BRYAN, GARNIER & CO

INDEPENDENT RESEARCH

13th May 2016

Food & Beverages

Royal Unibrew

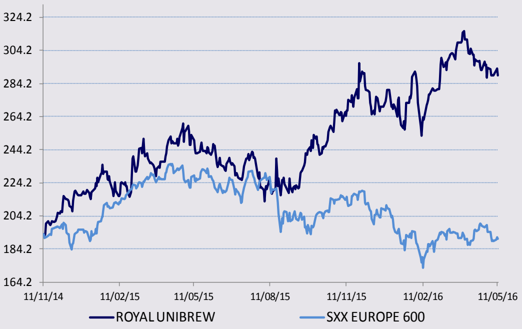
Camp Blue Lake

Fair Value DKK325 (price DKK290.80)

BUY
Coverage initiated

Bloomberg	RBREW DC
Reuters	RBREW.CO
12-month High / Low (DKK)	316 / 213
Market capitalisation (DKKm)	16,137
Enterprise Value (BG estimates DKKm)	16,204
Avg. 6m daily volume ('000 shares)	84.20
Free Float	100%
3y EPS CAGR	8.6%
Gearing (12/15)	40%
Dividend yields (12/16e)	0.62%

YE December	12/15	12/16e	12/17e	12/18e
Revenue (DKKm)	6,032	6,328	6,341	6,455
EBIT(DKKm)	916.96	984.35	1,010	1,050
Basic EPS (DKK)	12.93	14.55	15.43	16.58
Diluted EPS (DKK)	12.93	14.55	15.43	16.58
EV/Sales	2.74x	2.56x	2.53x	2.49x
EV/EBITDA	13.5x	12.5x	12.2x	11.8x
EV/EBIT	18.0x	16.5x	15.9x	15.3x
P/E	22.5x	20.0x	18.8x	17.5x
ROCE	20.2	23.0	24.2	25.7



We are initiating coverage of Royal Unibrew with a Buy recommendation and a fair value of DKK325 (+12%). The company is very tightly run and management is doing a great job. Royal Unibrew is a leading regional beverage provider in the wider Baltic Sea area and owns profitable niche export businesses (super premium beer to Italy, non-alcohol malt beverages and Faxe beer all over the world).

- With the company being active in mainly mature markets where volume and prices are under pressure, management is keeping a strong lid on costs. The drive for small cost-efficient operations has allowed operating margins at the company to improve to 15.2% in 2015 from 11% in 2011. We believe there is further upside (although downplayed by management) and look for a margin of over 17% in the next five years. If Finland and the Baltics could enjoy an economic rebound, the margin could well reach 20%.
- Being close to the operations also has commercial benefits. In Denmark, the company gained share in beer to 16% in 2015 from 14% in 2009 and, in the first quarter of 2016, the company boosted Finnish volumes by 23% as it looks for ways to cement links with the biggest Finnish retailer whilst promoting product tasting. Furthermore, as a small-sized brewer (9.1m hl) most of the company's products are in the sweet spot of profitability and consumer sentiment that increasingly asks for authenticity. On top of that, the company could be a major beneficiary of Carlsberg's value management strategy, which includes increased beer prices in Denmark and Finland, where Royal Unibrew generates two thirds of its profits.
- Being in mature cash-generative markets allows for a great platform for further acquisitions but, in the absence of any suitable projects, the company is buying back shares. If a material acquisition is not forthcoming, the company has significant potential to extend its share buy-backs. However, the company could be increasingly looked at as a target, offering not only a strong management team, but also the opportunity to extract more value from the company using global cost efficiencies and introducing owned international brands.

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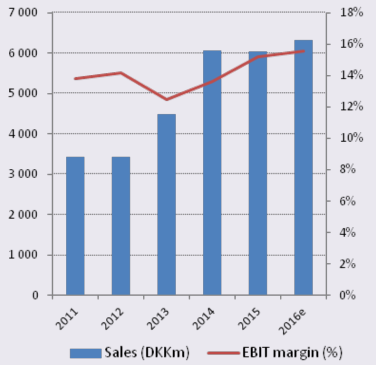

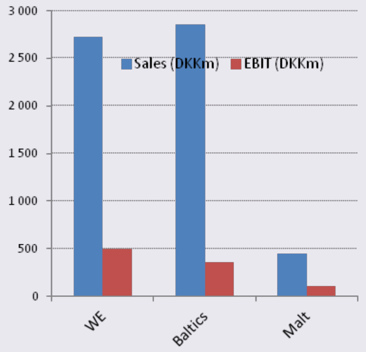

Company description

Royal Unibrew is the second largest brewery in Denmark, where its head office is also located. Its two most important markets are Denmark (36% of 2015 EBIT) and Finland (32%). Around 65% of its sales are generated in Western Europe, with Denmark, Italy and Germany as the most important markets. The Baltics account for another 5% of operating profit. Furthermore, it has two export businesses: shipping Ceres Strong Ale to Italy (16% 2015 EBIT) and exporting non-alcoholic malt beverages all over the world (11%).

Simplified Profit & Loss Account (DKKm)	**2013**	**2014**	**2015**	**2016e**	**2017e**	**2018e**
Revenues	4,481	6,056	6,032	6,328	6,341	6,455
Change (%)	*30.6%*	*35.1%*	*-0.4%*	*4.9%*	*0.2%*	*1.8%*
Adjusted EBITDA	732	1,130	1,225	1,295	1,320	1,360
EBIT	560	876	917	984	1,010	1,050
Change (%)	*15.4%*	*56.5%*	*4.6%*	*7.4%*	*2.6%*	*3.9%*
Financial results	(45.3)	(60.4)	(45.7)	(38.1)	(38.1)	(39.4)
Pre-Tax profits	514	816	871	946	972	1,010
Exceptionals	0.0	0.0	0.0	0.0	0.0	0.0
Tax	(68.7)	(176)	(191)	(200)	(206)	(214)
Profits from associates	33.6	34.8	31.1	32.0	33.0	33.9
Minority interests	0.0	0.0	0.0	0.0	0.0	0.0
Net profit	479	674	711	778	799	831
Restated net profit	480	662	711	778	799	831
Change (%)	*31.3%*	*38.0%*	*7.5%*	*9.4%*	*2.7%*	*3.9%*
Cash Flow Statement (DKKm)						
Operating cash flows	735	1,140	1,235	1,295	1,320	1,360
Change in working capital	90.9	(34.2)	169	(96.6)	1.9	16.2
Capex, net	(75.0)	(95.5)	(155)	(45.5)	(235)	(239)
Financial investments, net	(2,837)	2.0	5.3	0.0	0.0	0.0
Dividends	(242)	0.0	(374)	(430)	(441)	(459)
Other	348	(186)	(508)	(656)	(711)	(719)
Net debt	(1,980)	826	372	66.6	(64.6)	(40.4)
Free Cash flow	623	824	1,032	946	877	918
Balance Sheet (DKKm)						
Tangible fixed assets	2,709	2,570	2,438	2,173	2,098	2,026
Intangibles assets	2,944	2,941	2,920	2,920	2,920	2,920
Cash & equivalents	244	491	333	333	333	333
current assets	879	868	909	953	955	973
Other assets	148	153	147	147	147	147
Total assets	6,925	7,024	6,748	6,527	6,453	6,399
L & ST Debt	2,623	2,044	1,517	1,451	1,515	1,556
Others liabilities	2,168	2,161	2,296	2,244	2,247	2,281
Shareholders' funds	2,133	2,818	2,935	2,833	2,691	2,563
Total Liabilities	6,925	7,024	6,748	6,527	6,453	6,399
Capital employed	4,837	4,691	4,373	4,205	4,127	4,039
Ratios						
Operating margin	12.50	13.64	15.20	15.56	15.93	16.26
Tax rate	12.53	22.04	21.15	21.15	21.15	21.15
Net margin	10.70	10.93	11.79	12.30	12.60	12.87
ROE (after tax)	22.48	23.48	24.24	27.46	29.70	32.41
ROCE (after tax)	17.18	17.34	20.23	22.95	24.24	25.71
Gearing	112	55.09	40.34	39.44	43.93	47.70
Pay out ratio	0.0	58.66	57.27	57.14	57.14	57.14
Number of shares, diluted	55.49	55.49	55.02	53.48	51.78	50.08
Data per Share (DKK)						
EPS	8.64	12.15	12.93	14.55	15.43	16.58
Restated EPS	8.64	11.92	12.93	14.55	15.43	16.58
% change	*25.1%*	*38.0%*	*8.5%*	*12.5%*	*6.1%*	*7.4%*
EPS bef. GDW	8.64	11.92	12.93	14.55	15.43	16.58
BVPS	37.24	51.06	53.64	53.27	52.27	51.48
Operating cash flows	13.25	20.54	22.45	24.21	25.50	27.16
FCF	11.23	14.85	18.75	17.70	16.93	18.33
Net dividend	1.80	1.80	1.80	1.80	1.80	1.80

Source: Company Data; Bryan, Garnier & Co ests.

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1. Investment Case

Why the interest now?

The reason for writing now

This note on Royal Unibrew fits into our expanding coverage of the European beverages sector. Royal Unibrew is a regional European beverages company that has a proven track record of delivering efficiency improvements and market share gains, coupled with a value creative M&A strategy (the company has been selling assets before embarking on the acquisition of Hartwall in Finland).

Cheap or Expensive?

Valuation

At 18.8x 2017e EPS, the stock is cheaper than the sector (20.1x), although its 7% 5 years EPS growth is in line. Also its EV/EBITDA (11.8x) is below the sector (12.4x). Furthermore, the company is far less geared than the other brewers. Its net debt/EBITDA stands at 0.8x for 2016e compared to 2.4x for the sector. If we take into account the value of its stake in Hansa Borg, net debt/EBITDA falls to 0.3x. This indicates the significant value creation that the company could achieve if it where to find an attractive acquisition target or buy back more shares. Our fair value of DKK325 is based on a DCF of its current operations and using a risk free rate of 1.6%, a beta of 0.85 and a risk premium of 7%.

When will I start making money?

Catalysts

The company reports every quarter, updating the markets on the progress of its commercial agenda. In the coming quarters we look for signs of a more normal summer in the Nordics. Next, an important catalyst for share price performance would be news on a potential acquisition project from Royal Unibrew. But also progress of Carlsberg's strategy to focus more on profits than volume market share could be seen as a catalyst for further improvements in competitive tension in its core markets.

What's the value added?

Difference from consensus

Our earnings expectations are very much at the top of the company's guidance (2016 EBIT expectation of DKK984m compares with guidance of DKK885m to DKK985m) and is ahead of the DKK958m of the consensus. Furthermore, we do differ from the consensus on the likelihood that Royal Unibrew could be an acquisition target for another beverages company.

Could I lose money?

Risks to our investment case

Royal Unibrew's operational success depends on two countries, Denmark and Finland, which each account for about a third of net revenues and EBIT. Any dramatic regulatory changes or competitive pressure, could significantly alter the financial outlook for the company.

2. SWOT analysis

Strengths

Improving operational performance in regional strongholds

- A focused strategy of operational performance through an improved market position and efficiency is executed diligently. This has created the impression that its business is highly predictable and has low cyclicality. Increasing profits coupled with lower capex, has improved the free cash flow profile of the company.
- A full beverages company active around the Baltic Sea with number two or strong niche positions in all markets.
- The company has an interesting position in the super premium beer category in Italy and in the international market of malt beverages. Overall, the company holds mainly smaller and regional brands which fit well with the current consumer trend for authenticity.

Weaknesses

Limited geographic diversification

- With its smaller scale (9.1m hl of volumes spread over 6 countries – but mainly 2 countries), improving buying terms is limited.
- No owned international beer to distribute in its home markets. Its international Heineken and PepsiCo brands are licenced-in which limits profitability and in the end builds brand strength for others.
- Limited geographic diversification and changes in consumer/tax landscape in one country can have an important impact on group profitability.

Opportunities

Further consolidation

- As a relative small player, there should be acquisition opportunities that create significant value. Further consolidation in the Nordic market (beer or soft drinks) and the market for international malt beverages are only some of the possibilities.
- Having strong local roots (in beer and soft drinks), is increasingly an important competitive advantage.
- Leveraging its market positions to sell other beverages or categories that go together (e.g. snacks). Diversifying its sales mix has been offsetting volume pressure.

Threats

Disruptions (legal or competitive) in its core Danish and Finnish markets

- We estimate that Royal Unibrew sells as much beer to the Danes through border trade as through Danish outlets. A change in excise duties could alter consumer behaviour significantly.
- Licences to produce, sell and distribute international brands tend to be limited in time (typically 5 to 10 years), although Royal Unibrew has been a successful Pepsi licence holder in Denmark for more than 40 years and in Finland since 1999. It has been importing Heineken in Denmark since 2001 and has held a licence since 2007.
- The company's profitability hinges on a couple of markets which have its challenges. The Danish and the Finnish markets are in structural decline and there is no reason to believe that the decline will stop. On the contrary, with the continued increase in excise duty on beer, the negative trend could potentially be accelerated. In addition to the negative volume trend, prices have also been under pressure in both markets, which makes competition hard.

3. Key investment considerations

3.1. Running a tight ship

Stable earnings outlook provides base for high free cash generation

Royal Unibrew's management team, new since 2008, has a proven track record of running the brewer efficiently. Management's strategy was to first build a cost-efficient, agile platform and from that, build a commercial agenda with the retailers with the aim to increase volumes (and hence operating leverage).

Improving efficiency of the organisation

Continuously looking to improve the cost base. When the new management team took control of Royal Unibrew, it was very quick to improve the efficiency and agility of the Danish organisation by concentrating production on two breweries (the site of the third one has been developed and sold), warehouse and logistics were improved (new distribution terminals and fewer distribution points). In Latvia and Lithuania, management structures were combined. In the subsequent years, this continued, although the focus has gradually shifted to a commercial agenda. And the same is happening in the Finnish business (acquired in 2013) with initially enhancing efficiency through a new organisation and distribution platform. And once that was in place, the company prepared for a more commercial agenda. The latest of which we have seen in Q1 2016 when it agreed to supply SOK, the largest Finnish retailer for a period of 6 months with Karjala at a heavily discounted price (aiming to improve relationships with this retailer and increase the trial for Finnish consumers).

Gaining share through customer focus

Working hard on the top line. As Royal Unibrew generates more than 75% of its revenue in mature Western European markets, overall revenue growth is slow, volumes tend to decline and price competition causes deflation. Within that framework, Royal Unibrew's management has been gaining share (in Denmark from 14% share in 2009 to 16% in 2015), albeit at a slow rate. We expect this to continue and the company to replicate this in Finland (first evidence seen in Q1 2016). Key to the increase in market shares is the strong relation that the company has with its on- and off-trade customers and that goes from having an efficient distribution model, to helping the retailers using beer to attract footfall (discounting), to bring innovations to keep its brands new and relevant for consumers (craft/speciality brews, functional beverages) and adding international brands (Heineken, Pepsi).

A full beverage company

Furthermore, we believe that management has also been particular successful in profiling the group as a full beverage company rather than regarding soft drinks as an add-on (other brewers have soft drinks but often they do not regard them as properly belonging to its core business, with the possible exception of AB InBev in Brazil).

Aiming to keep financial flexibility

A sound financial base allowing flexibility. Management has been striving to generate free cash flow which allows it to maintain an appropriate capital structure which would allow it to act on acquisition proposals and give it some leverage against its bankers without overcapitalising the company. It targets to have a net debt/EBITDA of a maximum 2.5x and an equity ratio of at least 30% - at the end of 2015 its net debt/EBITDA stood at 1.0x and its equity ratio at 46%.

Next to improving the profit margin, management has also worked hard to improve the capital that is tied up in the business. Not only has it been developing/selling the Aarhus brewery site in Denmark (cashing in close to DKK500m after tax) but it has also been selling some country operations. The Polish business was first merged with Van Pur (2010) and the 20% stake in the new group was subsequently sold (2012). The three breweries that the company owned in the Caribbean were sold

(2009). Furthermore, management has worked hard to reduce trade working capital from 10.4% of revenues in 2008 to -2.6% in 2015, freeing up nearly DKK800m. But also capital expenditure has been kept under control with the company spending less than 4% of revenues (and below depreciation levels).

With the acquisition of Hartwall in 2013, Royal Unibrew temporarily increased the debt level beyond the 2.5x ratio while putting its distribution of profits on hold. However, it resumed dividend payments (policy is 40-60% of net profit) and has started to execute a new DKK450m share buy-back programme covering the period to 28 February 2017.

3.2. Decent earnings upside, but definitely a slowdown

Despite the maturity of the markets in which it operates, Royal Unibrew has been increasing net profit by on average 21% over the past five years. But this growth has come from improving the efficiency in both Denmark and Finland. Now that both countries have already strongly improved, there is less upside left. Hence, we are expecting only an average 7% EPS growth for the next five years.

Its core Danish and Finnish markets are in structural decline, but we expect Royal Unibrew to continue to gain share

Indeed, two of its markets, Denmark and Finland, are each about a third of the company's operating profit and both are in structural decline and face price deflation (sometimes of Royal Unibrew's own making). But we expect that Royal Unibrew, in both of them, will be gaining market share, allowing for some stability of revenues and opportunities to enhance margin (improving mix). In Italy, its third most important market, Royal Unibrew owns a 10% value share in the super premium category with its Ceres Strong Ale and should be able to benefit once the country's economy picks up again (especially as there is still room for growing beer consumption per head). In the Baltic countries, per capita consumption is already 76 litres in Lithuania and 71 litres in Latvia which is in line with the European average of 70 litres and the 75 litres consumed in Denmark (including border trade). However, there is more upside in the soft drinks business (which includes not just carbonates but also packed water and juice) which stands at 99 litres per capita in Lithuania, 123 litres in Latvia and 130 litres in Finland compared to 210 litres in Denmark. The largest upside comes probably from the non-alcoholic malt beverages which are exported to the Caribbean, Africa and some major cities in Europe and US (mainly those with a large Caribbean population).

Next to the slower top-line growth, we believe there is also less opportunity for margin expansion. In 2010, the EBIT margin was 11% and this rose to 15.2% in 2015. For 2016, we expect the margin to come in at 15.6% as we assume a more normal summer after the bad summer in 2015 and over the medium term, i.e. in five years' time, we are expecting an EBIT margin of 17.2% even assuming that there is no economic rebound in Finland or the Baltics.

3.3. Participating in the industry consolidation

Further consolidation in the Nordics possible

The main attraction of Royal Unibrew's markets is their stability of revenues and free cash flows, which provides a good base for an acquisition-driven strategy. Indeed, this is something that Royal Unibrew's management recognises and it actively pursued the Hartwall acquisition in 2013. With the operational improvements and the (mainly) debt financing of the deal, the acquisition has been particularly value creative. Hartwall was bought for DKK2.8bn (EV of DKK3.3bn, EV/Revenues 2013 1.4x, EV/EBITDA 2013 8.8x, EV/EBIT 2013 15.9x). The leveraging/ deleveraging and efficiency improvements at Hartwall, nearly doubled Royal Unibrew's EPS to DKK12.9 in 2015 from

DKK6.9 in 2012. However, such a value creation is unlikely in the near term as there seems to be a scarcity of assets for sale within the company's remit of type (and price!). So there will most likely be add-on acquisitions which reinforce its existing market positions in smaller markets, e.g. Estonia in soft drinks/water. However, in the longer term, opportunities still exist including a further consolidation of the Nordic market. Currently, Royal Unibrew still holds 25% in Hansa Borg, Norway's second largest brewer. Other potential Nordic partners include Olvi (no. 3 in Finland and Lithuania and market leader in Latvia and Estonia, or Danish Harboes (no. 3 in Denmark and Estonia), but family owners seem, currently, unlikely sellers and the relatively small weight of these countries makes a merger of operations (e.g. Estonia) unlikely.

Royal Unibrew could attract interest from a bigger brewer

Options in Italy (e.g. the Peroni sale) are limited in view of the attraction of such assets (purchase multiples) and this seems also to be the case for malt beverages, which limits expansion outside its core Nordic market. Indeed, although the company has the ability to manage local small operations, management seems reluctant to venture away from the mainstream and its Nordic region, which might indicate that the ultimate goal is to be taken-out by a bigger international player. Indeed, this would allow for additional cost synergies and revenue synergies using the Royal Unibrew distribution platform. Furthermore, profits from selling an owned international brand (EBIT margins of 40%), should be well ahead of our estimates for the licenced-in brand margins (15%). We believe the business could fit well with MolsonCoors, AB InBev or Asahi. Until Heineken sold its Finnish business to Royal Unibrew, occasionally speculation would surface about the benefits for Heineken to acquire Royal Unibrew. But that speculation, and the speculation about any other candidate has died down since 2013, when Heineken sold its Finnish business to Royal Unibrew and Royal Unibrew managed to improved EBIT margins from an estimated 8.8% in 2013, under Heineken management, to 14.5% in 2015 (BG estimate), proving that sometimes bigger structures are not most optimal for small operations.

4. Valuation

4.1. Peer group comparison

Cheaper than the sector, although earnings growth in line

On 2017e numbers, Royal Unibrew trades at below the sector valuation (the 2016e figures are somewhat distorted for TAP and ABI). Its 2017e P/E of 18.8x compares with the sector at 20.4x and EPS growth of 7% is in line with the sector's. However, the company is far less geared than the other brewers. Its net debt/EBITDA ratio stands at 0.8x for 2016e compared to 2.4x for the sector. Furthermore, if we take into account the value of its stake in Hansa Borg, net debt/EBITDA falls to 0.3x. This indicates the significant value creation that the company could achieve if it were to find an attractive acquisition target or buy back up to 20% of its shares. In terms of EV/EBITDA, Royal Unibrew is at 11.8x whereas the sector trades at 12.4x 2017e numbers (for the sector valuations we have excluded SABMiller which is the subject of a takeover bid from AB InBev.)

Fig. 1: Ratio Valuation

	local c'cy	Share price	Market cap (EURbn)	P/E		EV/EBIT		EV/ EBITDA		FCF yield		Net debt/EBITDA		Net yield		5yr EPS CAGR	PEGD
				2016e	2017e	2016e	2017e	2016e	2017e	2016e	2017e	2016e	2017e	2015e	2016e		
AB InBev	EUR	111.2	170.5	27.4	22.1	21.0	18.6	17.2	15.6	3.2%	5.6%	2.8	3.8	2.3%	1.9%	7%	2.82
Carlsberg	DKK	635.5	11.4	20.7	19.3	18.7	16.5	11.4	10.5	3.0%	5.9%	2.4	1.9	1.2%	1.0%	10%	1.88
Heineken	EUR	82.6	40.7	20.5	18.6	16.7	15.1	12.6	11.3	4.2%	5.1%	2.2	1.8	1.6%	1.5%	9%	1.90
Molson Coors	USD	99.9	16.3	27.1	20.2	38.2	16.6	21.8	12.3	3.8%	5.8%	3.2	3.6	1.6%	1.8%	10%	2.28
SABMiller	GBp	4,228.5	84.6	29.0	26.4	25.0	22.7	19.3	17.7	3.1%	4.0%	2.0	1.6	2.0%	2.2%	7%	3.16
Royal Unibrew	DKK	290.8	2.1	20.0	18.8	16.3	15.4	12.4	11.8	6.1%	5.8%	0.9	0.9	2.0%	2.1%	7%	2.14

Source: Company Data; Bryan, Garnier & Co ests.

4.2. DCF-based fair value of DKK325

Our DCF-based fair value of DKK325 for Royal Unibrew is based on a consistent method to generate fair values using a standardised DCF model. Following this, our valuations are compared against a peer group in order to formulate our final investment view.

Our standardised DCF model incorporates the following:

- The WACCs are calculated using a levered beta which allows us to adjust for the companies' different financial structures. We use as an unlevered beta 0.85 (Bloomberg beta shows 0.7 for 2-, 3- and 5-year history), which we believe is particularly justified given the companies low gearing and high free cash flow.
- The WACCs are calculated using cost of debt forecasts which account for the differing tax rates and interest charges of the companies under our coverage.
- The long-term growth rates for the companies reflect their geographic spread and potential growth of their markets.
- The cost of equity is based on a BG standardised 1.6% risk free rate and 7% equity risk premium.

For Royal Unibrew, given its low financial gearing, the WACC of 7.4% which we compute is very close to the required return on equity of 8.1%.

Fig. 2: DCF-based fair value of DKK325

EUR m	Dec-15e	Dec-16e	Dec-17e	Dec-18e	Dec-19e	Dec-20e	Dec-21e	Dec-22e	Dec-23e	Dec-24e	Dec-25e
Sales growth	0%	5%	0%	2%	2%	2%	2%	3%	3%	3%	3%
EBIT margin	15.2%	15.6%	15.9%	16.3%	16.6%	16.9%	17.2%	17.5%	17.8%	18.1%	18.4%
Tax rate	-21.2%	-21.2%	-21.2%	-21.2%	-21.2%	-21.2%	-21.2%	-21.2%	-21.2%	-21.2%	-21.2%
Depreciations	5.1%	4.9%	4.9%	4.9%	4.9%	4.9%	4.9%	4.9%	4.9%	4.9%	
Investments	-2.6%	-0.7%	-0.7%	-0.7%	-0.7%	-0.7%	-0.7%	-0.7%	-0.7%	-0.7%	
WACC		7.4%	7.4%	7.4%	7.4%	7.3%	7.3%	7.3%	7.3%	7.3%	7.3%
Working capital	2.8%	-1.5%	0.0%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%
Sales	6,032	6,328	6,341	6,455	6,574	6,699	6,829	7,000	7,175	7,354	7,538
EBIT	917	984	1010	1050	1091	1134	1175	1225	1278	1332	1388
Taxes	-194	-208	-214	-222	-231	-240	-249	-259	-270	-282	-294
Operating profit after taxes	723	776	796	828	860	894	926	966	1,007	1,050	1,094
+ Depreciations	310	310	311	317	322	329	335	343	352	361	0
-Investments in fixed assets	-155	-45	-46	-46	-47	-48	-49	-50	-52	-53	0
Total net investments in fixed assets	156	265	265	270	275	280	286	293	300	308	0
-Investments in working capital	169	-97	2	16	17	18	19	21	22	22	23
=Operating cash flow	1,047	944	1,064	1,114	1,152	1,192	1,231	1,280	1,329	1,380	1,117
Discount factor		0.98	0.91	0.85	0.79	0.74	0.69	0.64	0.60	0.56	0.52
Present value of free cash flow		928	973	949	914	881	848	821	795	769	579
Cumulative present value of free cash flow		8,457									
+Present value of terminal value		9,737					LT Growth	2.5%			
=Enterprise value		18,194					LT WACC	8.6%			
Adjusted net debt (restated cash)		-1,184					Beta	0.85			
Other liabilities and commitments		-390									
(Revalued minority interests)											
Assoc. + revalued investments		680									
=Excess Stock											
=Theoretical market cap		17,300									
Theoretical share price fully diluted		325									

Source: Company Data; Bryan, Garnier & Co ests.

4.3. Further upside to fair value

Buying back shares would increase the fair value to DKK380 per share

But there is more upside for investors if the company were to maximise its leverage. Even assuming no additional acquisition and operational efficiencies, buying back shares would create significant additional upside. Indeed, one way to look at how the company can maximise value for shareholders is assuming that it buys back an additional 10% of its shares (to bring net debt/EBITDA to an industry standard of 2.5x), which would increase the fair value per share to DKK340 (even assuming a beta of 1). Buying back 20% of the shares and allowing net debt/EBITDA over 3.0x for 12 months would increase the fair value per share to DKK380 (with a beta of 1).

Take out value of DKK500

However, because of the particular interesting position that the company holds in the Nordics, we believe that a bigger international brewer might be interest in Royal Unibrew as a fill-in for its Nordic distribution channel and access to its international non-alcoholic beverages. An interest would generate efficiency improvements of between 10% and 20% of revenues (international benchmarking) which, assuming that half of this is paid to the Royal Unibrew shareholders, equate to an additional DKK100 (5%) to DKK200 (10%) per share. As a result, we calculate a potential take out price of DKK500 per share.

5. Business and Strategy

A leading Northern European beverages group (beer, soft drinks, cider, water, juice)

Royal Unibrew, with its headquarters in Faxe, Denmark, is a leading regional Northern European beverage company (Denmark, Finland and the Baltics) with an additional presence in the premium beer segment in Italy and in the international malt beverage market. The company produces, markets, sells and distribute beer and cider (43% of 2015 sales volumes), soft drinks (44%), malt beverages (7%) and long drinks (6%). Furthermore, Royal Unibrew has a 25% stake in Hansa Borg, the Norwegian number 2 with a 20% share of the market and a 32% stake in Nuuk Imeq in Greenland.

Owned by financial investors

Since, 2009, the company's main shareholder is the Danish Chr. Augustinus Fabrikker (which also holds 51% of Scandinavian Tobacco Group) that holds 10.4% and, since 2013, Hartwall Capital that holds 7.1% (the Hartwall family previously owned Hartwall Brewery before it was sold in 2002 to Scottish & Newcastle). Other shareholders are Danish and international institutional investors. There is only one class of voting shares.

5.1. Portfolio and positioning

5.1.1. A portfolio of assets around the Baltic Sea complemented by a profitable export business

No. 2 in Denmark and Finland

A leading beverages group in the Baltics

Export of non-alcoholic beverages and Faxe beer

Royal Unibrew's main markets are Denmark, Finland, Italy and Germany as well as Latvia, Lithuania and Estonia. In Denmark, it is the second largest provider of beer and soft drinks and distributes additionally international spirits and wine brands. Its German business is mainly supplying retailers on the German/Danish border with beer (Royal, Ceres, Thor, Albani, Slot) and soft drinks (not Pepsi). Faxe beer is exported for the German market. In Finland, the company is not only the second largest brewer and soft drinks provider, but also sells cider and long drinks. In the Baltic countries, the company is among the leading providers of beer and soft drinks holding considerable market positions (leader in soft drinks in Latvia and second largest brewer in Lithuania). In Italy, Royal Unibrew is among the market leaders in the super premium segment for beer with Ceres Strong Ale. Furthermore, the company is active in the international markets (mainly for premium dark malt beverages exported from Denmark) made up of established markets in the Caribbean and major cities in Europe (London, Amsterdam, Paris) and North America (New York, Miami, Atlanta) as well as emerging markets in Africa.

Breakdown of Royal Unibrew volumes 2015 (m hl)

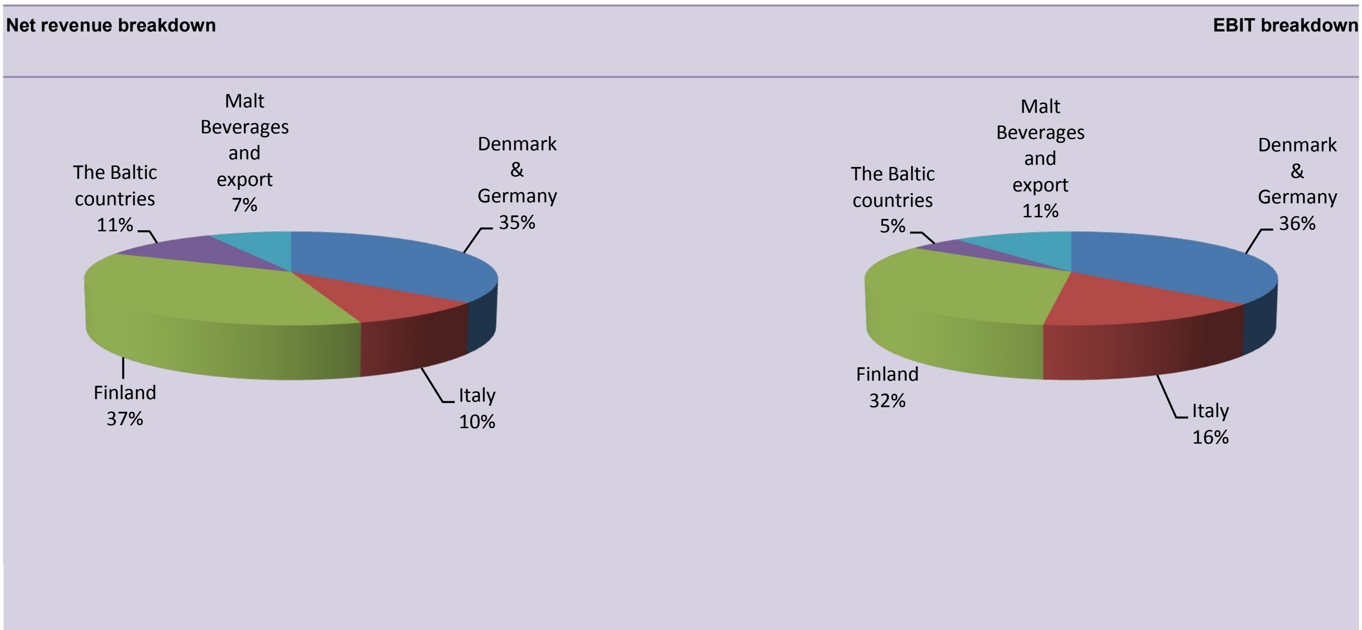
m hl	Beer	Cider	Soft drinks	Malt beverages	Wine & spirits	Group
Denmark	0.7		1.2			1.9
Germany border trade	0.7		0.5			1.2
Germany export	0.2					0.2
Finland	0.9	0.1	1.4		0.5	2.9
Italy	0.4					0.4
Latvia	0.4		0.6			0.9
Lithuania	0.6	0.1	0.3			0.9
Estonia	0.0					0.0
International markets	0.3			0.4		0.7
Group	4.1	0.2	3.9	0.4	0.5	9.1

Source: Canadean; Bryan, Garnier & Co ests.

Denmark and Finland are each roughly 1/3rd of revenues and profits

We estimate that the Danish/German business and the Finnish business are roughly the same size, each accounting for just over 1/3rd of net revenues and EBIT. However, the most profitable areas in terms of margin seem to be the Italian export business (estimated 26% EBIT margin) and the export business (estimated 23% EBIT margin), compared to an estimated 14% EBIT margin in Finland and 16% in Denmark/Germany. The Baltic countries are the least profitable with an estimated 7% EBIT margin.

Fig. 3: Revenue and EBIT by division, 2015



Source: Company Data; Bryan, Garnier & Co ests.

5.1.2. Local brands supplemented with licensed based international Heineken and Pepsi brands

The biggest brand is Pepsi, followed by Karjala and Faxe

Royal Unibrew has very much a portfolio of local beer and soft drink brands which is complemented through strategic bottling agreements with Heineken and PepsiCo. Pepsi is the company's largest brand accounting for 1.13m hl (12% of group volumes) but the Heineken brand (0.13m hl does not make the top 10 brands). Mainstream Finnish beer brand, Karjala, is the second largest brand in the company followed by Faxe (super premium beer export), Ceres Strong Ale (super premium beer in Italy) and Royal (Premium beer in Denmark).

Fig. 4: Table of the top 10 largest brands by sales volume, 2015

Brand	m hl	Area
Pepsi	1.13	Soft drink mainly in Denmark and Finland
Karjala	0.51	Mainstream beer Finland
Faxe	0.40	Super premium beer export
Ceres	0.38	Super premium beer Italy
Royal	0.36	Premium beer Denmark
Kondi	0.35	Soft drink Denmark
Hartwall Jaffa	0.32	Soft drink Finland
Lapin Kulta	0.31	Mainstream beer Finland
Hartwall Novelle	0.27	Water Finland
Mangali	0.26	Water Latvia

Source: Canadean, BG estimates

A lot of local brands

In Denmark, Royal Beer and the Heineken brand are the company's national brands, whereas other brands, such as Albani, Ceres and Thor, are sold locally. Within soft drinks, Royal Unibrew offers its own brands including Faxe Kondi (carbonates and energy drinks) and Egekilde (water), as well as licence-based brands of the PepsiCo Group (Pepsi, Pepsi Max, 7UP and Mirinda). As of 2016, the beverage range is supplemented by the PepsiCo Lay's and Bugles snack products, which should add about 2% to the Western European division's revenues.

The brand structure in Finland is very similar to the Danish one with Royal Unibrew offering local, national and international brands as well as a number of international wine (e.g. Lanson) and spirits brands (spirits mainly from the Diageo range). The range of brands for the Finnish market include own brands such as the Karjala and Lapin Kulta beer brands, Jaffa (soft drinks), Original (RTD), Upcider (cider), ED (energy drink) and Novelle (mineral water) as well as international brands such as Fosters, Heineken and Pepsi.

Royal Unibrew is also an important beverage provider in the Baltic countries offering a combination of own strong national brands as well as the international Heineken brands and, as of 2016, also a number of PepsiCo soft drinks brands. Royal Unibrew's brewery business, Kalnapilio-Tauro Grupe, is the second largest in Lithuania with the national beer brands Kalnapilis and Taurus, as well as Faxe and Heineken as international brands. Cido is the number two fruit juice brand. Royal Unibrew's Cido Grupa in Latvia is the leading provider of fruit juices (Cido), nectar drinks (Fruts) and mineral water (Mangali). With the national beer brands Lacplesa Alus and Livu Alus as well as Heineken as an international brand, Cido Grupa holds a number three position within beer. The primary brands in Estonia are Cido in the soft drinks category and Meistriti Gildi, Faxe and Heineken in the beer category, but all those brands are relatively small.

Ceres Strong Ale is exported from Denmark to Italy and is there amongst the market leaders in the super premium beer segment (BG estimates a 10% value share). About 70% of Ceres Strong Ale is consumed away from home, whereas the rest is consumed at home. Following on from a 50-year history of penetrating the market (originally it was a product used to fill the trucks transporting canned ham), Ceres Strong Ale is well distributed in the on-trade channel. However, Faxe is Royal Unibrew's strategic export brand mainly exported to Germany, the Baltics, and Italy but also to the regions where it sells malt beverages.

With a similar type of history of gradually penetrating markets is the malt beverages business, which grew alongside the Danish government's aid to developing countries (and part of this was giving money to buy the very nutritious malt beverages). The Malt Beverages and Exports business is an export and licence business, mainly relating to non-alcoholic malt beverages but also to beer exports under the Faxe brand. Royal Unibrew has several internationally strong dark malt beverage brands which are sold in the premium segment. Vitamalt is probably Royal Unibrew's malt beverage with the broadest global distribution, whereas Supermalt and Powermalt hold strong regional positions. The key market areas for Royal Unibrew's malt beverages are countries in the Americas and Africa, as well as among ethnic groups from these areas living in and around major cities in Europe and the USA. The malt beverages and exports markets are primarily supplied by exports from Royal Unibrew's Danish breweries, but in certain cases are produced locally by licence holders.

In itself with its many small local beers, Royal Unibrew should be well positioned to benefit from the consumer trend that calls for greater originality and locally-produced products. Unlike most of its bigger competitors, Royal Unibrew is not shying away from developing its own craft beers. In

Denmark it has launched Schiøtz and Lottrup, In Finland, it developed the Hartwall 1836 Classic range and, in Lithuania, it launched the Vilkmerges craft beer brand and Liekvardes in Latvia. But all this remains still a very small business, which we estimate to be around 60,000hl.

Craft beers in early development stage

Fig. 5: Craft beers developed by Royal Unibrew

Schiøtz in Denmark

Lottrup in Denmark

Hartwall 1836 Classic in Finland

Vilkmerges in Lithuania

Source: Company; Bryan, Garnier & Co ests.

5.2. Strategy

It is Royal Unibrew's strategy to be a focused, regional beverage provider within beer, malt beverages and soft drinks – and to achieve leading positions in the markets or the segments in which it operates. The main elements of its strategy are:

- Running operations from a local platform and developing leading positions;
- Keeping the brands and company relevant through innovation and development;
- Improving operational efficiency;
- Keeping financial flexibility in order to take advantage of external growth opportunities.

5.2.1. Leading (number 2) positions

A focused strong regional beverages group

The first element from the company's strategy is to be a focused, strong regional beverage company, aiming to hold leading positions in beer, malt and soft drinks, including soda water, mineral water and fruit juices as well as cider and long drinks (RTD).

In Denmark and Finland, the second largest beverages group behind Carlsberg

As such, Royal Unibrew is the second largest beverages company (beer and soft drinks) in Denmark and Finland. In Denmark it has two production facilities – one in Faxe and one in Odense. Both off-trade and on-trade customers are serviced through direct distribution from its own terminals. In Finland, Hartwall operates two production facilities in Lahti (produces all products but not mineral water) and Karijoki (mineral water), respectively. A distribution network of own terminals supplies off-trade and on-trade customers directly.

Top 3 in the Baltics for beer and soft drinks

In Lithuania, it is the second largest brewer and has a number 3 position in soft drinks. In Latvia, it holds a number three position within beer and is the largest soft drinks company. In Estonia, its presence is still fairly limited but it is allowed to sell the Heineken brand (as in the other Baltic countries, Denmark and Finland). And, with the agreement to distribute PepsiCo soft drinks products in Latvia, Lithuania and Estonia (from 1 January 2016), the company is getting a footprint through which it can better promote its Cido soft drinks and Meistriti Gildi, Faxe and Heineken beers. Royal Unibrew has three production facilities in the Baltic countries – one in Lithuania producing beer, and two in Latvia producing beer and soft drinks, respectively. Sales are made business-to-business, and distribution is made directly to the individual off-trade and on-trade customers from its own terminals.

A 10% value share in Italian super premium

In Italy, the company has built a leading position (10% value share) in the super premium beer segment with Ceres Strong Ale. It distributes the brand mainly through wholesalers which serve the on-trade channel.

Export of malt beverages and Faxe beer

Furthermore, the company has an interesting position in the premium segment for dark malt beverages. The key market areas for Royal Unibrew's malt beverages are the Caribbean and Africa (West Africa) as well as among ethnic groups from these areas living in and around major cities in Europe (mainly London, Amsterdam and Paris) and the USA (incl. New York, Buffalo, Miami). The malt beverages and exports markets are primarily supplied by exports from Royal Unibrew's Danish breweries, but also in certain cases on the basis of licence agreements with local breweries.

Fig. 6: Market positions Royal Unibrew

Beer							
	m hl	No 1		No 2		No 3	
Denmark	3.5	Carlsberg	54%	Royal Unibrew	19%	Harboes	9%
Finland	4.3	Carlsberg - Sinebrychoff	46%	Royal Unibrew - Hartwall	21%	Olvi	21%
Lithuania	2.8	Svyturys-Utenos Alus	51%	Kalnapilio-Tauro Group	20%	Volfas Engelman	16%
Latvia	1.6	Cesu Alus	33%	Aldaris	26%	Royal Unibrew Latvia	24%
Estonia	1.2	A Le Coq	49%	Saku	37%	Viru Olu	6%
Norway	2.6	Ringnes	58%	Hansa Borg	25%	Aass Bryggeri	6%
Sweden	4.7	Carlsberg	33%	Spendrups	30%	Abro Bryggeri	9%
Italy	16.8	Heineken	31%	Peroni	20%	Carlsberg	7%
Germany	84.4	Radeberger	14%	AB InBev	9%	Bitburger	8%
Soft drinks							
	m hl	No 1		No 2		No 3	
Denmark	10.9	Carlsberg	36%	Royal Unibrew	11%	Kavli	9%
Finland	6.9	Eckes-Granini	24%	Carlsberg - Sinebrychoff	21%	Royal Unibrew - Hartwall	20%
Lithuania	3.4	CCHBC	16%	Druskininku Rasa	6%	Royal Unibrew - Svyturys-Utenos Alus	6%
Latvia	2.7	Royal Unibrew - Cido	30%	CCHBC	19%	Gutta	9%
Estonia	1.7	A Le Coq	25%	CCHBC	20%	Värska Vesi	14%

Source: Canadean, Bryan, Garnier & Co ests.

5.2.2. Innovation & development

Royal Unibrew's portfolio is built on local brands and continues to develop. This development can take the form of new tastes and varieties of existing brands. For example, in 2015, Royal Unibrew strengthened its position in Denmark with the launch of the organic beer Royal Økologisk (Royal Organic) and craft beers Schiøtz and Lottrup.

Another way of developing the portfolio is to include in the portfolio international brands. As such, Royal Unibrew has long standing cooperation agreements with Heineken and PepsiCo. And, as of 2016, the PepsiCo beverages distribution agreement expanded to the Baltic countries. In Denmark, the company is taking over the sale of PepsiCo's snack products under brands such as Lay's and Bugles in Denmark.

5.2.3. Operational efficiency improvements

New management team arrived in 2008 and started a big clean up

After years of international expansion on the back of cheap credit, Royal Unibrew ran into disappointing results with the financial crisis in 2008. By the end of that year, a new CEO Henrik Brandt had arrived and the "doubling up" strategy was scraped. Restructurings started already in 2008. It included not only the disposal on non-profitable activities like the Polish business, but also a complete change of the organisations in Denmark, Lithuania and Latvia. In Denmark, the production in Aarhus was moved to Faxe and Odense (the Aarhus site was developed and sold) and distribution was insourced. In the Baltic countries, the operations in Lithuania and Latvia were merged into one structure, except for the sales organisation. Reflecting all the changes was the decline in the number of employees from 2,755 in 2008 to 1,635 in 2012 and the EBIT margin went from 3.2% in 2008 to 14.1% in 2012.

Improving the profitability of Hartwall after its 2013 acquisition

With the acquisition of Hartwall (from Heineken), the margin was diluted as Hartwall was running at an EBIT margin of 8.8%. Royal Unibrew's full management team relocated to Finland for the first couple of years to steer the efficiency drive and indeed significant improvements were achieved (mainly in supply). Over a period of two years, production per employee increased by 14%, extract losses decreased by over 50%, syrup loss declined by 30%, the distribution utilisation rate increased by 9% and electricity consumption per hl went down by 3%. The group's EBIT margin increased from 12.5% in 2013 to 15.2% in 2015.

With this margin, the company has reached its target of 15% and reckons that, after years of significant improvements, the efficiency-enhancing opportunities are now limited. Nevertheless, improvements continue with a planned change in Finland to a common SAP platform during Q1 2016. And also strengthening the relationships with its clients will improve the margin further. Outside Finland, the integration of the PepsiCo beverages portfolio in the Baltic countries should also improve the efficiency of the organisation (operating leverage).

5.2.4. M&A the answer to limited internal growth opportunities

Acquisitions are an important part of the strategy

Overall, Royal Unibrew's markets are not particularly attractive in terms of growth profile or margin upside. However, acquisitions are an important part of the company's strategy. Its acquisition in 2013 of Hartwall (Finland) from Heineken has been particularly value creative. Hartwall was bought for DKK2.8bn (EV of DKK3.3bn, EV/Revenues 2013 1.4x, EV/EBITDA 2013 8.8x, EV/EBIT 2013 15.9x) which was partially financed (DKK 0.56bn) with new shares and the remainder with debt. The leveraging/deleveraging and efficiency improvements at Hartwall, nearly doubled Royal Unibrew's EPS to DKK12.9 in 2015 from DKK6.9 in 2012.

Consolidating the Nordic market

However, in the near term, we don't see anything similar and look more for smaller external growth opportunities which reinforce its existing market positions in smaller markets, e.g. Estonia in soft drinks/water. In the longer term, opportunities still exist including a further consolidation of the Nordic market. Currently, Royal Unibrew still holds 25% in Hansa Borg, Norway's second largest brewer. However, the Swedish no. 2 Spendrup, which had a 15% share in Hansa Borg, sold it, pouring cold water on an imminent further consolidation in the Nordic market. Other potential Nordic partners include Olvi (no. 3 in Finland and Lithuania and the market leader in Latvia and Estonia, or Danish Harboes (no. 3 in Denmark and Estonia), but family owners seem, currently, unlikely sellers and the relatively small weight of these countries makes a merger of operations (e.g. Estonia) unlikely.

Options in Italy (e.g. the Peroni sale) are limited in view of the attraction of such assets (purchase multiples) and this seems also to be the case for malt beverages which limits expansion outside its core Nordic market. Indeed, although the company seems to have the ability to manage local small operations, management seems reluctant to venture away from the mainstream and its Nordic region, which might indicate that the ultimate goal is to be taken-out by a bigger international player.

5.3. Financial targets and capital structure

Target EBIT margin of 15% is not very challenging

The company is targeting an EBIT margin of 15% (despite already achieving 15.2% in 2015) which, according to its management, reflects challenging European markets, expected lower growth in the malt business than in previous years, smaller efficiency gains than achieved in recent years as well as increased investments in market positions and brands. Our take on this is that management does not want to put too much external pressure on itself and we guess that an 18% EBIT margin is probably feasible (in our model we use 17%) depending on the macro-economic recovery in the Baltic countries and opportunities to gear up that business. Indeed, in the Danish, Italian, Finish and export business, the company is already reaching an 18% margin.

Net debt/EBITDA below 2.5x

In terms of leverage, Royal Unibrew wants to keep net debt/EBITDA below 2.5x and keep an equity ratio of at least 30%. However, at the end of 2015 its net debt/EBITDA was at 1.0x which seems to be a level that the company is trying to keep (hence a share buy-back) as it would allow it to act on business opportunities and maintain independence in relation to its bankers, and, on the other hand, ensures that Royal Unibrew is not heavily overcapitalised. With the acquisition of Hartwall, Royal Unibrew temporary increased the debt level beyond the 2.5x ratio while putting its distribution of profits on hold. However, it resumed dividend payments (policy is 40-60% of net profit) and has started to execute a new DKK450m share buy-back programme covering the period to 28 February 2017.

Part of the target of keeping financial flexibility also focuses on generating enough cash and we estimate the company will continue to generate free cash flow around 90% of EBIT or about 14% of revenues (it was exceptional 17.1% in 2015).

Working capital: Since 2008, management has been working on reducing working capital and we calculate that trade working capital as a percentage of revenues fell from 10.4% in 2008 to -2.6% in 2015, releasing nearly DKK800m. One of the areas which contributed was the lowering of inventories in Denmark following the logistics restructuring in 2008 (insourcing distribution and customer service), but also trading terms improved. On the other hand, the company has been paying its supplies later (from 40 to 60 days). However, the company has indicated that working capital is unlikely to improve further and actually, in 2016, it is expecting to reduce current liabilities by DKK160m compared to the end of 2015 due to the expected termination of an extraordinary campaign in Finland.

Limited capex programme: We estimate that total production capacity at year end 2015 was about 15m hl compared to a production of 9.1m hl, which puts the estimate 12-month capacity utilisation at 60%. Although there is some seasonality of the business, it does imply that there is some opportunity to reduce capex. Indeed, we estimate the brewer's ongoing maintenance capex at 3% of net revenues, i.e. DKK180m. Given the company's capex level has been between 3% and 4% over the past years, we expect the company has been expanding in some areas where there is some constraint or new product developments (i.e. craft brewing, malt products). Nevertheless, given the limited growth in the markets in which it is active, we expect capex to remain in that range. For 2016, the company has been guiding towards DKK230-250m (i.e. 3.7% to 4.0% of revenues).

Non-core assets: In addition to the positive cash flow from the underlying business, the gradual sale of the brewery site in Aarhus also contributed considerably to Royal Unibrew's total cash flow. In 2015, the last part of the site was sold and a cash flow after tax of around DKK195m from that sale is still expected for 2016. Over time other disposals are possible. Indeed Royal Unibrew still holds a 25% minority interest in Hansa Borg in Norway and a 32% stake in Nuuk Imeq in Greenland. However, both positions do make sense. Nuuk Imeq distributes Royal Unibrew products, and with the Hansa Borg stake, the company has an attractive starting position in case of further consolidation of the Nordic markets. In the meantime, the Hansa Borg stake generated in 2015 a handsome after tax income of DKK31m.

6. Results and profit forecasts

In 2015, poor consumer confidence affected beer and soft drinks consumption in Royal Unibrew's markets in Italy, in the Baltic countries and in Finland. Furthermore, the poor summer weather reduced consumption in Northern Europe, whereas the extraordinarily fine summer weather in Italy resulted in unchanged consumption as compared to 2014 (balancing the impact from negative consumer sentiment). Sales volumes for 2015 aggregated 9.1m hectolitres of beer, malt beverages and soft drinks, which was 1% above the 2014 figure. Net revenue for 2015 was at the 2014 level and amounted to DKK6,032m compared to DKK6,056m in 2014. Average net selling prices per hectolitre were 1.8% lower than in 2014, primarily due to a changed segment mix and more aggressive pricing in Finland. EBIT for 2015 amounted to DKK917m, which was, on a comparable basis, DKK41m above the 2014 figure of DKK876m (before deducting restructuring costs of DKK50m in 2014). The EBIT margin for 2015 was 15.2% and higher than in 2014 when it was 14.5% (13.6% after deducting 0.9 percentage point related to restructuring costs). The EBIT margin for 2015 was higher in both the Baltic Sea (changed mix) and the Malt Beverages and Exports segments, whereas it remained unchanged in the Western Europe segment compared to 2014.

Our estimate of a DKK984m EBIT in 2016 is at the high end of guidance and well above consensus and assumes a normal Nordic summer

Generally, Royal Unibrew is exposed to mature beer markets with declining volume trends. Over the medium term, only the beer export business to Italy, the soft drinks business in the Baltics and the malt export business are expected to show volume growth. However, in 2016, normal summer weather in Denmark, Germany and Finland should more than counter the structural decline in consumption in the Nordics. Furthermore, beverage consumption in the Baltics should remain stable and the consumption of malt beverages in Africa is expected to increase. There should be a positive impact of about 2% on revenues from the additional PepsiCo contracts in Denmark (Lay's and Bugles) and in the Baltics (PepsiCo beverages). On top of this, Royal Unibrew's aggressive campaign in Finland (mainly with one retailer) should result in significant volume growth, although not much revenue or operating profit growth. We forecast for 2016, net revenue growth of 4.9% to DKK6,328 (guidance is for net revenues of DKK6,150m to DKK6,400m). Although there seems to be limited restructuring potential left and we expect little additional gearing from the new PepsiCo contracts (mainly investing to gain traction vs Coca Cola), the better (normal) weather in Denmark and Finland should improve the EBIT margin to 15.6% from the 15.2% in 2015. As a result, we are forecasting EBIT to grow by 7.4% to DKK984m (which is at the high end of the EBIT guidance of DKK885m to DKK985m).

As we expect net financial costs to be slightly lower (we assume only slightly lower net debt because most cash flows are distributed to shareholders through the dividend or share buy-backs), annual growth in net profit of 9.4% is roughly in line with the EBIT growth. Including the positive effect from a lower number of shares from the share buy-back programme, we project for 2016 EPS 12.6% higher than in 2015. For 2017, we expect somewhat slower growth in operating and net profit due to the absence of the boost of normal weather in 2015 (as compared to a very bad Danish and Finnish summer in 2014). We expect EBIT growth in 2017 of 2.6% and EPS growth of 6.1%.

Expecting an EBIT margin of 17.2% by 2021.

For the medium term, the company has given an EBIT margin guidance of 15% (up from a previous target of 14% and in line with the 2015 15.2%), but we expect the company to get to 17.2% in 2021 (even assuming no significant improvement in the Finnish and Baltics economies)

Fig. 7: Summary of financial results and forecasts

EUR m	2015	2016e	2017e	CAGR 16/21
Western Europe				
Net revenue (45% of group)	2,728	2,904	2,962	1%
Operating profit (52% of group)	493	540	559	3%
Operating margin (%)	18.1%	18.6%	18.9%	
	Danish consumption of beer and soft drinks was down for 2015 and, in Italy, the extraordinarily fine summer weather compensated for the subdued macro-economics. Against this background, Royal Unibrew's 1% volume and 2% revenue growth reflects well on the commercial initiatives that the company has been undertaking. Margin was flat.	The company is up to tough comps on weather in Italy but easy weather comps for Denmark and Germany, and also the European Football Championship should give some support for top line. Furthermore, the company has started selling the PepsiCo Lay's and Bugles snack products. However, these products are not likely to contribute meaningfully to the operating profit.	The Danish consumer market is expected to structurally decline in the coming years, but the Italian beer market should show a slight structural increase, given the low per capita consumption. However, in both markets, Royal Unibrew is a small player and should be able to pick up share assuming it remains true to its principles of being close to the consumer. Opportunities are in craft and non-alcoholic beers, premium beers (Heineken) and new sub-categories in soft drinks and water (e.g. health trends).	
Baltic Sea				
Net revenue (47% of group)	2,852	2,941	2,852	1%
Operating profit (37% of group)	355	377	377	3%
Operating margin (%)	12.4%	12.8%	13.2%	
	In the Baltic countries, declining prices (in Lithuania due to off-trade price competition and in Latvia because of a large increase in beer taxes in Q3) (4%) affected revenues and profit margins (although volumes were up 2%). Moreover, in Finland, consumption continued to decline due to consumer restraint and poor summer weather. However, the full year effect of the restructuring and efficiency improvement improved earnings despite the price pressures and changed product and channel mix. The EBIT margin for the division went up by 2.5 percentage points from 9.9% to 12.5%.	Underlying conditions remain challenging given the economic link between Finland and Russia. However, assuming normal weather conditions in Finland and the uplift from adding PepsiCo products in the Baltic countries, this should allow for top line and margin expansion. We calculate in the Baltic countries alone, the additional revenue at 8%. We also assume that the aggressive campaign in Finland with one of the retailers is more about having consumers taste the product rather than making a profit. As a result, we are expecting operating profit margin growth to be restricted at 0.4% (big positive impact from normal weather).	With beer consumption in the Baltics at the European level, there is little expectation for further growth in the category, which leaves premiumisation as the only route to deliver organic growth (but then the macro-economic conditions need improving). However, there seems more upside in the non-alcoholic soft drinks and water segment, where levels of consumptions are not yet at Western European levels. We assume some negative top-line impact of stopping the 2016 Finnish campaign but with profits on this contract close to zero, the impact on operating profit is limited.	

Malt beverages				
Net revenue (7% of group)	452	484	527	9%
Operating profit (11% of group)	102	102	108	8%
Operating margin (%)	22.6%	21.1%	20.6%	
	2015 volumes grew by 7% and net revenues by 11% (of which 5% from USD and GBP strength). The lower net revenue per volume unit is primarily due to a changed market mix. Organic EBIT margin for 2015 was 19.8% (compared to 22.6% reported), which was lower than the 20.6% in 2014 due to higher investments made in marketing and penetration of markets with a lower selling price.	Organic top-line growth is expected to remain strong despite more difficult conditions in some emerging markets, but some of the currency gains from 2015 are reversing (e.g. GBP/USD) and this slows down top-line growth and also impacts profit margins.	There is still plenty of scope for malt beverages to gain traction in the global markets. And as the market for dark malt beverages is still geographically fragmented, it might be an area where Royal Unibrew could leverage its brands.	
Holding costs				
Operating profit	-34	-34	-35	na
Group				
Net revenue	6,032	6,328	6,341	2%
Revenue growth (%)	-0.4%	4.9%	0.2%	
Organic revenue growth (%)	-0.6%	3.4%	0.3%	
		Guidance is for net revenues of DKK6,150m to DKK6,400m		
Adjusted operating profit	917	984	1,010	4%
Operating profit growth (%)	4.6%	7.4%	2.6%	
Organic operating profit growth (%)	4.0%	7.6%	2.6%	
Operating margin (%)	15.2%	15.6%	15.9%	
		Guidance is for EBIT of DKK885m to DKK985m		
Exceptional items				
Financial expenses	(46)	(38)	(38)	
	Average interest rate of 2.6%.	With dividend and share buy-backs, the company is targeting to keep net debt/EBITDA at 1.0x, which is the level of 2015. For 2016, we expect net debt/EBITDA of 0.9x		
Tax	(191)	(200)	(206)	
		Tax rate assumed to remain at 21.2% (guidance is for 20-21%)		
Affiliates - net profit	31	32	33	3%
		Steady increase in profits from Hansa Borg		
Net profit	711	778	799	
Adjusted net profit	711	778	799	4%
Adj. diluted EPS (EUR)	12.93	14.55	15.44	7%
Growth (%)	8.5%	12.5%	6.1%	

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Stock rating

BUY 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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