

22nd August 2016

Food & Beverages

Carlsberg

Price DKK628.50

No Pernille

Fair Value DKK600 (-5%)

SELL

We are updating our estimates for the next three years and are mainly lowering our 2016 figure given higher than expected marketing costs for the Euro football championship.

Last week, Carlsberg published slightly disappointing results disconnected from the recent share price increase, therefore prompting us to downgrade the stock to Sell (from Neutral). Today we are fine-tuning our model to take into account these recent results and trends. We are lowering our operating profit forecast for this year by 2%, mainly because of higher marketing costs linked to the Euro football championship. However for 2017 and 2018, our forecasts remain unchanged.

ANALYSIS

- Margins are down, not up.** While the company had been showing off with significant margin expansion in each of the regions (Western Europe +70bp, Eastern Europe +100bp, Asia +60bp), the reality is slightly different. Marketing costs for the Euro football championship and costs for the strategic development and efficiency programmes are accounted for under non-allocated central costs (whereas their benefits are booked under regional profits). Overall group operating margin declined by 10bp to 11.0% from 11.1%.
- Savings? What savings?** As the company is embarking on its efficiency improvement programme with a total budgeted DKK1.5 to DKK2.0bn efficiency improvements by 2018, a quarter of these improvements should be generated in 2016 and would be mainly savings (as opposed to investments), but with first half operating margin narrowing by 10bp and also by 10bp for the full year on our estimates, the savings are nowhere in sight. This is no genuine surprise. Indeed, we note that brewers (not just Carlsberg) need to save about 50-80bp of revenues p.a. to fund normal sales efforts (price or marketing). However, next year, we are looking for the company to step up its efficiency improvements to 160bp of revenue (vs 80bp this year) and would expect some of that to be visible in profit growth (assuming no currency drag).
- Russian pain not over.** From 1st July, urban retailers need to connect to UFAIS (Unified Federal Automated Information System) and Carlsberg assumes that some of these retailers will not want to make the investment (on 1st July 2017, retailers in rural areas will also need to connect) and that volumes might be impacted. Moreover, as of 1st January 2017, brewers will no longer sell beer in PET bottles of more than 1.5l (around a quarter of total beer consumption) and this is expected to impact beer volumes by about 10%. Since brewers (and also Carlsberg) are likely to stop producing these bottles in Q4, Carlsberg is expecting its Russian beer volumes to decline by 5% in H2 2016 (after a flat H1 2016). But with the full impact of the PET 1.5l+ ban to come in 2017, Russian beer volumes are likely to decline by a further 5% in 2017 (according to our estimates).
- Quick de-levering will lead to new acquisitions.** Over the last 12 months plenty has been done to clean up assets with 11 breweries already sold/closed in China and more to come with the sales of a Danish malting business, a Vietnamese greenfield and the Malawi operations. Furthermore, capex has been reined in and trade working capital was already -7.5% of revenues by the end of the first half of 2016. As such, we expect the company to close 2016 with a net debt/EBITDA of 2.1 vs 2.5 at the end of 2015 and believe that an improvement to 1.6x by the end of 2017 is possible. We believe this could trigger renewed interest in acquiring assets.

VALUATION

- Our fair value of DKK600 is based on a risk free rate of 1.6%, a risk premium of 7%, a beta of 0.95 and a long term growth rate of 3.5%

NEXT CATALYSTS

- 9th November 2016: Q3 trading statement

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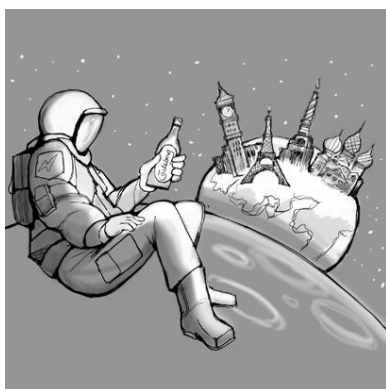
| | |
|----------------------------|---------------|
| Bloomberg | CARLB DC |
| Reuters | CARCb.CO |
| 12-month High / Low (DKK) | 679.0 / 490.6 |
| Market Cap (DKKm) | 96,270 |
| Ev (BG Estimates) (DKKm) | 141,335 |
| Avg. 6m daily volume (000) | 265.7 |
| 3y EPS CAGR | 6.9% |

| | 1 M | 3 M | 6 M | 31/12/15 |
|----------------|-------|------|------|----------|
| Absolute perf. | -2.2% | 1.8% | 3.8% | 2.6% |
| Food & Bev. | 0.2% | 5.4% | 6.8% | 0.5% |
| DJ Stoxx 600 | 0.8% | 1.9% | 4.2% | -7.0% |

| YEnd Dec. (DKKm) | 2015 | 2016e | 2017e | 2018e |
|------------------|--------|--------|--------|--------|
| Sales | 65,354 | 63,522 | 65,637 | 67,289 |
| % change | | -2.8% | 3.3% | 2.5% |
| EBITDA | 12,614 | 12,276 | 12,879 | 13,392 |
| EBIT | 7,940 | 7,602 | 8,304 | 8,899 |
| % change | | -4.3% | 9.2% | 7.2% |
| Net income | 4,557 | 4,439 | 5,108 | 5,561 |
| % change | | -2.6% | 15.1% | 8.9% |

| | 2015 | 2016e | 2017e | 2018e |
|------------------|------|-------|-------|-------|
| Operating margin | 12.1 | 12.0 | 12.7 | 13.2 |
| Net margin | 7.0 | 7.0 | 7.8 | 8.3 |
| ROE | 10.5 | 9.4 | 10.1 | 10.1 |
| ROCE | 5.5 | 5.3 | 6.3 | 6.8 |
| Gearing | 79.9 | 62.1 | 47.9 | 36.0 |

| (DKK) | 2015 | 2016e | 2017e | 2018e |
|-----------------|-------|-------|-------|-------|
| EPS | 29.87 | 29.10 | 33.49 | 36.45 |
| % change | - | -2.6% | 15.1% | 8.9% |
| P/E | 21.0x | 21.6x | 18.8x | 17.2x |
| FCF yield (%) | 7.7% | 5.0% | 6.7% | 6.3% |
| Dividends (DKK) | 6.48 | 6.48 | 6.80 | 7.14 |
| Div yield (%) | 1.0% | 1.0% | 1.1% | 1.1% |
| EV/Sales | 2.2x | 2.2x | 2.1x | 1.9x |
| EV/EBITDA | 11.5x | 11.5x | 10.6x | 9.8x |
| EV/EBIT | 18.2x | 18.6x | 16.4x | 14.7x |



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| | |
|---------|---|
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| NEUTRAL | Opinion recommending not to trade in a stock short-term, neither as a BUYER or a SELLER, due to a specific set of factors. This view is intended to be temporary. It may reflect different situations, but in particular those where a fair value shows no significant potential or where an upcoming binary event constitutes a high-risk that is difficult to quantify. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion. |
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