

11th January 2016

Food & Beverages

# Carlsberg

Price DKK588.00

Things are going to get worse before they get better. Downgrade to sell.

Fair Value DKK485 vs. DKK519 (-18%)

SELL vs. NEUTRAL

Bloomberg	CARLB DC
Reuters	CARCb.CO
12-month High / Low (DKK)	648.5 / 473.1
Market Cap (DKK)	90,597
Ev (BG Estimates) (DKK)	149,726
Avg. 6m daily volume (000)	367.3
3y EPS CAGR	-8.3%

We are downgrading the stock to Sell from Neutral and set a new fair price of DKK485 which is 18% below the current share price. We are doing this after reviewing the company's outlook and management's statements on profitability which are well below where the market forecasts are. We are lowering our 2015 and 2016 operating profit forecasts by 12% and 8% and lower our fair value of the company by 7% to DKK485 from DKK519. And our operating profit forecasts for 2015 and 2016 are 6% and 11% respectively below consensus.

	1 M	3 M	6 M	31/12/14
Absolute perf.	1.4%	11.4%	0.3%	22.8%
Food & Bev.	-6.3%	1.2%	1.6%	11.0%
DJ Stoxx 600	-6.7%	-5.6%	-8.5%	-0.3%

## ANALYSIS

- The recent management changes and clean up at Carlsberg has created, falsely in our view, the impression that after the current difficult 2015, things can only get better. Indeed, consensus operating profit forecast for 2016 is 6% higher than in 2015 and, for 2017, the market expects another 10% growth. We prefer to differ and believe that management is likely to give a wake-up call at the results announcement on 10 February. Not only is our 2015 operating profit forecast of DKK7,817m (including affiliates) 15% down on 2014 and 6% below consensus but, furthermore, for 2016 our estimates call for an operating profit of DKK7,629m (again down) which is in sharp contrast to consensus estimates of a 10% growth to DKK8,822 (we are 11% lower than consensus).
- For Western Europe, the company has been warning of an additional DKK300m UK restructuring charge and a reclassification of the Staropramen termination compensation. But also for 2016, we are expecting another DKK300m operating charge from the UK business. This comes on top of the problems in executing the business standardisation programmes, which have not and are not yet delivering the anticipated cost savings, and the declining volumes. As a result we have lowered our 2015 Western Europe operating profit forecasts by 9% and slashed 12% from our forecasts for 2016. After that we only see a gradual recovery and, by 2018, the company could realise an operating margin of 14.4% which is still below the 14.5% realised in 2014.
- Eastern Europe has been the big disappointment over the past years and things are likely to get worse. For 2015, we are expecting an organic decline in operating profit of 19% which is unchanged to our previous estimates and is driven by the lower volumes, higher COGS and sales and marketing investments. Furthermore a negative currency impact of an estimated 23% drives operating profit down by 43% for 2015. And 2016 is not going to be any better! Another drop in volumes and a further weakening of the rouble is expected to sink Eastern European profit by an additional 38%. As a result, the operating profit margins in Eastern Europe are likely to end up at 14.9% in 2016 which ends an area of superior profitability (even back in 2009 the operating margin was still 28.5%). Our Eastern European earnings outlook is in sharp contrast with the consensus forecast which calls for a flattish operating profit in Eastern Europe.
- In Asia, we expect the strong performance from the first 9 months (organic revenue growth of 6% and organic operating profit growth of 16%) to moderate only fractionally. But as some of the performance in 2015 was held back by bad weather (China, Vietnam) and start-ups (Myanmar) and the increased competition in Eastern China (the plan is to close/scale down the 'Eastern China assets'), 2016 should continue to see a strong performance.
- We are also drawing attention to the fact that the company expects its new overall profit improvement programme to deliver annual benefits by 2018 of DKK 1.5-2.0bn of which about half will be re-invested in the business and half should increase the company's profitability. The reference year is 2015. For us this means that the company is looking for a max DKK1bn of operating profit improvement by DKK2018. In our estimates we are looking for an improvement of DKK750m by 2017. The consensus, from a higher 2015 base is looking for an improvement of DKK1.4bn. It might be that management is being too conservative (and yes our 2018 figures show a further DKK750m improvement), but 6 months into the job (not even after 18 months in the job), the new CEO is going to change his view and message. So the only thing that he can do is bring down market expectations.
- The new CEO is also conducting a strategic review, labelled SAIL2022 (immediately already hinting at the time it will take to execute that strategic review). The outcome will be communicated at the end Q1 2016 (so that is end March and not as some are hoping at the results announcement on 10 February). Indeed, you would not want to mix a positive message with bad results and

### YEnd Dec. (DKKm)

	2014	2015e	2016e	2017e
Sales	64,506	64,988	64,355	65,698
% change		0.7%	-1.0%	2.1%
EBITDA	12,561	11,532	11,279	12,145
EBIT	8,458	7,159	6,941	7,843
% change		-15.4%	-3.1%	13.0%
Net income	5,496	3,779	3,564	4,239
% change		-31.2%	-5.7%	18.9%

	2014	2015e	2016e	2017e
Operating margin	13.1	11.0	10.8	11.9
Net margin	8.5	5.8	5.5	6.5
ROE	10.5	6.9	6.3	7.1
ROCE	5.3	4.7	4.6	5.2
Gearing	74.3	65.0	56.8	47.5

(DKK)	2014	2015e	2016e	2017e
EPS	35.92	24.70	23.29	27.70
% change	-	-31.2%	-5.7%	18.9%
P/E	16.4x	23.8x	25.2x	21.2x
FCF yield (%)	1.7%	4.9%	4.8%	5.8%
Dividends (DKK)	6.48	6.80	7.14	7.50
Div yield (%)	1.1%	1.2%	1.2%	1.3%
EV/Sales	2.4x	2.3x	2.3x	2.2x
EV/EBITDA	12.1x	13.0x	13.0x	11.8x
EV/EBIT	18.0x	20.9x	21.2x	18.3x



outlook.

#### VALUATION

- We calculate a DCF based fair price of DKK485 per share based on a medium term growth rate of 3.5% and a Cost of Equity of 8.4% (2.0% risk free and 6.4% risk premium).
- The stock is trading at 25.2x 2016 estimates (our down beat estimates!) and 21.2x 2017 estimates (the highest in our beverages universe).

#### NEXT CATALYSTS

- Results announcement on 10 February and SAIL2022 strategic review presentation at the end of March.

*[Click here to download document](#)*



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