

Criteria | Corporates | Industrials:

Key Credit Factors For The Branded Nondurables Industry

May 7, 2015

(Editor's Note: We're republishing this article following our periodic review completed on May 1, 2018. See the "Revisions And Updates" section for details.)

1. This article presents S&P Global Ratings' methodology and assumptions for the branded nondurables industry (which we also refer to as the branded nondurables consumer products industry). This article is related to our corporate criteria (see "Corporate Methodology," published Nov. 19, 2013) and to our criteria article "Principles Of Credit Ratings," published Feb. 16, 2011, on the Global Credit Portal.
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SCOPE OF THE CRITERIA

4. This article describes S&P Global Ratings' criteria for the global branded nondurables consumer products industry. We define "nondurables consumer products companies" as companies that derive a majority of their revenues and earnings from manufacturing, marketing, and selling consumer nondurable products. Nondurable consumer products (for example, food and beverage items) are typically consumed over a shorter period of time than consumer durable goods (for example, kitchen appliances), which normally last more than three years.
5. These criteria apply globally to branded nondurable consumer products companies as well as private-label nondurable consumer products manufacturers (who share many characteristics with their branded counterparts), including the following subsectors: (1) apparel, accessory stores, and related products (footwear and accessories); (2) beverages (nonalcoholic and alcoholic), including spirits and soft drink bottlers; (3) food (including packaged and branded) and kindred products; (4) personal care and cosmetics; (5) household products; (6) tobacco products (excluding tobacco leaf merchants/suppliers, which are covered in "Key Credit Factors For The Agribusiness And Commodity Foods Industry"); and (7) miscellaneous and diversified consumer products.

SUMMARY OF THE CRITERIA

6. This article describes S&P Global Ratings' criteria for analyzing branded nondurables consumer products companies, applying our corporate methodology.

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7. We view branded nondurables consumer products as a "low risk" industry under our criteria, given its "low" cyclical risk and "low" degree of competitive risk and growth. In assessing the competitive position of nondurables consumer products issuers, we put particular emphasis on market position and growth prospects of its market segments; brand and product differentiation; level of diversity; operating efficiency; and profitability. In our assessment of financial risk, we consider leverage, company-specific working capital characteristics, capital expenditure needs, shareholder policies, and the effect of those factors on cash flow and leverage ratios.
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METHODOLOGY

Part I--Business Risk Analysis

Industry risk

10. Within the framework of S&P Global Ratings' criteria for assessing industry risk, we view branded nondurables consumer products to be a low risk industry (category 2). We derive our industry risk assessment for nondurables consumer products companies from our view of the industry's low degree of cyclical risk (category 2), and our assessment that the industry is low (category 2) in terms of competitive risk and growth.
11. In our opinion, companies in the nondurables consumer products industry usually have somewhat lower risk than most other industries and sectors, to the extent that these companies have relatively stable demand trends overall. Key drivers of cyclical risk in the nondurables consumer products industry tend to be key macroeconomic indicators, including real GDP growth, the unemployment rate, changes in household net worth, consumer sentiment, percent changes in disposable income and real consumer spending, as well as the price of gasoline or petrol, as this is often a large portion of a family's weekly expenses, particularly in the U.S.
12. **Price cyclical risk:** Although there is some variability by category, nondurable consumer products in general carry fairly low price points, and many are nondiscretionary in nature. Nonetheless, price competition can still be intense in many branded nondurables categories, especially those with a high percent of private-label penetration, such as household products (for example, kitchen paper towels), and may manifest in multiple forms, including reduction of list prices, promotion, discounts, and other incentives. Price competition is often more pronounced in established, more-developed markets.
13. Because the price gap between private-label and branded products is generally maintained in periods of higher inflation, we believe that, to a large extent, private-label manufacturers experience the same degree of price cyclical risk as their branded peers.
14. For apparel companies, price points may be higher, especially for luxury items, and these items tend to be more discretionary in nature. There can be some price cyclical risk related to changes in consumer discretionary spending patterns for nonluxury apparel, but it tends to be less cyclical for luxury goods.

15. **Volume cyclicality:** The nondiscretionary nature of many nondurable products does serve to mitigate significant variability in demand. Thus, swings during periods of economic weakness are less pronounced in the sector than other, more-cyclical industries (for example, consumer durables, airlines, and gaming), although trade-down or substitution can occur. In addition, favorable secular long-term growth prospects as a result of underpenetration of many nondurable products in emerging markets does tend (at least partially) to offset volume declines experienced in developed markets during weak economic periods (this is applicable primarily to global companies). At the same time, deceleration of GDP growth in emerging markets can hurt overall global volume growth trends. For apparel and related companies, volume cyclicality exists because of the more discretionary nature of the products.
16. **Cyclicality in profitability tends to be moderate.** Nondurables companies are sensitive to rises in key input costs, which can be volatile. These include agricultural commodities, oil-based resins, pulp and paper, cotton, and energy-related costs. Prolonged periods of economic weakness and commodity price inflation can squeeze margins, as it is usually more difficult for nondurables companies to pass through price increases during such periods. However, thanks to diversification in raw materials, geographic reach, and product innovation (which allows for premium pricing even in economic downturns), cyclicality in profitability is typically moderate.

Cyclicality

17. We assess the cyclicality for the branded nondurables consumer products industry as "low risk" (category 2). Average peak-to-trough (PTT) declines in revenues and profitability (the two key measures we use to derive an industry cyclicality assessment) have been relatively modest compared to many other industries (see "Methodology: Industry Risk," published Nov. 19, 2013). Based on our analysis of global Compustat data, average PTT declines in revenue and EBITDA were approximately 1.1% and 3.2% since 1952, respectively. However, in the most recent recessions, revenue declines were steeper. Specifically, from 2000-2002, average PTT in revenue declined 4.4%; from 2007-2009, it declined 3.8%. Average PTT decline in EBITDA margin during 2007-2009 was roughly 5.4%, and in 2000-2002 was a bit more moderate, at a 2.2% decline. These were largely because of the severity and length of those recessions.

Competitive risk and growth

18. We view the nondurables consumer products sector as having a "low" (category 2) competitive risk and growth assessment. To assess competitive risk and growth, we analyze four subfactors as low, medium, or high risk. These subfactors are:
 - Effectiveness of industry barriers to entry;
 - Level and trend of industry profit margins, including ability to manage cost structure;
 - Risk of secular change and substitution by products, services, and technologies; and
 - Risk in growth trends.

Effectiveness of consumer nondurables industry's barriers to entry--Medium Risk

19. Barriers to entry are moderate; new players are not generally barred from entering the market, but

can experience some disadvantages. For example, smaller companies may have some difficulty competing against larger, global industry leaders that have not only established brands but also greater financial flexibility to advertise and market these brands; established distribution networks, and economies of scale. In some nondurables categories, barriers to entry can be steep, fostering more predictable and stable cash flow streams (e.g., tobacco products, given the high degree of regulation in developed markets).

20. Access to capital can be an important differentiator during difficult market conditions, favoring larger and more financially sound players. Having a lower cost of capital provides larger nondurables companies greater opportunity and flexibility to quickly build out and expand infrastructure and distribution networks internationally, particularly in higher-growth emerging markets. Lack of capital market access can become more pronounced during weak global economic conditions and can be a particular issue for smaller, private-label players if third-party capital is unavailable or too costly.

Level and trend of consumer nondurables industry profit margins--Low Risk

21. Degree of seasonality varies by category within nondurables consumer products, as certain subcategories are more sensitive to seasonality (e.g., lawn and garden nondurable products). Therefore, certain factors, such as weather, may have meaningful short-term effects in such subsectors. However, many larger players have fairly diverse product portfolios as well as geographic diversification that mitigate the impact of seasonality on profitability.
22. Nondurables companies have some exposure to weaker consumer spending and consumer trade-down to lower price-point products. However, ongoing innovation, product development, and brand support by branded nondurable consumer staples have historically helped to blunt the negative impact of such trends.
23. Increases in key raw material/input costs (such as resins, packaging, fuel, labor, energy-related, soft commodities, and pulp and paper) may pressure margins. Additionally, currency volatility can pressure margins. Although substantial commodity price inflation and movements in currencies can squeeze margins in the near term, nondurables issuers often have some ability to pass through price increases, but not always to do so fully or in a timely manner, especially during economic downturns and/or fluctuations in currencies. In such instances, nondurables issuers have focused on restructuring and cost savings initiatives to preserve margins to the extent possible. Nondurables issuers also rely on product innovation as these products tend to be higher priced and margin accretive.
24. In general, the ability of nondurables issuers to manage their cost structure is good, thanks to the variable cost structure and the ability to reduce operating costs through productivity measures. In evaluating an issuer's cost structure, we evaluate the amount of the company's costs that are variable in nature, its commodity exposure, and degree of volatility. We take into consideration factors such as input costs as a percentage of the company's total costs.

Risk of secular change and substitution by products, services, and technologies--Low Risk

25. We view the risk of secular change and substitution by products, services, and technologies as "low" because of the nondiscretionary nature of consumer nondurables. Consumer nondurable products are generally used daily and viewed as necessary items. Nonetheless, customers have a variety of options from industry participants as far as brand, quality, and price range. The pace of technological change in nondurable consumer products is relatively slow, and technological

displacement is typically not a major risk factor, although advances in manufacturing capabilities can drive innovation and operating efficiency and can enhance a company's competitive advantage.

26. There are nondurable product categories that the consumer perceives as more commodity oriented, thus less value-added. Such products primarily compete on price and are more exposed to increases in private-label penetration.
27. Need for continuous innovation is important to differentiate from private-label alternatives, maintain strong brand equity, and achieve pricing power. A company's ability to introduce new products or launch product extensions is key to addressing such risks and preserving market share and profitability.

Risk in consumer nondurables industry growth trends--Low Risk

28. Nondurable consumer products are generally nondiscretionary in nature, although shifts do occur from premium products to value-oriented branded and private-label (or store-branded) products during difficult economic times.
29. Nondurable consumer product companies' revenue growth generally exceeds GDP growth in emerging markets, although economic slowdowns will dampen consumer demand and growth prospects. There is also a continued need to increase brand awareness to the consumer in such markets because most of these companies have lower penetration rates in emerging markets. Growth trends are less favorable in developed markets because of high market penetration and entrenched competition. Nondurables companies may need to restructure, rationalize, or streamline businesses to grow profitability, given sluggish sales in these regions.
30. Secular growth trends in emerging markets have been strong during the past few years, as growth in these markets has exceeded developed market growth (which we expect to continue to grow in the low single digits). However, there are certain risks with entering emerging markets, such as currency devaluation and local trade policy changes, that somewhat temper the growth rates in these markets. Still, the growth trends seem likely to persist for an extended period given most companies' limited market penetration in these markets. Demographic trends are supportive of long-term demand, which includes population growth, a rising middle class, and increased household penetration of nondurable consumer products, most notably within developing markets.

Country risk

31. Country risk plays a critical role in determining all ratings on companies in a given country. Country-related risks can have a substantial effect on company creditworthiness, both directly and indirectly. While our sovereign credit ratings suggest the general risk local entities face, the sovereign ratings may not fully capture the risk applicable to the private sector. We look beyond the sovereign rating to evaluate the specific economic, demographic, and other country risks that may affect the entity's creditworthiness. In assessing country risk for a nondurables consumer products company, our analysis uses the same methodology as with other corporate issuers (see our corporate methodology). We generally determine exposure to country risk using revenues.

Competitive position (including profitability)

32. Under our corporate methodology, a company's competitive position is assessed as (1) excellent, (2) strong, (3) satisfactory, (4) fair, (5) weak, or (6) vulnerable. In assessing the competitive position

for nondurables consumer products companies, we review an individual company's

- Competitive advantage;
- Scale, scope and diversity;
- Operating efficiency; and
- Profitability.

33. We assess the first three components independently as either (1) strong, (2) strong/adequate, (3) adequate, (4) adequate/weak, or (5) weak. We assess profitability through the combination of absolute profitability and the volatility of profitability.
34. After evaluating competitive advantage, scale, scope, diversity, and operating efficiency, we determine the preliminary competitive position assessment by ascribing a specific weight to each component. The applicable weightings will depend on the company's Competitive Position Group Profile (CPGP). The CPGP assigned to most nondurables consumer products companies is "Services and Product Focus." Private-label manufacturers tend to be included in this profile but could also be classified as "Capital or Asset Focus," as noted below. The "Services and Product Focus" CPGP weighting are as follows: competitive advantage (45%); scale, scope, and diversity (30%); and operating efficiency (25%).
35. Although seldom used, we may assign the "Capital or Asset Focus" CPGP to those nondurables consumer products companies requiring sizable capital investment and asset outlays to sustain competitive position. The corporate methodology generally consider a capital-intensive company as having a ratio of ongoing capital spending to sales of greater than 10%, or depreciation to sales of greater than 8%. We may assign this CPGP to a company with a lower capital spending or depreciation to sales ratio than stated above if a sizable asset base and infrastructure is crucial to its operation. For example, private-label manufacturers typically attempt to achieve cost leadership, which requires continual reinvestment in infrastructure and technology. In these cases, operating efficiency is a relatively more important component in our competitive position assessment. The "Capital or Asset Focus" CPGP components are weighted as follows: competitive advantage (30%); scale, scope, and diversity (30%); and operating efficiency (40%).

Competitive advantage

36. In assessing the competitive advantage of a nondurables consumer products company, we consider the following:
- Brand equity;
 - Market share, and ability to defend and increase market share;
 - Effectiveness of marketing strategy and sales force; and
 - Pricing power and purchasing power.
37. In reviewing brand equity, we consider a company's brand strength, or lack thereof. Brands commanding a clear price premium demonstrate strong brand equity and reputation. Companies successfully leveraging existing brand names into new product categories also show strong brand equity and reputation. Asset impairments or the potential for asset impairments of brands may indicate poor brand equity and reputation. We use third-party independent brand rankings and valuations that measure the strength of brands and year-over-year trends where available to support our assessment.
38. In reviewing a nondurables consumer products company's market share and ability to defend or

increase its market share, we consider the company's share in its categories, key markets, and regions in relation to market size and growth prospects. In assessing market share trends we consider the company's performance in recent periods as well as prospectively, as a company that is able to defend and increase share is more likely to adjust its strategy to evolving market conditions, be more innovative, enjoy some pricing advantage, and maintain sales growth and profitability, even during adverse economic conditions.

39. In reviewing a nondurables consumer products company's marketing strategy and sales force, we consider the performance of new product introductions and product innovation to measure marketing strategy and sales force effectiveness. We assess the trend of new products revenue as a percent of total revenue and degree of favorable sales mix that should benefit margins.
40. In assessing a nondurables consumer products company's pricing power with key customers and purchasing power with key suppliers, we consider the company's ability to pass through direct cost increases or avoid accepting cost increases. An evaluation of gross margin trends among direct competitors can provide a quantitative measure of the company's ability to pass along cost increases. We also consider information provided by management, including on earnings calls and in public filings about customer and supplier relationships, when assessing pricing and purchasing power.
41. A nondurables consumer products company with a "strong" or "strong/adequate" competitive advantage assessment typically has a combination of:
 - Products that typically command a price premium relative to competitors thanks to its brand equity, helping the company's bargaining power with a consolidated retailer customer base.
 - Industry leading market shares, typically in the top two, with relatively stable or growing share in sizable categories with attractive growth prospects in key markets/regions, or globally relative to other participants in the industry.
 - An effective business strategy, as evidenced by maintaining or strengthening share positions in the marketplace. The company's strategy may be either cost leadership or product differentiation (in few cases, both), and its actions should be consistent with its strategy. Competitors typically find it difficult to achieve a comparable low-cost position or to offer a comparable product. A consistent and realistic business strategy maximizes opportunities and minimizes risks relative to competition.
 - A demonstrated track record of product development and innovation, as evidenced by a continuous pipeline of successful new products, as new products typically command higher pricing.
 - Possess average to above-average gross margins relative to competitors, even during periods of high inflation.
42. A nondurables consumer products company with a "weak" or "adequate/weak" competitive advantage assessment typically has a combination of:
 - A limited number of lesser known brands, and products that typically do not command a premium price.
 - A business strategy inconsistent with or not well adapted to marketplace conditions. The company lacks cost leadership or product differentiation, or its execution is inconsistent with its strategy. Competitors typically have a better cost position or stronger product differentiation. An inferior business strategy misses opportunities and increases risks relative to competition.
 - No leading market share positions in sizable product categories with attractive growth

prospects in key markets or regions.

- Leading market share positions in product categories with lower growth prospects and possibly a high degree of private-label competition.
- An inconsistent track record of successful innovation, including slowness in developing and marketing new products, and an inability to raise prices, hurting the company's position within a consolidated retailer customer base often found in developed markets.
- Products that generally enjoy very limited or no price premium relative to competing brands, thanks to poor brand equity or high private-label penetration.
- Gross margin percentage is weaker than that of competitors in the sector.

Scale, scope, and diversity

43. In assessing a nondurables consumer products company's scale, scope, and diversity, we consider the following:

- Size of revenue base relative to close competitors;
- Range of products or services; and
- Diversity of sources of revenue and cash flow in terms of products, brands, and price points.

44. We generally assume participation in a variety of attractive markets and operating scale will result in greater financial performance stability in market downturns.

45. We measure diversity as a percentage of volume or revenues, through profitability by geography, brands, and product category, concentration or breadth of customers, manufacturing/sourcing locations, as well as concentration of key commodities. We also examine a company's exposure to a mix of emerging and mature markets.

46. A nondurables consumer products company with a "strong" or "strong/adequate" assessment of its scale, scope, and diversity typically has a combination of:

- For a "strong" assessment, a company's net sales base is significantly larger than competitors', and the company has dominant market share on both a global and regional basis. For a "strong/adequate" assessment, net sales are below the level of clear leaders in the sector globally, and the company may have a leading regional share but not global share.
- A comprehensive range of products, product categories, and service offerings.
- More than five sizable brands and brand extensions with limited brand or category concentration, typically with no more than 50% of revenues from one brand or category. A company could have greater than 50% concentration in a particular category if the category's size is very large and spans globally.
- Geographic diversification of revenues in several regions with a mix of exposure to developed, developing, and emerging markets, typically with no one country representing more than 50% of net revenues.
- A diverse manufacturing base as well as sourcing as measured by the company's ability to manufacture products in other facilities and no reliance on a single commodity for its top raw material needs.
- Diverse customer and distribution channels. The company does not rely on a single customer for more than 25% of its net revenues.

47. A nondurables consumer products company with a "weak" or "adequate/weak" scale, scope, and diversity assessment typically has a combination of:
- A leading, but not dominant, market share in a fragmented and relatively small category or subset of a category on a regional or country basis, with modest growth prospects at best.
 - It offers only a few products and participates in only a single or few niche product categories.
 - It participates in only a few regions, typically less than two, with limited growth prospects.
 - It has significant manufacturing and sourcing concentration as measured by reliance on a single manufacturing plant or third-party manufacturer, and a few key suppliers for its top raw material needs.
 - It relies on a single or a few customers, with one customer accounting for more than 25% of revenues.

Operating efficiency

48. In assessing a nondurables consumer products company's operating efficiency, we consider:
- the degree of operating leverage;
 - the degree of sensitivity to raw material and energy costs volatility;
 - the company's relative cost position versus industry peers; and
 - the flexibility of its cost structure.
49. In reviewing the degree of operating leverage of a nondurables consumer products company, we look at various operating statistics. This is measured by the percentage change in EBIT over the percent change in sales, return on assets, or invested capital. In addition, we evaluate the company's working capital productivity, such as total asset turnover, inventory turnover, and cash conversion cycle. High fixed costs relative to variable costs increase operating leverage. This provides a company with the ability to realize scale benefits in product development and production.
50. In determining the degree of sensitivity to raw material and energy costs volatility, we consider a company's ability to limit margin deterioration during periods of rising costs, and the ability to either mitigate or offset exposure to significant commodity price swings. This is usually through cost reduction and the ability to pass on input cost increases. Indicators of cost flexibility may include: proportion of fixed and variable costs; degree of operating leverage; degree of vertical integration and outsourcing; labor cost characteristics, including unionized/nonunionized workforce profile and pension cost considerations; and raw material or component cost exposure, and related pass-through profile.
51. For a company to warrant a "strong" or "strong/adequate" operating efficiency assessment, it typically has some combination of these characteristics:
- A high degree of size and scale that yields strong purchasing power, which can provide discounts for higher volume purchases of key input costs.
 - Economies of scale and efficiencies that lead to better profit margins (measured by gross margin and EBITDA to revenues) than peers, taking into account differences in sales mix and average selling prices.
 - Extensive reach and well-established distribution networks. In developed markets, most companies will have greater penetration and established sales channels. In emerging markets,

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most companies' reach would be less, but a stronger company may have established relationships through joint ventures or a few large customers.

- Operating costs as a percentage of sales that are below peer averages.
 - Ability to adjust costs through internal efficiencies or outsourcing.
52. For a company to warrant a "weak" or "adequate/weak" operating efficiency assessment, it typically has these characteristics:
- Profitability that consistently lags below peers.
 - Noncompetitive levels of operating expenses are required to increase sales.
 - Underutilization of manufacturing facilities.
 - A track record of execution issues or disruptions that is more likely to contribute to supply chain deficiencies and operating inefficiency.
 - Substantial seasonality in the business and working capital requirements that could lead to excess inventory levels if seasonal demand is weaker than anticipated.
 - Inability to adequately source raw materials relative to peers, which could be attributed to factors such as lack of size and scale, or lack of centralized procurement.

Profitability

53. The profitability assessment can confirm or modify the preliminary competitive position assessment. The profitability assessment consists of (1) the level of profitability, and (2) the volatility of profitability. The two components are combined into the final profitability assessment using a matrix.

Level of profitability

54. We determine level of profitability on a three point scale: "above average," "average," and "below average."
55. EBITDA margin is the primary metric we use to evaluate profitability for consumer nondurables companies. For the majority of companies, the level of profitability assessment and EBITDA margin will align. Table 1 summarizes the guideline ranges of EBITDA margin by subsector.
56. But there are additional factors to consider. We may also base our profitability assessment on return on capital. For example, a company with an EBITDA margin slightly below the guideline ranges may have excellent asset turnover, which boosts return on capital. In this example, we may assess the level of profitability stronger than the EBITDA margin table would indicate. Conversely, a company with an EBITDA margin slightly above the guideline ranges may have poor asset turnover, which hurts return on capital. In this example, we may assess the level of profitability weaker than the EBITDA margin table would indicate. We place less emphasis on return on capital when financial leverage is the major component in the ratio outcome, which is the case with many financial sponsor-owned companies. For this reason we do not provide guideline ranges for return on capital. We place a stronger emphasis on return on capital when financial leverage is not the major component in the ratio outcome because this section focuses on operational performance. Financial leverage is assessed as part of our cash flow/leverage analysis.
57. We may also consider the level of profitability compared with a company's closest competitors. For example, a private-label company may have EBITDA margin slightly below the guideline ranges

yet may have stronger profitability than its closest competitors. In this example, we may assess a private-label company's level of profitability stronger than its EBITDA margin would indicate. Generally, private-label nondurables companies with EBITDA margins in the high-single digit to mid-teens area are considered average. Because of the limited number of rated private-label nondurables companies, we are not including a separate summary table.

Table 1

Guideline Ranges Of EBITDA Margin By Subsector

	EBITDA Margin		
	Above Average	Average	Below Average
Apparel	Above 15%	10% to 15%	Below 10%
Nonalcoholic Beverage and Packaged Food	Above 20%	10% to 20%	Below 10%
Personal Care and Household Products	Above 25%	15% to 25%	Below 15%
Tobacco and alcoholic beverage	Above 30%	15% to 30%	Below 15%

Volatility of profitability

- 58. We assess the volatility of profitability on a six-point scale from "1" (least volatile) to "6" (most volatile).
- 59. In accordance with our corporate criteria, we generally assess the volatility of profitability using the standard error of regression (SER), provided we have at least seven years of historical annual data. As with the level of profitability, we evaluate an SER in the context of the industry.
- 60. We use EBITDA to determine the SER for nondurables consumer products companies. When a company's EBITDA is distorted by significant swings in foreign currency or acquisition activity, we will determine SER based on EBITDA margins or return on capital if, in our opinion, those measures provide a more accurate picture of the underlying level of earnings. In accordance with the corporate criteria, we may--provided certain conditions are met--adjust the SER assessment by up to two categories better (less volatile) or worse (more volatile). In the event there are anomalies in the seven-year historical data, we use a peer proxy to establish the volatility assessment. If no peer exists, we perform an assessment based on expected volatility as outlined in our corporate methodology.

Part II--Financial Risk Analysis

Accounting characteristics and analytical adjustments

- 61. In assessing the accounting characteristics of nondurables consumer products companies, the analysis uses the same methodology as with other corporate issuers (see our corporate methodology). Our analysis of a company's financial statements begins with a review of the accounting to determine whether the statements accurately measure a company's performance and position relative to its peers and the larger universe of corporate entities. To allow for globally consistent and comparable financial analyses, our rating analysis may include quantitative adjustments to a company's reported results. These adjustments also enable better alignment of a company's reported figures with our view of underlying economic conditions. Moreover, they allow a more accurate portrayal of a company's ongoing business. Adjustments that pertain broadly to all corporate sectors, including this sector, are discussed in "Corporate Methodology:

Ratios And Adjustments" (Nov. 19, 2013). Accounting characteristics and analytical adjustments that are unique to specific sectors are discussed below.

Excise taxes

62. For companies operating in subsegments where excise taxes are levied against consumers, including tobacco and alcoholic beverages, we deduct such excise taxes from both revenues and cost of sales if the company includes them in their reported revenues figure, as we do not consider those tax items as operating revenues or costs.

Cash flow/leverage analysis

63. The pattern of cash flow generation, current and future, in relation to cash obligations is often the best indicator of a company's financial risk. Cash flow/leverage analysis is the foundation for assessing an issuer's financial risk profile. The assessment of cash flow/leverage is evaluated on a scale of (1) minimal, (2) modest, (3) intermediate, (4) significant, (5) aggressive, and (6) highly leveraged.
64. The corporate methodology provides benchmark ranges for various cash flow ratios we associate with different cash flow leverage assessments for standard volatility, medial volatility, and low volatility industries. We apply the "standard volatility" table to branded nondurables companies, notwithstanding our "low risk" industry assessment, because the operating environment often exhibits some sign of volatility, including commodity price volatility and exposure to currency volatility.

Core ratios

65. In assessing the cash flow/leverage of nondurables consumer products companies, we utilize two core ratios: debt to EBITDA and funds from operations (FFO) to debt. We determine these ratios in accordance with S&P Global Ratings' ratios and adjustment criteria. When there is a divergence in ratios (for instance, when leverage indicates one financial risk descriptor and FFO to total debt indicates another), we apply greater emphasis on supplemental ratios (see below).

Supplemental ratios

66. We consider supplemental ratios in order to develop a fuller understanding of a company's credit risk profile and fine tune our cash flow analysis. We consider debt coverage ratios (free operating cash flow [FOCF] to debt and discretionary cash flow [DCF] to debt) and interest coverage ratios (EBITDA to interest and FFO to interest).
67. If the business risk profile is in the "satisfactory" or better category, we tend to apply DCF to debt, since a large proportion of the companies with satisfactory or better business risk profiles have high dividend payout ratios. We would also apply other supplemental ratios such as cash flow from operations to debt or FOCF to debt if we believe those ratios are more applicable, such as for working-capital-intensive or high-growth companies. If the business risk profile is in the "fair" or below category, we tend to apply the interest coverage ratios as we focus more on the company's ability to service their interest expense.
68. Notwithstanding paragraph 66, if a company is working-capital- or capital-intensive, or if the preliminary cash flow leverage assessment is "significant" or weaker, then we will give two interest coverage ratios--EBITDA to interest and FFO plus interest to cash interest--greater

importance. These ratios become particularly important in our analysis of companies that have highly seasonal businesses and resultant significant swings in working capital investment needs (such as private-label manufacturers and lawn and garden companies). These seasonal companies typically borrow intra-year, and the interest coverage ratios capture all annual interest costs.

Part III--Rating Modifiers

Diversification/portfolio effect

69. In assessing the diversification/portfolio effect of nondurable consumer products companies, our analysis uses the same methodology as with other corporate issuers (see our corporate methodology). However, it is rare to find such diversification, as defined in our methodology, in the consumer products nondurables sector following several years of divestitures of noncore businesses.

Capital structure

70. In assessing capital structure on a nondurables consumer products company, our analysis uses the same methodology as with other corporate issuers (see our corporate methodology).

Liquidity

71. In assessing liquidity on a nondurables consumer products company, our analysis uses the same methodology as with other corporate issuers (see our corporate methodology).

Financial policy

72. In assessing financial policy on a nondurables consumer products company, our analysis uses the same methodology as with other corporate issuers (see our corporate methodology).

Management and governance

73. In assessing management and governance on a nondurables consumer products company, our analysis uses the same methodology as with other corporate issuers (see our corporate methodology).

Comparable ratings analysis

74. In assessing the comparable ratings analysis on a nondurables consumer products company, our analysis uses the same methodology as with other corporate issuers (see our corporate methodology).

REVISIONS AND UPDATES

This article was originally published on May 7, 2015. These criteria became effective on May 7, 2015, and superseded "Key Credit Factors For The Branded Nondurables Industry," published Nov. 19, 2013.

Changes introduced after original publication:

- Following our periodic review completed on May 6, 2016, we updated the contact information and criteria references and deleted paragraphs 2, 3, 8, and 9, which were related to the initial publication of our criteria and no longer relevant.
- Following our periodic review completed on May 4, 2017, we renamed "Appendix: Material Related To The Initial Publication Of The Criteria" to "Revision History."
- Following our periodic review completed on May 1, 2018, we updated criteria references and the contact information and renamed the "Revision History" section to "Revisions And Updates."

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- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Methodology: Industry Risk, Nov. 19, 2013
- Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

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