

Carlsberg

Price DKK595.00

Making the case to Sell the stock

Fair Value DKK520 vs. DKK485 (-13%)

SELL

Bloomberg	CARLB DC
Reuters	CARCb.CO
12-month High / Low (DKK)	648.5 / 490.6
Market Cap (DKKm)	90,771
Ev (BG Estimates) (DKKm)	146,647
Avg. 6m daily volume (000)	382.9
3y EPS CAGR	-8.3%

	1 M	3 M	6 M	31/12/15
Absolute perf.	9.6%	1.0%	19.8%	-2.9%
Food & Bev.	-2.0%	-9.3%	7.0%	-5.5%
DJ Stoxx 600	-2.9%	-14.3%	-8.4%	-10.7%

YEnd Dec. (DKKm)	2015	2016e	2017e	2018e
Sales	65,354	64,108	65,441	65,698
% change		-1.9%	2.1%	2.1%
EBITDA	12,614	12,234	12,940	12,145
EBIT	7,940	7,560	8,314	7,843
% change		-4.8%	10.0%	13.0%
Net income	4,557	4,051	4,767	4,239
% change		-11.1%	17.7%	18.9%

	2015	2016e	2017e	2018e
Operating margin	12.1	11.8	12.7	11.9
Net margin	7.0	6.3	7.3	6.5
ROE	10.5	8.8	9.7	7.1
ROCE	5.5	5.6	6.2	5.2
Gearing	79.9	71.1	57.9	47.5

(DKK)	2015	2016e	2017e	2018e
EPS	29.78	26.48	31.16	27.70
% change	-	-11.1%	17.7%	18.9%
P/E	20.0x	22.5x	19.1x	21.0x
FCF yield (%)	8.1%	3.3%	6.0%	5.8%
Dividends (DKK)	6.48	6.48	6.80	7.50
Div yield (%)	1.1%	1.1%	1.1%	1.3%
EV/Sales	2.3x	2.3x	2.2x	2.2x
EV/EBITDA	11.7x	12.0x	11.0x	11.7x
EV/EBIT	18.7x	19.4x	17.2x	18.1x

Despite the company delivering better results than I anticipated, they were still bad and I keep my recommendation to sell the stock. The huge restructuring charges are artificially improving operating margins (they do take away depreciation and negative operating gearing), profits will be down again in 2016 and the new strategic plan SAIL'22 is likely to focus on organic growth – which is the area where Carlsberg has not failed in the past. The company's problem has been value destructive acquisitions whereas the other brewers have done better on the front. My earnings forecasts for Carlsberg were too prudent and I am updating those. My fair value estimate of the company increases by 7% to DKK520 from DKK485.

Post the results statement from 10 February, we are updating our forecasts. Although the results came in well ahead of my forecasts with an EBIT of DKK8,457m compared to my low estimate of DKK7,817, I don't feel particularly inclined to upgrade my sell recommendation. Indeed:

ANALYSIS

- Results in both Western and Eastern Europe were better than I was anticipating (both about 10% better) but that does not mean that they were good results. In Western Europe operating margin operating profit was down 3% (on a revenue increase of 3%) and operating margin declined to 13.7% from 14.5%. In Eastern Europe operating profit was down 36% (19% decline organic) and operating margin declined to 17.4% from 21%. The better 2015 starting point allows us to increase our profit estimates going forward and drives our increased fair value of DKK520 (up from DKK485)
- Operationally, the business has more difficulties than the 8.4% decline in operating profit suggests: a significant amount of operational loss has been shifted into the exceptional DKK8.7bn restructuring charge. One example is the loss of the low profitable Tesco contract (delisting). In going-concern we would expect the assets needed to brew, distribute, sell those lost volumes to continue to weight on the UK profitability. However, a DKK43m impairment on machines and equipment in the UK, moves the depreciation charge and negative operational gearing into special items. This is perfectly in accordance to accounting rules (that is not the point), the point is that in total a 2015 impairment of DKK1.6bn for property, plant and equipment impairment after already a DKK0.9bn in 2014, seems to be moving quite a lot of value loss into special items. And more (as I understand it another DKK1.3bn) is going to come in 2016 and 2017.
- Whatever the forecast scenario, operating profit in 2016 is going to be lower than in 2015. Yes there is some organic growth of low single digit (we estimate 3.5%) but if ones exclude the impact of devaluation driven inflation, true organic operating profit growth is nought. Including the impact of the devaluations (especially Russia and Ukraine), operating profit is forecasted to be down by another 3%. Adjusted net profit (with higher financial costs (and interest charge), more tax and higher minorities) should fall by 10% in 2016 to DKK4,075m (vs DKK4,557 in 2015). With that profits will be back down to the 2009 levels. Even assuming a gradual uptick in profitability (the company is guiding to save DKK1.5-DKK2.0 bn by 2018 (but with the majority of savings being reinvested) we derive a fair value of DKK520.
- Currently the new CEO Cees 't Hart is still moulding his strategic review which should culminate in the big SAIL'22 plan which is to be be communicated on 16 of March. It has already been speculated that there will be a lot about organic growth in that plan. However, that is not going to drive superior returns. In my view, Carlsberg has not really failed on that level (although one could highlight poor operational performance – in terms of market share - in Russia). Comparing the organic operating performance in Western Europe Carlsberg delivered on average over the past five years organic sales growth of 0.8% and operating profit growth of 2.8%. Its larger European competitor Heineken delivered an average organic sales decline of 0.9% and operating profit growth of 2.6%. So all pretty similar.
- Where it went wrong is the couple of expensive, badly timed acquisitions in Russia and China. Equally so, Carlsberg's competitors AB InBev, Heineken, Asahi, Molson Coors do not really create a lot of value with their organic growth. They do however, create value with big acquisitions and integrated them smoothly: Modelo, Fems, APB, MillerCoors to name a few. And on that level, we suspect that the new big strategic plan will disappoint.



VALUATION

- Carlsberg trades on 22.5x 2016 EPS and 19.1x 2017 EPS, compared to Heineken at 19.7x and 18.0x and AB InBev at 23.5x and 19.6x respectively.
- Our fair value of DKK520 is driven by a RRE of 8.4% and a long term growth rate of 3%

NEXT CATALYSTS

- 16 March 2016: publication of revised strategy SAIL'22

2015 results and forecast changes

DKKm	FY2015				FY2016e			
	Old	Published	% chge	% Incr.	Old	New	% chge	% Incr.
Net sales	64988	65354	0.6%	1.3%	64355	64108	-0.4%	-1.9%
North & Western Europe	38532	39000	1.2%	3.3%	39011	39290	0.7%	0.7%
Eastern Europe	10684	10963	2.6%	-22.2%	8787	8505	-3.2%	-22.4%
Asia	15614	15339	-1.8%	22.8%	16394	16259	-0.8%	6.0%
Non allocated	158	52	-67.0%	-66.0%	162	54	-67.0%	3.0%
Operating profit	7817	8457	8.2%	-8.4%	7629	8213	7.7%	-2.9%
North & Western Europe	4842	5325	10.0%	-2.7%	4980	5463	9.7%	2.6%
Eastern Europe	1698	1908	12.3%	-35.6%	1054	1121	6.4%	-41.2%
Asia	2697	2799	3.8%	27.5%	3028	3195	5.5%	14.1%
Non allocated	-1295	-1426	10.1%	11.2%	-1308	-1440	10.1%	1.0%
Other	-125	-149			-125	-125		
Special items	-7400	-8659		540.0%	-300	-500		-94.2%
Operating profit margin	12.0%	12.9%		-9.6%	11.9%	12.8%		-1.0%
North & Western Europe	12.6%	13.7%		-5.7%	12.8%	13.9%		1.8%
Eastern Europe	15.9%	17.4%		-17.2%	12.0%	13.2%		-24.3%
Asia	17.3%	18.2%		3.8%	18.5%	19.6%		7.7%
Net interest	-1414	-1531	8.3%	28.5%	-1286	-1581	23.0%	3.3%
PBT	-997	-1733	73.9%	-125.9%	6044	6132	1.5%	-453.8%
Tax	-850	-849	-0.1%	-51.5%	-1692	-1717	1.5%	102.2%
Minority interests	-450	-344	-23.6%	-34.2%	-605	-500	-17.4%	45.3%
Net profit - published	-2297	-2926	27.4%	-166.3%	3747	3915	4.5%	-233.8%
Net profit - adjusted	3779	4557	20.6%	-17.1%	3592	4051	12.8%	-11.1%
Number of fully diluted shares	153.0	153.0	0.0%	0.0%	153.0	153.0	0.0%	0.0%
Diluted EPS - Published	-15.0	-19.1	27.4%	-166.3%	24.5	25.6	4.5%	-233.8%
Diluted EPS - adjusted	24.7	29.8	20.6%	-17.1%	23.5	26.5	12.8%	-11.1%
Net dividend (DKK)	6.5	6.5	0.0%	0.0%	6.5	6.5	0.0%	0.0%

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