8th April 2016

Sector View

Brewers

Heineken remains a buy

	1 M	3 M	6 M	31/12/15
Food & Bev.	-0.1%	-0.3%	2.4%	-4.0%
DJ Stoxx 600	-3.8%	-5.3%	-9.1%	-10.3%

*Stoxx Sector Indices

Companies covered

AB INBEV		**NEUTRAL**	**EUR109**
Last Price	EUR107.1	*Market Cap.*	EUR172,243m
CARLSBERG		**SELL**	**DKK500**
Last Price	DKK622	*Market Cap.*	*DKK95,227m*
HEINEKEN		**BUY**	**EUR79**
Last Price	EUR78.84	*Market Cap.*	*EUR45,412m*
MOLSON COORS		**NEUTRAL**	**USD97**
Last Price	USD92.3	*Market Cap.*	*USD19,779m*
SABMILLER		**NEUTRAL**	**4400p**
Last Price	4226.5p	*Market Cap.*	*GBP68,528m*

Yesterday we lowered our recommendation for some of the brewers, which leaves Heineken as the only brewer that we consider worthwhile buying.

Yesterday we lowered our recommendation for SABMiller to Hold (from Buy) and for Molson Coors to Hold (from Buy); and kept our recommendation for AB InBev at Hold and for Carlsberg at Sell. Indeed on the back of the changed BG research risk free rate (1.6% vs 2.0%) and risk free rate (7% vs 6.4%), we have lowered our DCF-based fair value for AB InBev to EUR109 (vs EUR111), for Heineken to EUR79 (vs EUR83), for Carlsberg DKK500 (vs DKK520) and for Molson Coors to USD97 (vs USD101). For SABMiller the fair value of GBp4,400 is driven by the ABI offer price and remained unchanged. As a result of these fair value adjustments we have limited upside for the brewers. Indeed, AB InBev Heineken and Molson Coors are trading at fair value, SABMiller has an upside of 3% to fair value.

Although there is no upside to fair value for Heineken shares, we believe this stock is still worthwhile buying. We are summarising our buy case for the stock below.

ANALYSIS

- Organically Heineken is growing well with last year delivering organic revenue growth of 3.5% and organic profit growth of 6.9%. But on top of that Heineken is most likely to be the next brewer to make a significant acquisition. And acquisitions are the big value creator (or destructor in some cases) in the sector. AB InBev and Molson Coors will need a couple of years to digest the SABMiller and MillerCoors acquisitions, and Carlsberg is ruling itself out for big acquisitions. With deals like FEMSA Cerveza and Asia Pacific Breweries, Heineken's recent acquisition track record has been good. Furthermore we an estimated net debt/EBITDA of 2.2x by the end of 2016, the company has the capability to gear up. If external growth opportunities would not come along, we can expect at some stage, Heineken to start buying back to 20% that FEMSA has in the company. Indeed, FEMSA was mostly paid in shares when it sold FEMSA Cerveza to Heineken and has always made it clear that although it is a very happy shareholder of Heineken, the stake could be sold if an opportunity in its core retail and bottling business would arrive.
- Furthermore, Heineken has a well- balanced diversified geographic footprint with around 60% of operating profit from developing markets but it carries a low country specific operational risk with the highest contributors ranking Mexico (11%), Vietnam (10%), Nigeria (8%), France (7%) and the UK (6%).
- It has a strong innovation agenda with new products/packaging and extensions accounting for 9.2% of revenues in 2015 (up from a mere 3% in 2010), signalling that the company is adapting swiftly to the rapidly changing consumer environment.
- With brands like Heineken, Tecate, Tiger and Desperados, the company is leading in the international premium segment where growth and profitability are higher (see our note from March 2016 on high end beer). Indeed, Heineken is the brewer which has the highest exposure to high end beer with 36% of volumes and an estimated 60% of profits in that segment. Carlsberg's exposure to high end is 25% of volumes, for AB InBev it is 17%, for SABMiller it is 15% and for MolsonCoors it is 11%. Furthermore Heineken has the set-up (i.e. the geographic presence) to benefit further from the expected growth in import beers in emerging markets.
- Heineken is running programmes to improve the efficiency of its operations and has delivered on them. As a result Heineken's aim to increase operating profit margin by 40bps p.a. over the medium term (through cost savings and price/mix) is credible.
- Furthermore, as the company is reporting in euro it is benefiting from a translation impact from the stronger US dollar, British pound, Vietnamese dong and Mexican peso. However, as the company hedges the US dollar for transactions 18 months ahead, the impact of exporting Heineken from Amsterdam and the Mexican beers to the US, still has to come in 2016/2017.

VALUATION

- Heineken is trading at 19.8x 2016 and 18.3x 2017 earnings compared to 22.1x and 18.4x for ABI.

NEXT CATALYSTS

- 20 April : trading update Heineken q1 [Click here to download](#)

Analyst :
Nikolaas Faes
33(0) 1 56 68 75 72
nfaes@bryangarnier.com

Sector Team :
Loïc Morvan
Antoine Parison
Cédric Rossi

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Positive opinion for a stock where we expect a favourable performance in absolute terms over a period of 6 months from the publication of a recommendation. This opinion is based not only on the FV (the potential upside based on valuation), but also takes into account a number of elements that could include a SWOT analysis, momentum, technical aspects or the sector backdrop. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.

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London
Beaufort House
15 St. Botolph Street
London EC3A 7BB
Tel: +44 (0) 207 332 2500
Fax: +44 (0) 207 332 2559
Authorised and regulated by the Financial Conduct Authority (FCA)

Paris
26 Avenue des Champs Elysées
75008 Paris
Tel: +33 (0) 1 56 68 75 00
Fax: +33 (0) 1 56 68 75 01
Regulated by the Financial Conduct Authority (FCA) and the Autorité de Contrôle prudential et de resolution (ACPR)

New York
750 Lexington Avenue
New York, NY 10022
Tel: +1 (0) 212 337 7000
Fax: +1 (0) 212 337 7002
FINRA and SIPC member

Geneva
rue de Grenus 7
CP 2113
Genève 1, CH 1211
Tel +4122 731 3263
Fax+4122731 3243
Regulated by the FINMA

New Delhi
The Imperial Hotel
Janpath
New Delhi 110 001
Tel +91 11 4132 6062
+91 98 1111 5119
Fax +91 11 2621 9062