Foreign companies bet on China's consumers as industry slows

2 February 2016

Coffee shops, burger bars and clothes stores are among the foreign businesses in China that say they are thriving despite the economic slowdown that is hurting the manufacturing sector.

A Reuters examination of comments or recent statements from 34 large publicly-traded foreign companies that updated investors on their China operations shows a diverging experience between sectors.

Eighteen of the companies had products focused on consumers and 13 of these said sales grew in the fourth quarter or full year with just three down and two flat. Of the eight industrial companies in the search, six reported weakness in China or falling sales.

Coffee shop chain Starbucks, Sweden-based tissue maker SCA fashion group Hennes & Mauritz and fast-food seller McDonald's are seeing strong growth despite the economy expanding at its slowest pace since 2009 in the fourth quarter.

"The success we are enjoying in China is really kind of highlighted by this past quarter," said Howard Schultz, chairman and CEO of Starbucks, which like many foreign companies does not break out China operating results in its accounts. He was speaking on a Jan 21 call with investors.

"We opened over 150 stores in China, this past quarter, the most we've ever opened in our history."

McDonald's said its fourth-quarter comparable sales increased 4 percent in China and it plans to open more than 250 restaurants this year, the highest in any of its markets.

"We remain confident in the potential of this important market and in the strategies we have in place to expand the brand even further," Steve Easterbrook, McDonald's Corporation CEO told investors on Jan 25.

Magnus Groth, CEO of SCA, which also makes diapers, said the rate at which China’s population was shifting from being poor and rural to an urban middle class, was unmatched in other emerging markets, creating huge opportunities for his business.

But in the industrial sector the outlook was less rosy.
Construction goods maker Caterpillar and Germany's Siemens are among the industrial companies that suffered last year. U.S.-based United Technologies Corp., which makes elevators and refrigeration units predicted even lower sales in 2016.

"Short-cycle (industrial) business was affected by double-digit decline in China," said Siemens CEO Joe Kaeser told investors last week.

"China is going to be slow and it remains to be seen whether we see a sustainable demand-related pick-up," he added.

MATURING ECONOMY

Several CEOs said the divergence was a normal sign that China's economy is maturing from one based on industry to one fueled by consumption.

Growth for 2015 as a whole hit 6.9 percent after the fourth quarter slowed to 6.8 percent, capping a tumultuous year that witnessed a huge outflow of capital, a slide in the currency and a summer stocks crash. There has been further volatility in financial markets this year.

Data from China's statistics bureau showed that industrial output for December missed expectations with a rise of just 5.9 percent, illustrating how a slowing economy and shift to consumer-led growth is hurting industry.

By contrast, December retail sales, although disappointing, were a strong 11.1 percent.

Ford Motor Company reported a good fourth quarter in China with sales up 27 percent in December.

"It's going from an investment-led, and industry-led economy to a consumption-led one. And if you look at the consumption piece of GDP that's actually growing, which is a good sign," CEO Mark Fields said last month.

"It's going to be a bit bumpy as they go through that transition."

HEADWINDS

Consumer goods companies are not unaffected by China’s downturn. Several have reported weakness in the market but even they have largely shrugged it off.

Apple said it saw some "economic softness" in China – "something that we have not seen before" Chief Financial Officer Luca Maestri told Reuters in an interview. However, CEO Tim Cook said the iPhone maker was not changing its investment plans there, citing strong underlying demand trends.

"The middle class in China was less than 50 million people in 2010, and by 2020, it’s projected to be about half a billion. .. I think the demographics are great," he added.

Some companies, like Ford and Unilever, which reported moderated growth in the more developed markets within China, said secondary cities were picking up the slack.

"The growth is coming from really the lower tier and coastal cities, more so than the A cities," said Paul Polman, CEO of Unilever, which makes everything from ice-cream to cleaning products.

An increasing adoption of Western consumption patterns is also buoying companies. Drinks maker Remy Cointreau said Christmas gifting was becoming increasingly important for his business, helping to compensate for a reduction in the importance of the Chinese New Year market.

Starbucks said its growth in China was without the country having adopted the “morning ritual” of drinking coffee, but that it was confident it would, offering significant additional long term growth.
Yet some western trends currently being echoed in China, present challenges for companies. As in the United States and Europe, Chinese shoppers are increasingly eschewing hypermarkets. This has hit French supermarket chain Carrefour (CARR.PA) and companies, like chocolate maker Hershey, which mostly sell large shops.

In response, Carrefour is opening convenience stores and Hershey is refocusing on distributing through such stores.

And even in industry there are bright spots despite the slowdown.

"In China we're starting to see the aluminum dynamic improving," William Oplinger CFO of U.S. aluminum producer Alcoa said on a Jan. 11 earnings call.

"We see that fundamentals are solid....We continue to expect 6 percent growth in aluminum. Demand is on track to double between 2010 and 2020."