4th November 2016

Food & Beverages

Molson Coors

Price USD103.02

New savings targets in line with expectations

Fair Value USD112 vs. USD110 (+9%) **BUY**

Bloomberg	TAP US
Reuters	TAP.N
12-month High / Low (USD)	111.3 / 83.6
Market Cap (USDm)	22,136
Ev (BG Estimates) (USDm)	16,081
Avg. 6m daily volume (000)	1,934
3y EPS CAGR	16.7%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-5.2%	3.4%	4.8%	9.7%
Food & Bev.	-7.9%	-7.3%	-2.6%	-7.4%
DJ Stoxx 600	-3.4%	-1.2%	-1.2%	-9.4%

YEnd Dec. (USDm)	2015	2016e	2017e	2018e
Sales	3,568	3,352	11,556	11,759
% change		*-6.0%*	*NM*	*1.8%*
EBITDA	651	634	2,565	2,717
EBIT	352.2	331.5	1,910	2,062
% change		*-5.9%*	*NM*	*8.0%*
Net income	700.4	648.7	1,177	1,292
% change		*-7.4%*	*81.4%*	*9.8%*

	2015	2016e	2017e	2018e
Operating margin	9.9	9.9	16.5	17.5
Net margin	19.6	19.4	10.2	11.0
ROE	9.9	6.6	10.8	10.8
ROCE	2.7	2.5	8.9	7.1
Gearing	38.3	-1.8	90.2	72.0

(USD)	2015	2016e	2017e	2018e
EPS	3.76	3.00	5.44	5.97
% change	-	*-20.2%*	*81.4%*	*9.8%*
P/E	27.4x	34.4x	18.9x	17.2x
FCF yield (%)	2.1%	3.3%	6.2%	6.7%
Dividends (USD)	1.64	1.64	1.80	1.98
Div yield (%)	1.6%	1.6%	1.8%	1.9%
EV/Sales	5.5x	4.8x	2.8x	2.6x
EV/EBITDA	30.3x	25.3x	12.5x	11.3x
EV/EBIT	55.9x	48.5x	16.7x	14.9x

Q3 results showed that the trading environment in Canada is not getting easier, but that the US business is gaining traction. The newly published all-in efficiency target of USD550m is in line with what we were expecting (USD600 over 3 to 4 years), but most of that will be reinvested to make sure the company does reach its target for flat US volumes in 2018 and growing in 2019.

Last week, Molson Coors reported results after Q3. YTD worldwide beer volumes declined 1.4%, net revenue was down 0.1% in constant currency (a reported 4.9% decline) and underlying EBITDA fell by 0.8%. Following these figures we have updated our model and lowered our forecasts for Canada and to a lesser extent for the European segment. However, we have increased forecasts for the MillerCoors business. Overall we lowered our EPS forecast for 2016 by 8% to USD3.00 from USD3.28 but left 2017 unchanged (rather by accident as the improved US performance compensates the worser than expected Canadian and European business).

ANALYSIS

- **All-in efficiency target of USD550m in line with expectations**: In the Q3 2016 release, Molson Coors also updates investors on expected cost savings and synergies after the MillerCoors transaction. It now expects to improve efficiency by USD550m over the next three years (all-in target but it comments that half is cost savings and half synergies). This is very much in line with our previous forecast of USD600 over three/four years and its previous guidance of USD80m in cost savings p.a. for at least two years and USD200m synergies over four years, (which adds up to about USD520m over four years assuming that the costs savings continued), although the delivery is probably on the faster side. But of course there is no hint on how the efficiency improvement is going to be reinvested or flow trough to the bottom line. In the past only about 1/3 of Molson Coors's savings went through the bottom line. We assume this will repeat itself and look for about two percentage points operating margin improvement over the next three years. Indeed, with the company continue to target flat volumes in the US by 2018 and growth by 2019, it will have to cranck up investments behind its brands.

- **Irritated management**: During the call on the results, one participant asked CEO Mark Hunter what his track record is, and why investors should be comfortable that the right management team is on board to execute the significant plans. Answer: "I'm not going to conduct a performance review over our quarterly earnings call or get into detail as to why our board believes that I am the right leader for this business and why I believe Gavin is the right leader for this business." Nevertheless the question is timely: both Mark Hunter and Gavin Hattersley have been around in the group for a long time and today, the company is still only making the same operating profit than years ago (adjusted operating profit incl. MillerCoors of USD869 in 2015 v USD886 in 2010). Mark Hunter has been at Molson Coors since 1989 and has worked his way up first in the European division then in Canada and Asia before becoming CEO of Molson Coors on 1st January 2015. Indeed, on the face of it there does not seem to be much of a track record in moving topline or cutting costs. Gavin Hattersley started at SABMiller in 1998 in South Africa before moving to Miller in 2002 and since 2008 at MillerCoors (via Molson Coors back to MillerCoors in 2015). Also, here there is not the obvious track record in creating value for shareholders. However, Gavin's role in the past has been very much restricted to a pure finance role, whereas, according to insiders, his interest covers both finance and commercial (and in the past with two different shareholders at MillerCoors each having their own agenda and competing in Europe, there were many issues to take into account). But one thing that has coloured Gavin is his resolve to get on with things. On his second day in the job he replaced MillerCoor's chief marketing officer England (with Kroll) and the sales chief McBrien (with Doyle). Nevertheless, however we look at it, the jury is still out for both Mark and Gavin.

- **Saved by Cocaine?**: Canada's government has plans to decriminalise and regulate recreational marijuana in spring 2017. Although recreational drugs and alcohol might seem in competition, the experience of Colorado and Washington, is that liberalisation of drug use does improve alchol consumption (and tourism!). Maybe that is exactly what the Canadian beer industry needs.

- Although the company is trying to put a brave face on it, Molson Coors is havig a **tough time in Canada and Europe**. In Canada, declining volumes (ytd, volumes are down by 2.6%, 2.9% in Q3), and increased marketing spend (without significant improvement in price mix) have caused negative operational leverage and have driven operating margins down by 1.6% so far this year. According to the company, its cost savings programme has offset inflation, forex and other cost increases (i.e. more expensive raw materials because the increase in premium brands). Underlying operating profit was down by 13.4% after 9 months. These figures are significantly worse than those published by Labatt with ytd volumes down 0.6% organic (but +7.2% including acquisitions in craft, RTD and cider), net revenue growth of 1.2% organic and an EBIT decline of 2.9% organic. In Europe, year-to-date the benefit of higher net sales and net selling prices per hectoliter in local currency (premiumisation with Coors Light, Staropramen outside of the Czech Republic, and their craft portfolio including Blue Moon, Doom Bar, and other the Sharps brands, as well as Rekorderlig cider), volume and market share in Europe were more than offset by unfavorable foreign currency movements, higher brand amortisation expense, lower pension benefits and the termination of the Heineken contract arrangement in the UK. As a result underlying recorded operating profit for 9 months was down by 14.6% and operating profit margin after 9 months stood at 10.1% v 11.4% 9m 2015.

- However, the **US operations improved**. Overall sales to retail volume decreased 2.5% year-to-date on a trading day adjusted basis driven primarily by value and mainstream light brands, reflecting industry trends (although Coors Light and Miller Lite gained segment market share). However, Coors Banquet and the premium products (including the craft business) imcreased in volume. Domestic net sales revenue per hectoliter grew 1.2% year-to-date as a result of favorable net pricing and positive sales mix. On the bottom line, U.S. segment underlying equity income increased 9.3% in the 9 months driven primarily by lower cost of goods sold, higher net pricing and positive sales mix.

VALUATION

- DCF based Fair Value of USD112 assuming a risk free rate of 1.7% and a risk premium of 7%. The slight increase from our previous USD110 Fair Value comes on the back of an increased tax advantage from the MillerCoors acquisition (USD275m v USD250m).

NEXT CATALYSTS

- Mid February 2017: 2016 earnings

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