upside we expect EL to deliver through pricing/channel mix, operating leverage and slightly offset by incremental reinvestment needs.

Exhibit 148: Estee Lauder's bridge annual operating margin growth through 2025



Source: Company reports, RBC Capital Markets estimates

Exhibit 149: Estee Lauder's bridge to cumulative operating margin expansion by 2025



Source: Company reports, RBC Capital Markets estimates

Expecting margin upside from pricing and channel mix

Estee Lauder management noted that gross margin expansion driven by pricing, channel mix and SMI benefits combined would contribute 25% of the company's EBIT margin expansion or an implied 100 bps over the next 10-years. However, per our analysis we believe the margin opportunity for pricing and channel mix combined is 500 bps over the next 10 years (or 400 bps incremental to Estee's 100 bps target) – with each pricing and channel mix contributing 250 bps each to our forecast.

Pricing +25 bps annual contribution

Across sectors, it is rare to find a company that has real pricing power. Over the past few years, Estee Lauder's top line has been slowly shifting from 100% unit driven to an improving balance between pricing and volume (as the company is leveraging better analytics to understand where it has opportunities to take pricing). Looking forward we expect the company will realize at least 1.5% price/mix (net of inflation) annually across its business. Assuming a 100% gross margin and holding SG&A margins constant, we arrive at a cumulative lift to margins of 250 bps by 2025 (or about 25 bps per annum).

Exhibit 150: Estee Lauder FY15 channel mix

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Sales	10,791	10,959	$11,123	$11,290	$11,459	$11,631	$11,805	$11,982	$12,162	$12,345	$12,530	$12,718
Growth from Pricing at 100% GM			*1.5%*	*1.5%*	*1.5%*	*1.5%*	*1.5%*	*1.5%*	*1.5%*	*1.5%*	*1.5%*	*1.5%*
Incremental Sales Growth		$168	$164	$167	$169	$172	$174	$177	$180	$182	$185	$188
Gross Margin on Sales Growth		100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
Gross Income	8,810	8,680	8,844	9,011	9,180	9,352	9,527	9,704	9,884	10,066	10,251	10,439
Gross Margin	81.6%	79.2%	79.5%	79.8%	80.1%	80.4%	80.7%	81.0%	81.3%	81.5%	81.8%	82.1%
Total SG&A Margin (Held at 2015 Levels)		*66%*	*66%*	*66%*	*66%*	*66%*	*66%*	*66%*	*66%*	*66%*	*66%*	*66%*
Incremental EBIT Growth		$57	$56	$57	$58	$58	$59	$60	$61	$62	$63	$64
EBIT	1,736	1,739	$1,794	$1,851	$1,909	$1,967	$2,027	$2,087	$2,148	$2,210	$2,273	$2,337
EBIT Margin	*16.1%*	*15.9%*	*16.1%*	*16.4%*	*16.7%*	*16.9%*	*17.2%*	*17.4%*	*17.7%*	*17.9%*	*18.1%*	*18.4%*
Change in EBIT Margin			**27 bps**	**26 bps**	**26 bps**	**26 bps**	**25 bps**	**25 bps**	**25 bps**	**24 bps**	**24 bps**	**23 bps**
Average Annual Expansion												**25 bps**
Cumulative Contribution to 2025 EBIT Margins												**251 bps**

Source: Company reports. 2015 values adjusted for SMI

Channel mix +25 bps of cumulative margin through 2025

Just as strong of a driver as pricing, is channel mix where over-time we see the company growing fastest through its highest margin channels 1) e- commerce, 2) travel retail and 3) Estee Lauder brand retail stores (of which Estee Lauder now has 1,000). At the same time, we expect EL will grow the slowest in its lowest margin channels, particularly US department stores, salons/spas and "other channels", military bases, high-end pharmacies, (among others), which we estimate globally account for 45% of Estee Lauder's current sales.

We arrived at our 250 bps incremental contribution or 25 bps annually by applying Estee's 10-year top-line CAGR for each channel (based on available data) to RBC margin estimates for each channel based on discussions with our industry contacts. Note that for conservatism we discount the historical CAGR's for Estee's two highest margin channels, travel retail and e-commerce. Instead of travel retail's double-digit historical CAGR we apply a 6% rate going forward and instead of E-Commerce's 30% historical CAGR we apply a 15% rate going forward.

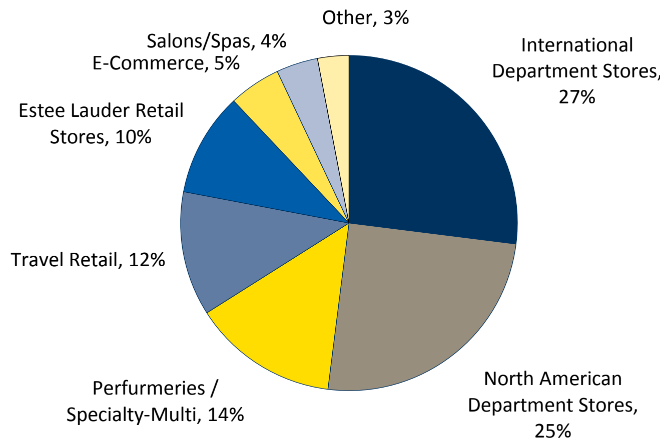
Exhibit 151: Estee Lauder FY15 channel mix

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
International Department Stores	2,959	3,136	3,325	3,524	3,735	3,960	4,197	4,449	4,716	4,999	5,299
Revenue Growth		*6%*	*6%*	*6%*	*6%*	*6%*	*6%*	*6%*	*6%*	*6%*	*6%*
% of Annual Sales	27%	27%	28%	28%	28%	28%	28%	28%	28%	28%	28%
EBIT	296	314	332	352	374	396	420	445	472	500	530
EBIT Margin	*10%*	10%	10%	10%	10%	10%	10%	10%	10%	10%	10%
North American Department Stores	2,740	2,740	2,740	2,740	2,740	2,740	2,740	2,740	2,740	2,740	2,740
Revenue Growth		*0%*	*0%*	*0%*	*0%*	*0%*	*0%*	*0%*	*0%*	*0%*	*0%*
% of Annual Sales	25%	24%	23%	22%	21%	19%	18%	17%	16%	15%	15%
EBIT	274	274	274	274	274	274	274	274	274	274	274
EBIT Margin	*10%*	10%	10%	10%	10%	10%	10%	10%	10%	10%	10%
Perfumeries (including specialty multi)	1,534	1,626	1,724	1,827	1,937	2,053	2,176	2,307	2,445	2,592	2,748
Revenue Growth		*6%*	*6%*	*6%*	*6%*	*6%*	*6%*	*6%*	*6%*	*6%*	*6%*
% of Annual Sales	14%	14%	14%	14%	15%	15%	15%	15%	15%	15%	15%
EBIT	230	244	259	274	291	308	326	346	367	389	412
EBIT Margin	*15%*	15%	15%	15%	15%	15%	15%	15%	15%	15%	15%
Travel Retail	1,315	1,394	1,478	1,566	1,660	1,760	1,865	1,977	2,096	2,222	2,355
Revenue Growth		*6%*	*6%*	*6%*	*6%*	*6%*	*6%*	*6%*	*6%*	*6%*	*6%*
% of Annual Sales	12%	12%	12%	12%	12%	13%	13%	13%	13%	13%	13%
EBIT	395	418	443	470	498	528	560	593	629	667	707
EBIT Margin	*30%*	30%	30%	30%	30%	30%	30%	30%	30%	30%	30%
Estee Lauder Retail Stores	1,096	1,205	1,326	1,459	1,604	1,765	1,941	2,136	2,349	2,584	2,842
Revenue Growth		*10%*	*10%*	*10%*	*10%*	*10%*	*10%*	*10%*	*10%*	*10%*	*10%*
% of Annual Sales	10%	10%	11%	12%	12%	13%	13%	14%	14%	15%	15%
EBIT	219	241	265	292	321	353	388	427	470	517	568
EBIT Margin	*20%*	20%	20%	20%	20%	20%	20%	20%	20%	20%	20%
E-Commerce	548	630	725	833	958	1,102	1,267	1,457	1,676	1,928	2,217
Revenue Growth		*15%*	*15%*	*15%*	*15%*	*15%*	*15%*	*15%*	*15%*	*15%*	*15%*
% of Annual Sales	5%	5%	6%	7%	7%	8%	9%	9%	10%	11%	12%
EBIT	219	252	290	333	383	441	507	583	670	771	887
EBIT Margin	*40%*	40%	40%	40%	40%	40%	40%	40%	40%	40%	40%
Salons/Spas	438	438	438	438	438	438	438	438	438	438	438
Revenue Growth		*0%*	*0%*	*0%*	*0%*	*0%*	*0%*	*0%*	*0%*	*0%*	*0%*
% of Annual Sales	4%	4%	4%	3%	3%	3%	3%	3%	3%	2%	2%
EBIT	66	66	66	66	66	66	66	66	66	66	66
EBIT Margin	*15%*	15%	15%	15%	15%	15%	15%	15%	15%	15%	15%
Other	329	312	297	282	268	254	242	230	218	207	197
Revenue Growth		*-5%*	*-5%*	*-5%*	*-5%*	*-5%*	*-5%*	*-5%*	*-5%*	*-5%*	*-5%*
% of Annual Sales	3%	3%	2%	2%	2%	2%	2%	1%	1%	1%	1%
EBIT	41	39	37	35	33	32	30	29	27	26	25
EBIT Margin	*13%*	13%	13%	13%	13%	13%	13%	13%	13%	13%	13%
Total Estee Lauder	10,959	11,482	12,051	12,669	13,341	14,072	14,867	15,734	16,678	17,709	18,835
Revenue Growth	*5%*	*5%*	*5%*	*5%*	*5%*	*5%*	*6%*	*6%*	*6%*	*6%*	*6%*
EBIT	1,739	1,848	1,966	2,096	2,240	2,397	2,571	2,763	2,974	3,209	3,468
EBIT Margin	*16%*	***16%***	***16%***	***17%***	***17%***	***17%***	***17%***	***18%***	***18%***	***18%***	***18%***
EBIT Margin Change		23 bps	22 bps	23 bps	24 bps	25 bps	26 bps	27 bps	28 bps	28 bps	29 bps
Average Annual Expansion											**25 bps**
Cumulative Contribution to 2025 EBIT Margins											**255 bps**

Source: Company reports, Euromonitor, conversations with industry contacts. We conservatively assume a less than 6% top-line CAGR for this analysis. 2015 values adjusted for SMI.

Today, Estee Lauder's fastest growing, highest margin channel e-commerce accounts for only 5% of total sales…

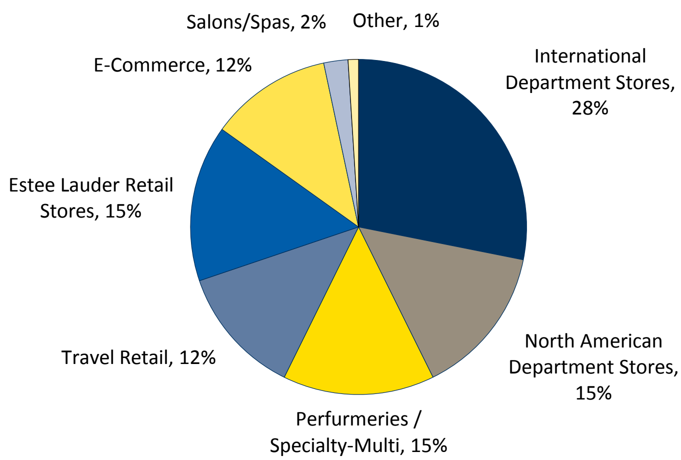
Exhibit 152: Estee Lauder FY15 channel mix



Source: Company reports

…though by 2025 e-commerce could account for as much as 12% of Estee's sales mix

Exhibit 153: Estee Lauder estimated FY25 margin mix



Source: RBC Capital Markets estimates

Understanding the beauty advisor expense

Part of the reason why US department stores are lower margin is the beauty advisor. The beauty advisor has long been the distinguishing factor of the prestige beauty channel. In fact, women who shop in the mass channel often have to buy an average of 2.3 products before they find what they are looking for, but in prestige with the help of a beauty advisor, consumers are able to find what they are looking for on the first purchase.

While a valuable component of Estee's high-touch model, it is important to note that Estee splits the cost of the beauty advisor (wages/commissions) with the department store. In addition, Estee funds all incremental training for these advisors to ensure they are knowledgeable and skilled in selling Estee Lauder products as well as the associated HR recruiting and processing costs. With technology and the emergence of other channels (like Travel Retail and e-commerce) consumers are migrating their purchases to these other channels (which happen to be much higher margin because they lack the significant costs associated with beauty advisors).

Operating leverage +30 bps annual contribution

Under Fabrizio Freda's leadership, Estee has developed a much more stringent cost culture than prior years and we expect the company will be able to generate an incremental 30 bps of EBIT margin expansion annually through operating leverage. We arrived at this estimate by applying one of Estee's stringent cost measures where each brand cannot grow its people expense by more than 75% of its own growth – so for example if a brand were to grow 6% in one year, the incremental cost of personnel associated with that brand could only increase 4.5% that year. This cost control measure along with Estee Lauder's "program management team" (a team that analyzes the business every day to address "non-value added costs) are factors that should enable Estee to achieve our estimate and expand profitability per employee. For the analysis below, we simply grow "Admin & Other Expense" by 75% of our long-run 6% estimated annual top-line, leading to annual operating leverage of ~30 bps and 300 bps by 2025.

Exhibit 154: Estee Lauder FY15 channel mix

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Sales	10,969	$11,627	$12,371	$13,163	$14,005	$14,902	$15,855	$16,870	$17,950	$19,098	$20,321	$21,621
Growth from Pricing at 100% GM	*6%*	*6%*	*6%*	*6%*	*6%*	*6%*	*6%*	*6%*	*6%*	*6%*	*6%*	*6%*
Admin & Other Expense (Growing at 75% of top-line)	(2,388)	(2,495)	(2,615)	(2,741)	(2,872)	(3,010)	(3,155)	(3,306)	(3,465)	(3,631)	(3,805)	(3,988)
EBIT	8,581	9,131	9,756	10,422	11,133	11,891	12,701	13,564	14,485	15,467	16,515	17,633
EBIT Margin	*78.2%*	*78.5%*	*78.9%*	*79.2%*	*79.5%*	*79.8%*	*80.1%*	*80.4%*	*80.7%*	*81.0%*	*81.3%*	*81.6%*
Change in EBIT Margin		**31 bps**	**32 bps**	**32 bps**	**31 bps**	**31 bps**	**30 bps**	**30 bps**	**29 bps**	**29 bps**	**29 bps**	**28 bps**
Average Annual Expansion												**30 bps**
Cumulative Contribution to 2025 EBIT Margins												**302 bps**

Source: Company reports. This is analysis is based off 2014 where we were able to back into Estee Lauder's Admin & Other expense, through removing A&P spend, shipping and handling spend and payments to customers.

Reinvestment needs -40 bps annual drag

Given Fabrizio Freda's statement that reinvestment opportunities are increasing at Estee Lauder, we felt it was appropriate to spend back more than half of the incremental margin benefits we see beyond Estee Lauder's guided range. We are encouraged by the way Fabrizio Freda manages the business for the long-term as well as tactically in the short-term, which may lead to elevated investment needs. Specifically, we understand Estee Lauder brand managers give frequent pitches to CEO Freda and CFO Travis, who decide on a monthly basis if they should reallocate a brand's previously allotted budget to another brand or region. This tactical strategy has in part enabled the company to deliver strong growth despite pockets of weakness across their brand/category/channel portfolio.

A Word on the Strategic Modernization Initiative

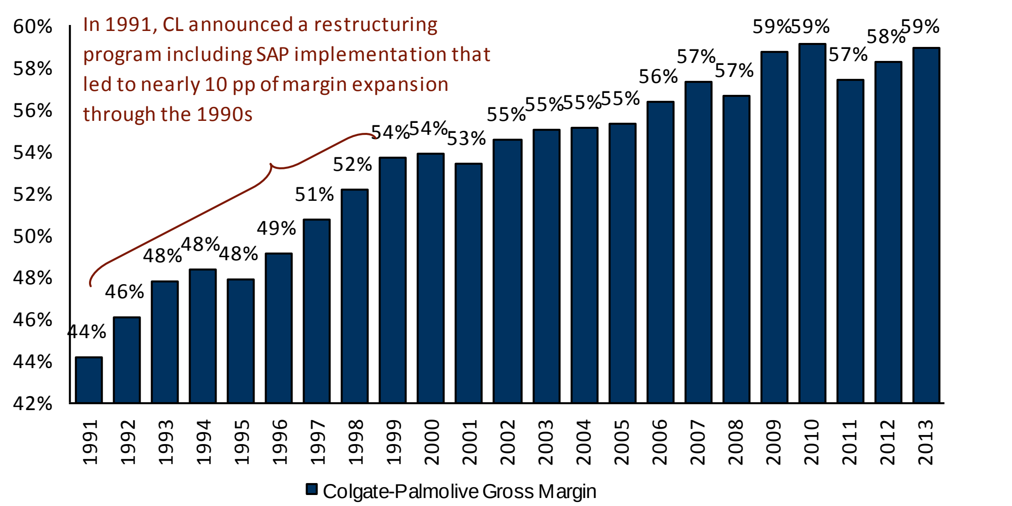
Estee Lauder has now finally completed the majority of the implementation of the "Strategic Modernization Initiative" (SMI)—which is a holistic program that includes the benefits of its SAP installation. The Strategic Modernization Initiative (SMI) is expected to transform Estee Lauder's global business by creating unified, more efficient processes into a highly integrated global organization (with one common IT backbone). We view SMI as an enabler for Estee to extract even more efficiencies out of its cost structure in addition to providing the necessary information to make better resource allocation decisions (pricing decisions, procurement, inventory management, etc). One specific example of improved efficiency is inventory and the coinciding advertising spend management around new product launches, which should become more efficient. While EL has already included SMI as a margin driver in its three-year guidance targets, we believe SMI alone could contribute an incremental 10 bps of annual margin expansion or 100 bps over the next ten years – though for conservatism, we are not factoring in additional SMI benefits beyond what management has guided to. Colgate's results following SAP installation are a testament to how transformative the program can be for business results.

The Colgate case study

Colgate's implementation of SAP has been often discussed by the company as a corner stone of its consistent margin improvement. In 1991, the company announced a restructuring program that included the implementation of SAP. Ten years after the SAP implementation, Colgate's gross margins improved by 1,000 bps. Also as important were the improvements Colgate saw in working capital post the 1991 restructuring. Days inventory on hand went from 76 days to 58 days over a 10 year stretch. While we will not attribute all of these gains solely to Colgate's SAP initiative, we have to acknowledge its impact.

Colgate expanded gross margins by 10 pp in less than 10 years following SAP installation

Exhibit 155: Colgate-Palmolive gross margins



Source: Company reports, RBC Capital Markets – Note: margins as of the most recent fiscal year for all companies

Edgewell Personal Care

Scarcity value

Our bullish view on Edgewell Personal Care is predicated on a takeout of the company over the next 12-18 months at approximately 17x EV/EBITDA. We are not expecting upside from fundamentals (though it could happen mainly due to moderating promotional activity in the wet shave category). We would look to take advantage of any pullbacks in the stock due to disappointing fundamental performance ahead of a what we see as a likely takeout.

Recognizing the strategic value of Edgewell Personal Care for global HPC suitors

We believe it is prudent to view the personal care asset from the eye of a potential suitor (and not based on what the business is growing today). Edgewell is virtually non-existent in many emerging markets, including the largest blades & razors market globally (Brazil). We believe a larger, multi-national suitor could use its scale and distribution network to significantly expand Schick/Wilkinson-Sword's presence globally (similar to how Unilever expanded TRESemme after acquiring Alberto-Culver). However, unlike Alberto-Culver (which competed in a highly fragmented shampoo market), Edgewell is the only other major player to Gillette in blades/razors. Ultimately, we believe the potential suitors for Edgewell personal care include Unilever, Reckitt Benckiser, Kimberly-Clark, Beiersdorf, Henkel, Colgate-Palmolive, Church & Dwight, L'Oreal, and Kao.

Prospective Suitors for Energizer’s Personal Care business

Unilever: We see Unilever making a suitable acquirer of Edgewell’s personal care assets given the company’s focus and scale in emerging markets, which they can leverage to expand Energizer’s business to new markets. We believe Unilever also has interests in getting in the wet shave business given the test partnership the company had with Energizer on Axe branded razor blades (2 years ago). In addition, Edgewell's sun care brands would also be highly incremental to Unilever's personal care portfolio. Given Unilever’s strengthening balance sheet (the company has been divesting its food business and refocusing investments on the personal care side), we see Edgewell’s personal care business fitting nicely in Unilever’s system.

Beiersdorf: The European skin care giant already operates in the post shave segment of men’s grooming through their Nivea brand, specializing specifically in after-shave balms. Beiersdorf would be able to leverage their developed and developing market scale and integrate their Nivea products with Schick to form a strong competitor to Gillette in new markets.

Colgate-Palmolive: Colgate would benefit from acquiring a diversified personal care portfolio that would supplement the company’s best in class growth profile. Grooming and Sun Care are two of the fastest growing categories in Personal and Beauty care, which would be nicely accretive to Colgate's overall category growth profile and margins. Colgate is also heavily focused in Latin America, which is the fastest growing grooming market globally and where Edgewell personal care is least penetrated.

Church & Dwight: While we believe Church & Dwight would be at a disadvantage in the bidding process due to its limited international reach, we believe the company would be interested in Edgewell's personal care assets. The high margin potential plus significant cost cutting opportunities at Energizer’s personal care business likely make an attractive business for Church’s management team, who are known to turn around market share positions of smaller brands and improve profitability at the same time.

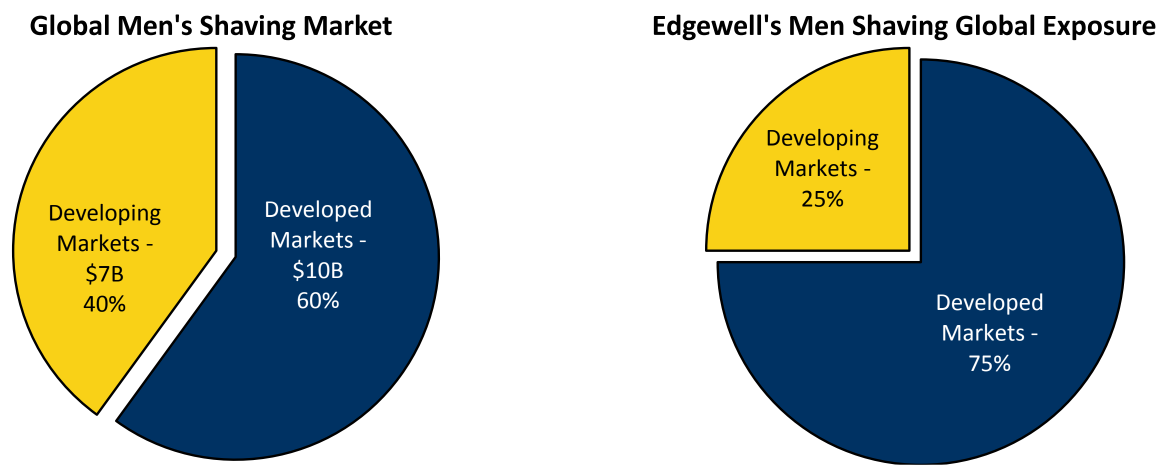
L'Oreal/Kao: The men's grooming market has become an area of increasing focus for global beauty players – as the men's category is growing over 9% globally, nearly twice the rate of total skin care. In addition, adding strong sun care brands, especially in the US would be a compelling growth avenue for both companies as well and could be integrated nicely with both companies' existing skin care businesses.

Reckitt-Benckiser: Reckitt attempted to buy the Merck consumer health business where it was interested in buying the Coppertone sun care brand. We also note that Reckitt was a bidder for the Schick franchise in the early 2000's but was outbid by Energizer.

Why Edgewell Personal Care business is so attractive

The global opportunity for Edgewell's personal care portfolio, particularly wet shave and sun care, is immense and likely underappreciated by investors, in our opinion. The players that we believe could be potential bidders for Edgewell Personal Care would have the opportunity to distribute high-margin and scarce wet shave brands globally and especially in emerging markets where the opportunity is largest.

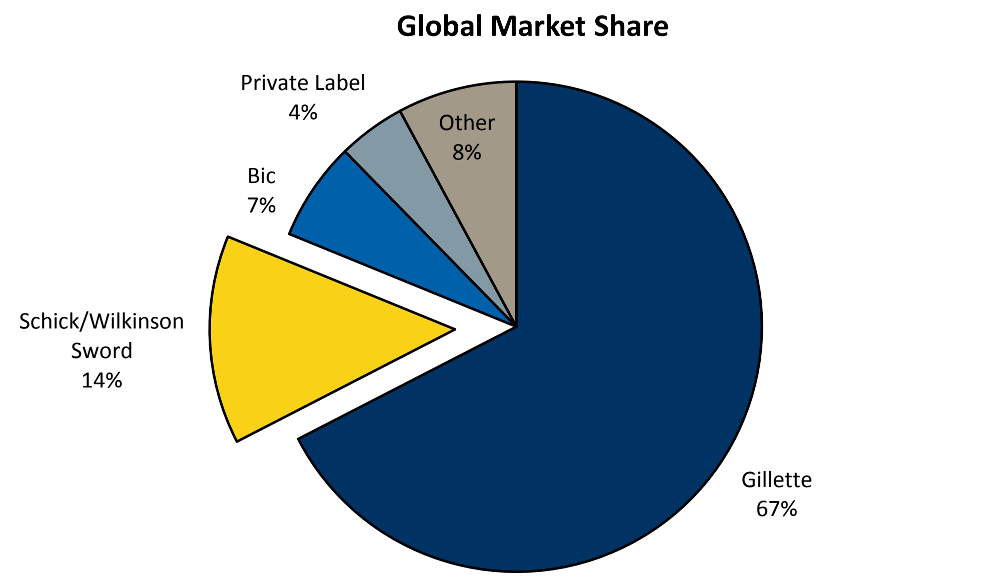
Exhibit 156: Global men's shaving market



Source: Euromonitor

Exhibit 157: Global Wet Shave Market

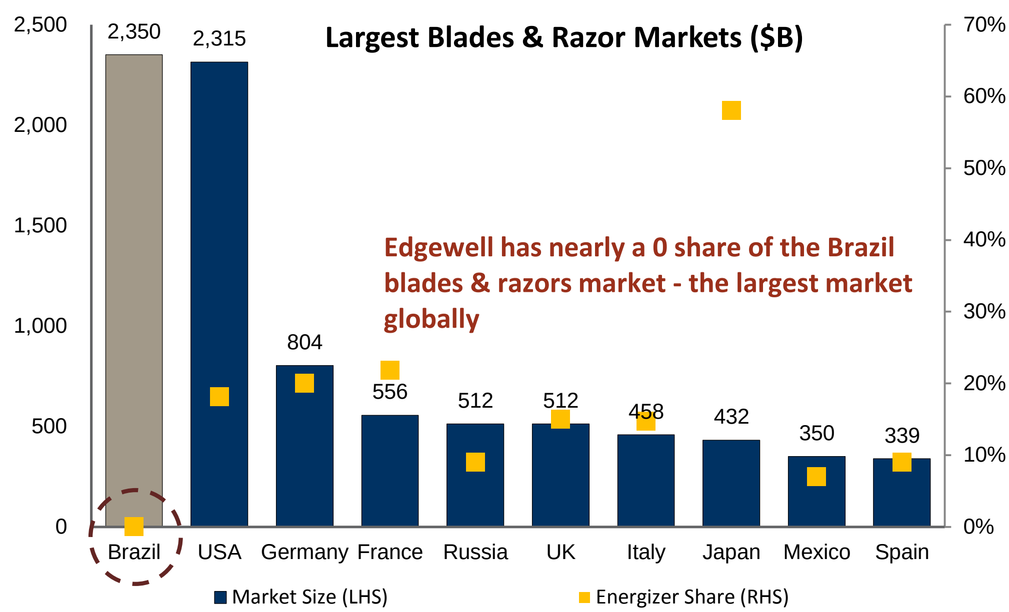
Edgewell's Schick business has a 14% share of the global market



Source: Euromonitor

Exhibit 158: Blades & Razors size by market

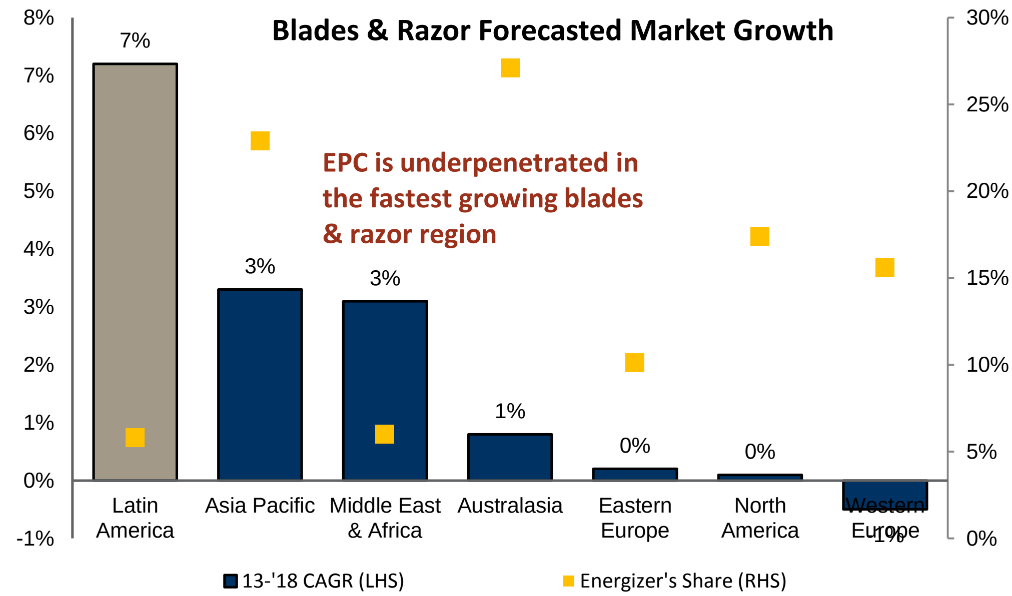
Edgewell's largest wet shave opportunity is Brazil, where Colgate, Unilever, Reckitt Benckiser, Beiersdorf and L'Oreal all have $1B+ businesses



Source: Euromonitor

Edgewell is well positioned to win from accelerated APAC category growth, with large opportunities to play more meaningfully in LatAm and the Middle East

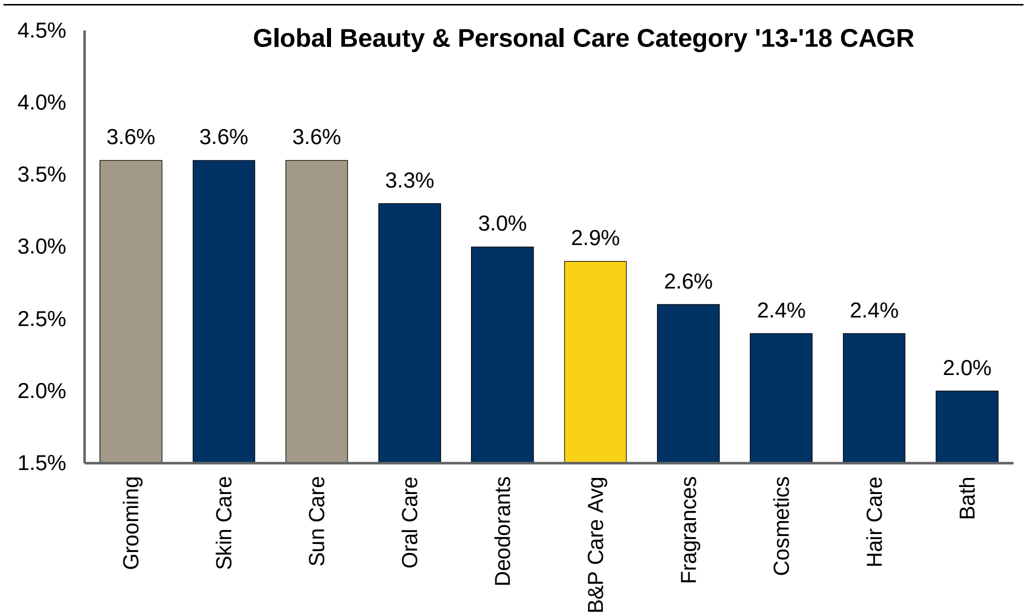
Exhibit 159: Blades & Razors global growth



Source: Euromonitor

Grooming and Sun Care are among the top three fastest growing personal care categories globally

Exhibit 160: Global beauty and personal care growth outlook



Source: Euromonitor

Alberto-Culver Case Study

For perspective on how big Edgewell personal care could grow under the ownership of a larger, more global company, we revisit the case study of Alberto-Culver and Unilever.

Unilever acquired Alberto-Culver in 2010 and has since rejuvenated the firm's TRESemme brand and stepped up investments into its hair care portfolio globally. TRESemme was significantly underrepresented in Latin America, and in particular Brazil (Unilever's and the hair care category's second largest market). By using its scale and distribution network, Unilever quickly propelled TRESemme into one of the largest hair care brands in Brazil and Latin America and doubled its global presence. In fact, Unilever increased sales of Alberto-Culver by 50% after 2 years of ownership. We believe Unilever could achieve similar results for Edgewell personal care.

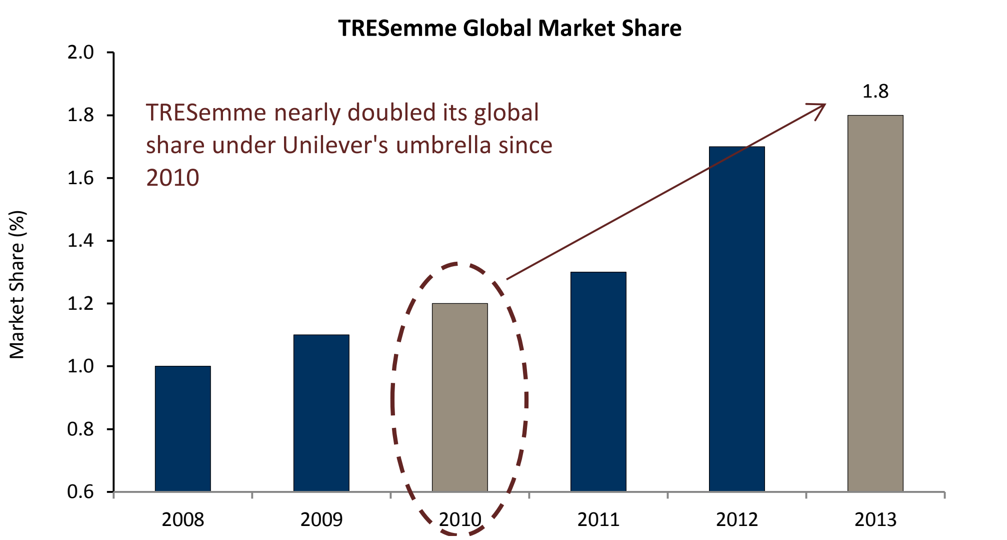
Exhibit 161: Unilever's Biggest Markets (% of Sales)

Brazil is Unilever's second largest market as well as the second largest hair care market globally

Source: Euromonitor

Exhibit 162: TRESemme Global Market Share

TRESemme nearly doubled its global share under Unilever's umbrella since 2010



Source: Euromonitor

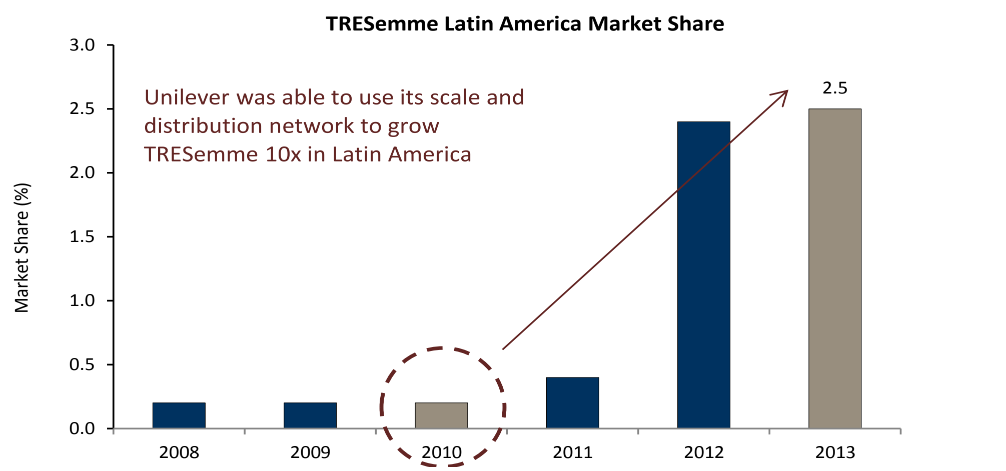
TRESemme had no base in Brazil prior to Unilever acquiring the brand and is now the 7th largest hair care brand in the country

Exhibit 163: TRESemme Brazil Retail Sales ($MM)

Source: Euromonitor – Note: In Brazilian Reals

Unilever was able to use its scale and distribution network to grow TRESemme 10x in Latin America

Exhibit 164: TRESemme Latin America Share



Source: Euromonitor

Recognizing the global sun care opportunity

The global sun care market grew 5% in 2013, outperforming both skin care and facial makeup (two focus categories for investors). We expect sun care will be able to maintain, if not expand, the growth gap versus these categories as sun care innovations (particularly those of Edgewell's Banana Boat and Hawaiian Tropic) accelerate the category. Looking forward, we should expect both multi-tasking innovation (anti-aging, moisturizing and tinting) as well as specialty sun care for babies, young children, adolescents with acne and people with tattoos to drive volume and margins for the category. Globally, sun care is a $9.5 B category, which has doubled in the past 10 years, with the US and Brazil each over $1 B and China expected to reach over $1 B in the next 5 years. Most notably, Indonesia, India and Mexico are the fastest growing sun care markets, which bodes particularly well for potential personal care suitors Colgate, Unilever and Reckitt Benckiser who already have large businesses in each of those markets. Lastly, per capita usage of sun care should improve as the global economy improves, especially in light of sun-related skin disease incidence growing over 1% a year in the US.

Reiterating a 2016 takeout at 17x EBITDA

A 17x takeout multiple for personal care would imply a 35% premium to peers today. This compares to a 56% take out premium for past transactions involving scarce assets (Beam, Durex, Heinz among others). More specifically, we believe it is appropriate to value the company's Wet Shave business at 19x 2016 EV/EBITDA, Skin Care 13x, Feminine Care 8x and Infant Care 5x. We also reiterate that consumer growth assets perceived as takeout candidates have outperformed the market post spin, most notably WWAV and MJN, who have ultimately not been acquired. We continue to believe Edgewell is highly likely to become an acquisition candidate in 2016, once the poison pill plan for the company expires at year-end – ensuring enough time for transition disruptions to be resolved.

Exhibit 165: Sum-of-the-parts valuation multiple justification

Takeout Comps				
Personal Care	EV/EBITDA	Sector Avg (at time of takeout)	Premium	Comment
Gillette (Takeout)	18.7x	11.2x	67%	Comparable Wet Shave business. Reminder that P&G's take out of Gillette included Duracell batteries.
BEAM (Takeout)	19.1x	12.4x	53%	1 of 2 global whiskey brands.
Durex (Takeout)	17.1x	8.8x	95%	Durex was 1 of 2 global condom brands.
H.J. Heinz (Takeout)	14.1x	10.7x	32%	Scarce condiment asset with margin upside
Merck Consumer Business (Implied takeout multiple at $14B valuation)	14.5x	11.1x	31%	Comparable sun care and consumer health business
Average	16.7x	10.8x	54%	
	HPC Sector Average		**Premium**	**Takeout Multiple**
Personal Care Takeout	**12.9x**		**35%**	**17.1x**

Source: RBC Capital Markets and FactSet. Based on consensus estimates.

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