BRYAN, GARNIER & CO

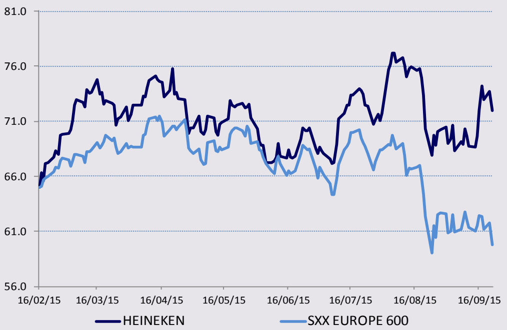
INDEPENDENT RESEARCH UPDATE

24th September 2015

Food & Beverages

Bloomberg	HEIA NA
Reuters	HEIN.AS
12-month High / Low (EUR)	77.2 / 54.8
Market capitalisation (EURm)	41,438
Enterprise Value (BG estimates EURm)	53,045
Avg. 6m daily volume ('000 shares)	889.2
Free Float	37.5%
3y EPS CAGR	9.8%
Gearing (12/14)	89%
Dividend yield (12/15e)	1.43%

YE December	12/14	12/15e	12/16e	12/17e
Revenue (EURm)	19,257	19,834	20,392	21,085
EBIT (EURm)	3,129	3,301	3,547	3,785
Basic EPS (EUR)	2.63	3.41	3.34	3.69
Diluted EPS (EUR)	3.05	3.37	3.72	4.04
EV/Sales	2.78x	2.67x	2.54x	2.38x
EV/EBITDA	11.7x	11.2x	10.3x	9.3x
EV/EBIT	17.1x	16.1x	14.6x	13.3x
P/E	23.6x	21.3x	19.4x	17.8x
ROCE	7.7	8.5	9.1	9.7



Heineken

Diversification pays off

Fair Value EUR75 vs. EUR78 (price EUR71.94) **BUY-Top Picks**

We are lowering Heineken's fair value by 4% to EUR75 from EUR78, following an update which takes into account the further weakening of some of emerging market currencies. However, we find that because of the company's diversification the impact is mitigated as some markets (currency and operations) are holding up very well.

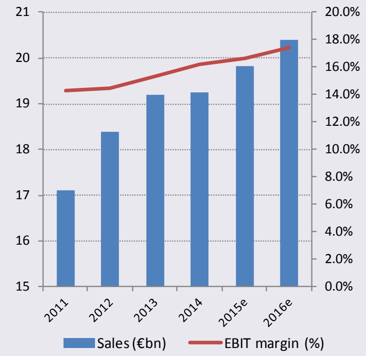
- Heineken has only been in China since 2004 and the country accounts for only 1% of revenue. Nevertheless, the Heineken and Tiger brands are showing good growth (around 30% p.a.) and the company seems to have hit full capacity at its two breweries. As a result, a new 8.5m hl brewery is being built close to Shanghai, which should quadruple the company's capacity in China, indicating its ambition to grow its premium brands further.

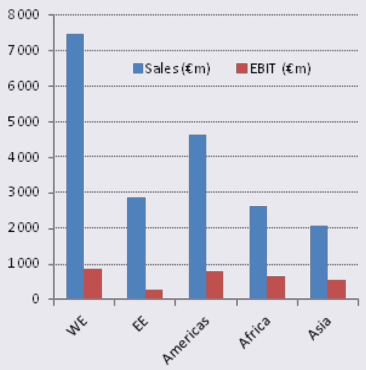
- We have adjusted our forecasts for Heineken taking into account the recent currency turmoil. The weakness of the naira and the peso are important but, due to its important Western European, US and Asian businesses (together more than half of EBIT), the impact of currencies is less at Heineken than the other companies, which is also helped by the fact that it reports in euros.

- Operationally the company is having a tough time in Nigeria and Indonesia and also in Mexico as price competition seems to be emerging, but this is partially offset by the delivery of strong results in Vietnam, Russia (!) and Western Europe (the weather has been good). Overall, we have lowered our earnings forecasts (net profit) by only 2% for 2015 and 4% for 2016. We believe that the company will report a double-digit net profit (adjusted) growth, although some currency impacts mean that we have to lower our fair value by 4% to EUR75 from EUR78.

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

Sector Analyst Team:
Loïc Morvan
Antoine Parison
Cédric Rossi
Virginie Roumage





Company description

Heineken is the world's third-largest brewer in terms of sales volumes, revenues and EBIT. In 2014, the group sold 232.6m hl of beverages, of which 198.8m hl was beer, giving it a global market share of 10%, behind AB InBev (21%) and SABMiller (12%). Heineken has No 1 or 2 positions in countries like Mexico (38%), Nigeria (69%), France (29%), the Netherlands (38%), Poland (29%), Spain (26%) or Rwanda (90%) and Indonesia (50%). The group's brands are positioned in all three segments of the market: premium (30% of sales), mainstream (65%) and economy (5%). The Heineken brand itself is present in more than 170 countries and is the largest international premium beer in the world, selling 29.5m hl in 2014.

Simplified Profit & Loss Account (EURm)	2012	2013	2014	2015e	2016e	2017e
Revenues	18,384	19,203	19,257	19,834	20,392	21,085
Change (%)	*7.4%*	*4.5%*	*0.3%*	*3.0%*	*2.8%*	*3.4%*
Adjusted EBITDA	3,983	4,522	4,566	4,738	5,036	5,371
EBIT	2,667	2,941	3,129	3,301	3,547	3,785
Change (%)	*8.6%*	*10.3%*	*6.4%*	*5.5%*	*7.5%*	*6.7%*
Financial results	(270)	(593)	(488)	(441)	(376)	(321)
Pre-Tax profits	2,397	2,348	2,641	2,860	3,171	3,464
Exceptionals	1,025	(387)	(349)	(400)	(310)	(280)
Tax	(525)	(520)	(732)	(867)	(858)	(955)
Profits from associates	213	146	148	161	176	192
Minority interests	(160)	(223)	(192)	(221)	(254)	(292)
Net profit	2,950	1,364	1,516	1,533	1,924	2,128
Restated net profit	1,696	1,585	1,758	1,942	2,141	2,324
Change (%)	*7.1%*	*-6.5%*	*10.9%*	*10.5%*	*10.2%*	*8.5%*
Cash Flow Statement (EURm)						
Operating cash flows	3,417	3,932	4,113	4,499	4,902	5,283
Change in working capital	101	51.0	27.0	29.4	28.4	35.3
Capex, net	(1,210)	(1,396)	(1,484)	(887)	(1,631)	(1,687)
Financial investments, net	(4,415)	555	(189)	0.0	0.0	0.0
Dividends	(604)	(710)	(723)	(798)	(858)	(932)
Other	(958)	(1,355)	(1,198)	(878)	(1,234)	(1,276)
Net debt	12,358	10,899	10,574	8,579	7,324	5,833
Free Cash flow	1,350	1,253	1,467	2,764	2,065	2,356
Balance Sheet (EURm)						
Tangible fixed assets	8,792	8,454	8,718	8,525	9,023	9,480
Intangibles assets	17,725	15,934	16,341	15,984	15,627	15,270
Cash & equivalents	1,133	1,327	1,191	1,191	1,191	1,191
current assets	4,365	4,157	4,717	4,858	4,995	5,165
Other assets	3,925	3,454	3,685	3,685	3,685	3,685
Total assets	35,940	33,326	34,652	34,243	34,521	34,791
L & ST Debt	13,491	12,226	11,765	9,770	8,515	7,024
Others liabilities	10,758	9,698	10,478	10,800	11,158	11,605
Shareholders' funds	11,691	11,402	12,409	13,673	14,848	16,162
Total Liabilities	35,940	33,326	34,652	34,243	34,521	34,791
Capital employed	29,405	26,697	27,763	27,155	27,220	27,216
Ratios						
Operating margin	14.51	15.32	16.25	16.64	17.39	17.95
Tax rate	15.34	26.52	31.94	30.00	30.00	30.00
Net margin	9.23	8.25	9.13	9.79	10.50	11.02
ROE (after tax)	14.51	13.90	14.17	14.21	14.42	14.38
ROCE (after tax)	7.68	8.10	7.67	8.51	9.12	9.73
Gearing	110	97.94	89.33	67.54	54.25	41.23
Pay out ratio	14.77	31.95	35.53	30.27	33.10	32.49
Number of shares, diluted	576	576	576	576	576	576
Data per Share (EUR)						
EPS	5.12	2.37	2.63	3.41	3.34	3.69
Restated EPS	2.94	2.75	3.05	3.37	3.72	4.04
% change	*9.0%*	*-6.5%*	*10.9%*	*10.5%*	*10.2%*	*8.5%*
EPS bef. GDW	2.94	2.75	3.05	3.37	3.72	4.04
BVPS	20.30	19.80	21.54	23.74	25.78	28.06
Operating cash flows	5.93	6.83	7.14	7.81	8.51	9.17
FCF	2.58	2.64	2.73	4.05	3.59	4.09
Net dividend	0.76	0.76	0.94	1.03	1.11	1.20

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

1. China operations and strategy

Limited presence but growing stake in International premium segment

Heineken currently has a limited presence in mainland China, with two breweries and a third one under construction, as the company is focusing on development in the international premium segment, putting in place optimal production facilities and extensive distribution networks. In China, the International premium segment accounts only for 3% of the total beer market but has been growing by 12% p.a. over the past ten years and is expected to continue to grow at that rate. Because of its geographic limited presence, Heineken beer is only 8% of the Chinese International premium segment, but growing fast (30% over the past five years)

Fig. 1: Heineken's premium position in China

Growth of Heineken beer in China, volume m hl | **Heineken share in the international premium segment in China**

Source: Canadean, Company, Bryan, Garnier & Co estimates

Fig. 2: Heineken's beer brands in China

Heineken mainstream brand in China | **Heineken premium brands in China**

Source: Company, Company, Bryan, Garnier & Co estimates

Heineken's involvement in China's beer market originates from January 2004, when Heineken and Asia Pacific Breweries formed a joint venture, which included the Shanghai Asia Pacific Brewery and the Hainan Asia Pacific Brewery. In 2004/05 the joint venture forged alliances with Kingway. However, in 2011 Heineken/APB sold the majority of its Chinese assets in Jiangsu Dafuhao Breweries, Shanghai Asia Pacific Brewery and Kingway to CR Snow. This happened with the China strategy changing to only focus on the International premium segment, which is a faster growing and more profitable segment.

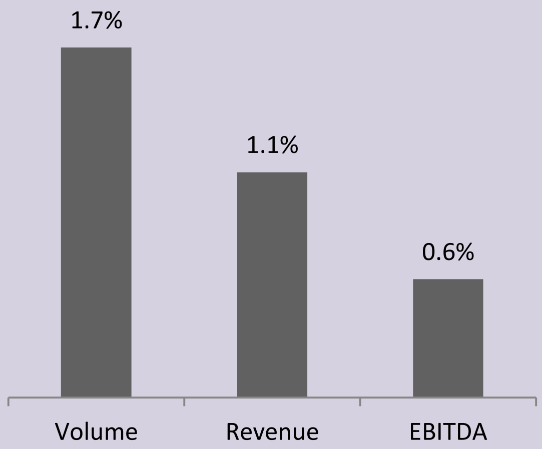
Building a new8.5m hl brewery as the current ones are full

For producing its Heineken, Tiger and Anchor brands, Heineken has two breweries, one in Guangzhou (2.2m hl) and one in Hainan (1.5m hl), but with close to full capacity, the company is building a new brewery located in Jiashan County in Zhejiang Province, 60 kilometres south-west of Shanghai and which is expected to have a 8.5m hl capacity – quadrupling the company's current Chinese capacity. This should open later this year (building started in April 2014).

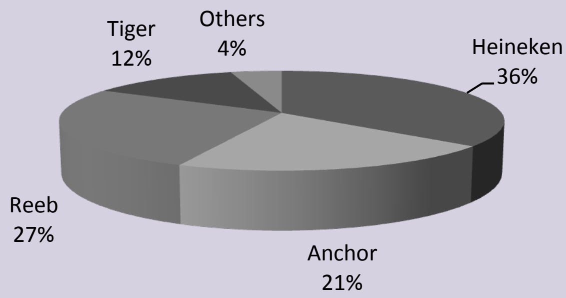
However, we estimate that the Chinese operations generated revenues of EUR200m in 2014 and an EBITDA of EUR24m, accounting for 1.1% and 0.6% of 2014 revenues and EBITDA. Indeed, despite being in the premium segment, the sub-optimal scale of the company allows for relatively low margins, which we estimate at 8% at the EBIT level and 12% on EBITDA.

Fig. 3: Importance of China and main beer brands in China

Heineken - importance of the Chinese business, 2014



Heineken Chinese brand portfolio, 3 m hl in 2014



Source: Company, Company, Bryan, Garnier & Co estimates

2. Updating forecasts

Americas' H2 results to slow down as price competition in Mexico emerges and the peso has been weakening

In the Americas, organic revenue growth in the first half was 5.8% driven by total volume growth of 3.1% and higher revenue per hectolitre of 2.8%, reflecting a positive brand mix and improved pricing. Currency movements favourably impacted revenues, mainly due to the appreciation of the US dollar and the Mexican peso, and consolidated operating profit (beia) grew 8.6% organically driven by continued strong growth primarily in Mexico and Brazil. For the second half, we are expecting a slightly less rosy picture. In the US, where sales to retailers were up only 0.2%, the underlying trend should improve given that in the first half, the company's Mexican brands were suffering from flooding in the Central Belt. However, sales to wholesalers were already up 1.1% in the first half so it is likely that in the second half sales to wholesalers would come in below sales to retailers. In Mexico, there are signs of increased price competition and the weakness of the Brazilian economy could impact sales volumes of the Kaizer brand (although the premium Heineken brand should continue to grow). So overall we are expecting flat volumes in the Americas in H2 and a price/mix improvement of only 2%. On top of this, we are looking for a diminishing positive currency impact as the Mexican peso has been weakening against the euro (while in the first half it was stronger).

Asian strength to continue in the second half

In the first half, net revenue in the Asia Pacific region grew 7.4% organically, with higher total volume growth of 8.5% organically (Vietnam, Cambodia, China and exports to Korea and Taiwan whilst Indonesia continued to adversely impact the overall regional volume) and revenue per hectolitre down 1.1%, negatively impacted by country mix. Excluding the adverse country mix, revenue per hectolitre would have been up 3.4%. Consolidated operating profit (beia) increased 9.3% organically reflecting increased profitability in Vietnam, China, New Zealand, Mongolia and Sri Lanka. At this stage, we are expecting a similar picture for the second half with Indonesia remaining tough and Vietnam pulling ahead. For the full year, we expect 8.5% organic volume growth and 7.5% net revenue growth with an EBIT margin expanding 70bps to 27% from 26.3%. On top of this, all the Asian currencies have been strong against the euro, albeit slightly less in the second half of the year than in the first half, and are expected to deliver an additional 14% boost to revenues and profits.

Refocusing Russian business on higher margin premium brands is paying off

Central & Eastern Europe's first half performance came in as a positive surprise with a 1.0% organic net revenue increase (volumes down 2.2% and price/mix up 2.7%). Consolidated operating profit (beia) increased by 15% organically, as the value growth strategy focused on improving revenue per hectolitre and profitability across the region delivered results. Improved profitability in Russia, Poland and Romania offset the weaker performance in Greece, Slovakia and Croatia. The main driver for volumes holding up relatively well (Russia down double-digit) was the high single-digit volume growth in Poland as the company continues to benefit from the relisting by convenience chain Żabka. However, at the same time, SABMiller was also delisted but is now back on the shelves, so the double impact causing the market share gain in H1 for Heineken will disappear. What is left is that the underlying market remains difficult and continues to be impacted adversely by the negative channel mix. So, the overall volume picture will get slightly worse in the second half. However the price mix should remain strong as, especially in Russia, the company's strategy of focusing on the higher revenue per hl seems to be working. For the full year, we are expecting flat net revenues and a 13% organic growth in operating profits. However, the adverse foreign currency movements, mainly the Russian rouble, are expected to negatively impact net revenues by 6% and operating profit by 1%.

Weather boost for Western Europe

H1, Western European figures were slightly better than expected (organic revenue decline of 0.8% driven by a total volume decline of 2.4%). The Western European markets were impacted by high comparables in 2014 (favourable weather and FIFA World Cup). The company reports seeing positive volume growth in Spain, France and the Netherlands. However, the UK market remains tough as Heineken's volumes declined in high single-digits due to challenging market conditions, and promotional off-trade pressures. On an organic basis, consolidated operating profit (beia) grew by 0.2% led by higher profit in Spain, Portugal and the Netherlands, and offset by lower profitability in the UK. For the second half of the year, we are expecting an improved volume and profitability picture as the weather in July and August was good. So, for the full year, we are expecting a decline in volumes of only 1% and a 1.5% increase in net revenues, which should help EBIT to rise 4% higher, organically.

Nigeria continues to weigh on profit development

The region that disappointed mostly in the first half was Africa. Top-line growth came in at 1.4%, organically driven by positive total volume growth of 2.5%. This was partly offset by lower revenue per hectolitre of 1.1%, primarily reflecting the impact of higher volume growth in the lower revenue per hectolitre countries. However, consolidated operating profit (beia) declined by 7.2%, on an organic basis, driven by margin pressure in Nigeria from the negative mix as a result of the continued volume growth in the value for money segment, currency devaluation and increased inflation. A weaker performance in the Democratic Republic of Congo and Egypt also weighed on the region's profit. Nigeria continues to be going through a challenging economic environment including a devaluation of the naira, high inflation and fuel scarcity. So, for the full year, we are not expecting a much different picture on Africa than that in the first half and look for organic top-line growth of 1.5% and an operating profit decline of 5%. On top of this, there is some mild positive impact from currencies (+1% on operating profit) but less than in H1 (2.3%).

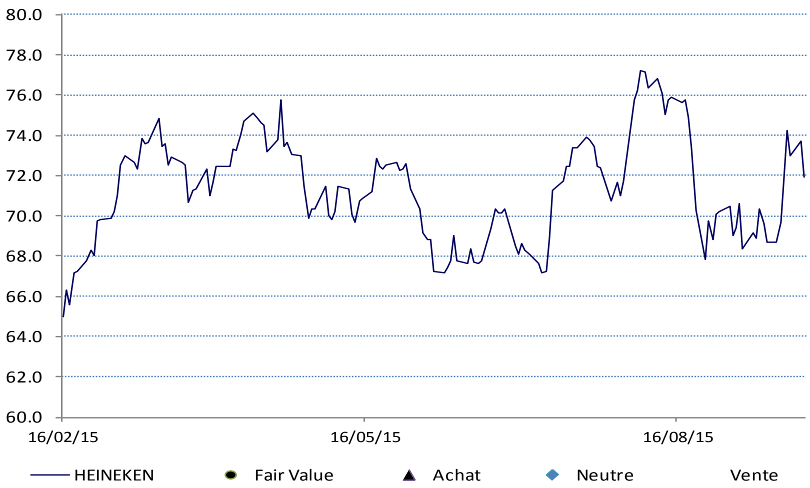
Fig. 4: Results outlook Heineken by division

	FY2013	FY2014		FY2015e		FY2016e	
DKKm	Published	Published	% Incr.	New	% Incr.	New	% Incr.
Revenues	19,203	19,257	0.3%	19,834	3.0%	20,392	2.8%
Western Europe	7,456	7,478	0.3%	7,762	3.8%	7,762	0.0%
Central & Eastern Europe	3,097	2,868	-7.4%	2,701	-5.8%	2,701	0.0%
Americas	4,495	4,631	3.0%	4,784	3.3%	5,103	6.7%
Africa	2,554	2,643	3.5%	2,736	3.5%	2,818	3.0%
Asia Pacific	2,037	2,088	2.5%	2,516	20.5%	2,692	7.0%
Head office	-436	-451	3.4%	-665	47.3%	-684	3.0%
Operating profit	2,941	3,129	6.4%	3,301	5.5%	3,547	7.5%
Western Europe	853	852	-0.1%	917	7.6%	925	0.8%
Central & Eastern Europe	290	272	-6.2%	304	11.8%	342	12.4%
Americas	719	780	8.5%	842	7.9%	965	14.6%
Africa	607	655	7.9%	629	-3.9%	668	6.1%
Asia Pacific	536	550	2.6%	679	23.5%	719	5.9%
Head office	-64	20	-131.3%	-71	-454.0%	-72	1.0%
Non recurring items	-241	-201	-16.6%	-239	18.7%	-134	-43.8%
Operating profit margin	15.3%	16.2%		16.6%		17.4%	
Western Europe	11.4%	11.4%		11.8%		11.9%	
Central & Eastern Europe	9.4%	9.5%		11.3%		12.7%	
Americas	16.0%	16.8%		17.6%		18.9%	
Africa	23.8%	24.8%		23.0%		23.7%	
Asia Pacific	26.3%	26.3%		27.0%		26.7%	
Net interest	-593	-488	-17.7%	-441	-9.7%	-376	-14.7%
PBT	2,107	2,440	15.8%	2,621	7.4%	3,037	15.9%
Tax	-520	-732	40.8%	-867	18.4%	-858	-1.0%
Minority interests	-223	-192	-13.9%	-221	15.0%	-254	15.0%
Net profit	1,364	1,516	11.1%	1,533	1.1%	1,924	25.5%
Net profit - adjusted	1,585	1,758	10.9%	1,942	10.5%	2,141	10.2%
Number of fully diluted shares	576	576	0.0%	576	0.0%	576	0.0%
Diluted EPS - adjusted	2.75	3.05	10.9%	3.37	10.5%	3.72	10.2%
Net dividend (EUR)	0.76	0.94	23.6%	1.03	10.4%	1.11	7.2%

Source: Company Data; Bryan, Garnier & Co ests

Price Chart and Rating History

Heineken



Ratings		
Date	**Ratings**	**Price**
05/05/15	BUY	EUR69.85

Target Price	
Date	**Target price**
05/05/15	EUR78

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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 including a SWOT analysis, positive momentum, technical aspects and the sector backdrop. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.

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.

SELL Negative opinion for a stock where we expect an unfavourable 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 downside based on valuation), but also takes into account a number of elements including a SWOT analysis, positive momentum, technical aspects and 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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BUY ratings 64.3% NEUTRAL ratings 31.3% SELL ratings 4.3%

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BRYAN, GARNIER & CO

London
Heron Tower
110 Bishopsgate
London EC2N 4AY
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