

16th December 2016

Food & Beverages

Heineken

Price EUR70.34

Reinforcing UK position

Fair Value EUR83 (+18%)

BUY

Bloomberg	HEIA.NA
Reuters	HEIN.AS
12-month High / Low (EUR)	84.4 / 68.0
Market Cap (EURm)	40,516
Ev (BG Estimates) (EURm)	54,831
Avg. 6m daily volume (000)	734.2
3y EPS CAGR	6.8%

Heineken is looking to buy 1,900 UK pubs currently owned by Punch Taverns for GBP1.27bn. The deal is to reinforce its position in the UK pub and beer market and if it goes ahead it could enhance earnings by 2% from the first year (BG estimate). A rival bidder Emerald Investment Partners has not yet given up its pursuit of the Punch Taverns pub estate. However, the three largest shareholders that control 52% of the shares have pledged their shares to Heineken unless a rival bid of over 200p per share for Punch Taverns is received. Heineken and Patron Capital offer 180p.

Heineken and Patron Capital made an offer for Punch Taverns at GBp180 per share that has been accepted by the Punch Taverns board and is backed by the three biggest investors in the company (Glenview Capital, Avenue Capital and Warwick Capital Partners). However, if a rival offer of over GBp200 emerges, the agreement with the biggest investor would lapse.

	1 M	3 M	6 M	31/12/15
Absolute perf.	-0.1%	-9.7%	-10.4%	-10.7%
Food & Bev.	4.0%	-5.5%	-1.3%	-6.6%
DJ Stoxx 600	5.8%	5.4%	10.9%	-1.9%

ANALYSIS

YEnd Dec. (EURm)	2015	2016e	2017e	2018e
Sales	20,511	20,530	21,033	21,595
% change		0.1%	2.4%	2.7%
EBITDA	4,975	5,080	5,412	5,760
EBIT	3,381	3,486	3,694	3,932
% change		3.1%	6.0%	6.4%
Net income	2,048	2,103	2,302	2,494
% change		2.7%	9.5%	8.4%

- Punch Taverns is a tenanted pub operator with 3,350 pubs located across the United Kingdom, 96% of which are on a freehold or long leasehold basis. Heineken will end up paying GBP1.27bn (GBP305m for the equity and GBP962m for the securitised debt) for 1,900 pubs. Heineken already has around 1,100 pubs in the UK and together with the 1,900 it is to buy, it will be the third largest owner of pubs in the UK with a 6% market share.

- Owning a pub estate comes with a number of benefits. The most important benefit is that a own estate can sell your own beers. With the current Punch estate selling beers and ciders from all major brewers (Molson Coors, AB InBev, Carlsberg, and Heineken), a move to a more exclusive Heineken contract could allow Heineken to improve its market share in the UK. Currently Heineken is the number one brewer in the UK with a 19% market share, just ahead of both AB InBev and Molson Coors that have 18% (Carlsberg has 13%).

- Owning pubs allows for direct contact with consumers and the pub estate can be a testing ground for new innovations. A recent example is the Strongbow Dark Fruit cider that was first tested in about 100 of its own pubs before rolling out (and meanwhile taking 35% of all Strongbow volumes). Also having an own estate is allowing for all the on trade managers of Heineken UK to better understand the pub environment when they speak with the on-trade.

- Furthermore, UK beer margins are very thin (7%) but cider is better (12%) and pubs are a lot better (40%). So there is visible margin uplift when integrating a pub estate. Heineken has stated that the acquisition would have an immediate accretive impact on earnings. We calculate earnings accretion at 2%

	2015	2016e	2017e	2018e
Operating margin	16.5	17.0	17.6	18.2
Net margin	10.0	10.2	10.9	11.6
ROE	15.1	14.4	14.5	14.5
ROCE	8.2	8.1	8.6	9.1
Gearing	86.0	75.2	62.6	50.4

VALUATION

- Our Fair Value of EUR83 is based on DCF using a 1.6% risk free rate, 7% equity premium and a beta of 1.0.

- At 17.5x 2017 earnings, Heineken shares are trading below their average of the last five years (18.0x)

NEXT CATALYSTS

- Full year results on 15th February 2017.

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