MOI GLOBAL

Thoughts on Church and Dwight's Acquisition of Flawless

This article is excerpted from a letter by Peter Mantas and Matthew Castel, general partners of Logos LP, based in Toronto, Canada.

In late March one of our core positions, Church and Dwight Inc. (NYSE: CHD), acquired FLAWLESS Finishing Touch Brand which is the #1 manufacturer of electric razors within the 'touch-up' hair removal category for women. CHD purchased the company from Ideavillage for $475 million plus another $425 million if certain targets are met. Ideavillage will assist CHD in selling the product while CHD controls all earnings and cash flows derived. It is estimated that the company will grow revenue by 15% annually over the next 5 years with operating margins in the 30% range, which is well above CHD's current 23% operating margin. We believe this a textbook acquisition that will be highly beneficial to current shareholders as CHD only paid 11x EBITDA and the newly acquired unit will benefit greatly from CHD's operating leverage.

We are pleased to see CHD's management execute diligently on its long-term roadmap and we believe the company can come close to its 10-year total shareholder return (TSR) rate (CHD saw its stock price appreciate by 20.5% on average for the last 10 years) over the long-run. We will remind investors of CHD's core strategy and why we believe the business will continue to thrive in a world of disruption within the CPG space:

1. CHD is an acquisition platform (some might say "rollup") focused on acquiring small asset-light personal care/health care brands that: 1) hold dominant (or rapidly growing) market share and; 2) operate in an oligopolistic market with long tailwinds. For example, in 2011 CHD acquired Batiste Dry Shampoo for $64M (which at the time had annual sales of $20M globally). As of 2018, Batiste controlled 63% of the Australian dry shampoo market (~37% globally) and generated nearly $25M in revenue in Australia alone. The list of these kinds of acquisitions is long throughout CHD's history: in 2016 CHD acquired the #1 and #2 UK, Canadian and South African hemorrhoid care brands for $130M (annual sales of $24M) and the #1 non-drug hair thinning supplement brand for men for $160M (annual sales of $44M). Their formula is quite simple: buy the right business in the right category at the right time and at the right price. Once acquired, CHD will then leverage their operational knowledge from other acquired "power brands" (i.e. OxiClean, Trojan etc.) to fortify or grow market share for that respective brand (i.e. new product innovation, innovative marketing campaigns, introduction of productivity or cost control programs, new distribution channels etc.). This acquisition strategy in search of new power brands coupled with fortifying current power brands through innovation should lead to 2-3% domestic revenue growth over the long run.

2. The second part of CHD's strategy is to use the cash flows from these power brands into international expansion efforts by exporting, acquiring and developing products for new international markets. The international story is a very long one, as the company previously had a very small international business: international grew 7.8% last year and 9% in Q4 alone, while the export business grew 16%. Recent partnerships in Asia (DKSH in SE Asia and Jahwa in China) will keep this story intact for decades, and we expect the export business to compound at double digits over that timeframe.

3. The final piece of the puzzle for CHD is to use cash flows from their domestic and international businesses to build out the animal productivity business. We are optimistic on animals as a long-term theme, since humans are consuming resources faster than they are replacing them, especially within protein markets. By focusing on probiotics, prebiotics and microbial solutions in the short-term for the swine, cattle and poultry markets, we believe CHD has put the wheels in motion to develop a large animal pharma business which can expand beyond prebiotics and probiotics (picture using the power of microbes for genetic therapy) over the long term.

The CPG space is a highly competitive one that is constantly under siege by private label, newly funded upstarts developing new brand categories and other purely digital e-commerce companies. It is unclear how many of the large CPG brands that had dominant market share in the past will continue to fortify their market position and we cannot say for certain that brands which occupy the "middle of the grocery aisle" today will still be around in the coming decades.

While we continue to monitor the ongoing disruption and competition within all categories of the consumer staples segment, we believe there are a few unique pockets (particularly niche beauty, wellness and quasi-healthcare markets) with specific tailwinds which we think have a fighting chance of growing faster than GDP over the long-term.