

## INDEPENDENT RESEARCH

25th July 2017

Food &amp; Beverages

## Refresco Group

Target or Consolidator

Fair Value EUR21.8 (price EUR17.40)

**BUY**  
Coverage initiatedFinalised on 24<sup>th</sup> July 2017

Bloomberg	RFRG NA
Reuters	RFRG.AS
12-month High / Low (EUR)	18.2 / 12.9
Market capitalisation (EURm)	1,412
Enterprise Value (BG estimates EURm)	1,976
Avg. 6m daily volume ('000 shares)	175.2
Free Float	72.2%
3y EPS CAGR	5.3%
Gearing (12/16)	124%
Dividend yields (12/17e)	1.81%

YE December	12/16	12/17e	12/18e	12/19e
Revenue (EURm)	2,107	2,306	2,401	2,501
EBIT(EURm)	134.40	140.13	148.32	156.98
Basic EPS (EUR)	1.00	1.06	1.15	1.24
Diluted EPS (EUR)	1.06	1.06	1.15	1.24
EV/Sales	0.97x	0.86x	0.80x	0.74x
EV/EBITDA	9.2x	8.6x	8.0x	7.4x
EV/EBIT	15.1x	14.1x	12.9x	11.8x
P/E	16.3x	16.4x	15.1x	14.0x
ROCE	7.7	7.9	8.3	8.8



Refresco is the leading European private label and co-packer of soft drinks. The company is aggressively consolidating in this market and has now also entered the US. In Europe, co-packing shows the highest growth as brand owners seek to improve their efficiency, whereas in the US, private label is expected to take off. In April 2017, Refresco rejected a EUR17.3 per share takeover bid from private equity firm PAI Partners. We are initiating Refresco with a Buy recommendation and Fair Value of EUR21.8 pointing to 25% upside.

■ Consolidator on both sides of the Atlantic: After 17 years of acquisitions, Refresco is the leading private label and co-packer of soft drinks in western Europe. However, it still only has a share of 15% in private label and 42% in co-packing, allowing for much more consolidation. The same goes for the US market, which Refresco only entered last year. Given the highly cash generative nature of the business and Refresco's superior margins (6% EBIT margin vs. 2% for most of its competitors), as well as synergy opportunities (around 4% of revenues), these acquisitions harbour significant upside potential. We calculate that out of the average 15% EBIT growth seen over the past five years, 11% has stemmed from acquisitions and 4% from organic growth.

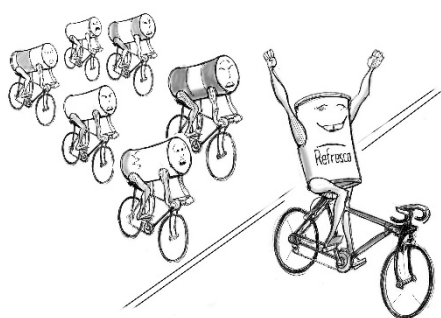
■ A play on the expansion of Aldi and Lidl in the US: With the acquisition of Whitlock Packaging in 2016, the company is entering the US where it finds the same co-packing and private label customers that it is successfully serves in Europe. More US acquisitions are likely to follow as the company is putting itself in pole position to benefit from an expected boom in private label soft drinks driven by the expansion of Aldi and Lidl in the US (as seen in Europe). Indeed, in the US private label only represents 10% of soft drinks volumes whereas the level stands at 26% in western Europe.

■ High single digit growth in co-packing: On the back of its private label business in Europe, the company has expanded into co-packing for bottlers, A-brand owners and also small soft drink companies. Co-packing is growing by about 9% p.a. in western Europe as customers are increasingly looking to outsource manufacturing of their soft drinks. This is also the case in the US where customers are equally tempted by potential efficiency gains. Refresco has a market leading 42% share of the western European market and has now also entered the US co-packing market.

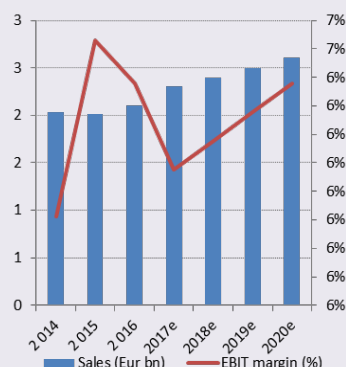


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## Refresco Group



### Company description

Refresco Group NV, is a company based in the Netherlands, operating as a bottler of soft drinks and fruit juices for retailers and branded customers. It offers total supply chain solutions, from planning and sourcing of raw materials and packaging through to warehousing and transportation. It is also engaged in the introduction of new packaging, flavours, soft drinks and juices and co-design of new products. Its portfolio includes: fruit juices, carbonated soft drinks, ready-to-drink teas, water, syrups, functional and energy drinks, waters and speciality drinks, available in packaging such as cartons, cans, pouches, glass and PET. The group has production facilities in Benelux, Finland, France, Germany, Iberia, Italy, Poland, the UK and the US.

<b>Simplified Profit &amp; Loss Account (EURm)</b>							
Revenues	2,037	2,016	2,107	2,306	2,401	2,501	2,606
Change (%)	-%	-1.0%	4.5%	9.4%	4.1%	4.2%	4.2%
Adjusted EBITDA	208	216	222	229	240	252	265
EBIT	120	132	134	140	148	157	166
Change (%)	-%	9.4%	2.1%	4.3%	5.8%	5.8%	5.8%
Financial results	(49.4)	(49.9)	(18.7)	(20.7)	(18.8)	(16.8)	(14.7)
Pre-Tax profits	71.0	81.8	116	119	130	140	151
Exceptionals	(11.4)	(21.2)	(5.1)	0.0	0.0	0.0	0.0
Tax	(20.9)	(18.8)	(29.1)	(33.5)	(36.3)	(39.2)	(42.4)
Profits from associates	NM	NM	NM	NM	NM	NM	NM
Minority interests	(0.10)	0.40	0.0	0.0	0.0	0.0	0.0
Net profit	38.6	42.2	81.5	86.0	93.3	101	109
Restated net profit	46.7	77.8	86.4	86.0	93.3	101	109
Change (%)	-%	66.6%	11.1%	-0.4%	8.4%	8.2%	8.1%
<b>Cash Flow Statement (EURm)</b>							
Operating cash flows	187	188	214	228	240	252	265
Change in working capital	28.1	12.1	(18.3)	1.2	(2.2)	(2.3)	(2.4)
Capex, net	(58.3)	(81.5)	(80.0)	(87.6)	(91.2)	(95.0)	(99.0)
Financial investments, net	19.7	0.50	(141)	0.0	0.0	0.0	0.0
Dividends	0.0	0.0	(27.3)	(30.1)	(32.6)	(35.3)	(38.2)
Other	(59.1)	(73.6)	(43.3)	(54.1)	(55.1)	(56.1)	(57.1)
Net debt	589	457	622	564	506	443	375
Free Cash flow	97.8	48.4	76.5	87.9	91.1	98.6	107
<b>Balance Sheet (USDm)</b>							
Tangible fixed assets	533	538	645	643	643	643	643
Intangibles assets	428	446	549	549	549	549	549
Cash & equivalents	100	96.6	139	139	139	139	139
current assets	581	561	631	641	667	695	724
Other assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total assets	1,643	1,641	1,964	1,973	1,999	2,027	2,056
L & ST Debt	690	553	761	703	645	582	514
Others liabilities	595	574	665	675	700	725	752
Shareholders' funds	359	514	539	594	654	720	791
Total Liabilities	1,643	1,641	1,964	1,973	1,999	2,027	2,056
Capital employed	1,067	1,067	1,281	1,279	1,281	1,284	1,286
<b>Ratios</b>							
Operating margin	5.91	6.53	6.38	6.08	6.18	6.28	6.38
Tax rate	35.07	31.02	26.31	28.00	28.00	28.00	28.00
Net margin	2.29	3.86	4.10	3.73	3.88	4.04	4.19
ROE (after tax)	13.03	15.14	16.04	14.47	14.26	14.02	13.79
ROCE (after tax)	7.33	8.51	7.73	7.89	8.33	8.81	9.30
Gearing	173	95.15	124	103	84.41	67.97	53.27
Pay out ratio	0.0	34.76	35.70	35.00	35.00	35.00	35.00
Number of shares, diluted	74.26	74.26	74.26	74.26	74.26	74.26	74.26
<b>Data per Share (EUR)</b>							
EPS	0.52	0.53	1.00	1.06	1.15	1.24	1.34
Restated EPS	0.63	0.98	1.06	1.06	1.15	1.24	1.34
% change	-%	55.6%	8.8%	-0.4%	8.4%	8.2%	8.1%
EPS bef. GDW	0.63	0.98	1.06	1.06	1.15	1.24	1.34
BVPS	4.83	6.46	6.64	7.32	8.06	8.87	9.74
Operating cash flows	2.52	2.53	2.88	3.08	3.23	3.39	3.57
FCF	1.32	0.65	1.03	1.18	1.23	1.33	1.44
Net dividend	0.0	0.29	0.32	0.32	0.34	0.37	0.40

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

## Table of contents

1. Investment Case.....	4
2. Executive summary .....	5
2.1. Key charts executive summary .....	6
2.2. SWOT analysis .....	8
3. Refresco valuation .....	9
3.1. Ratio valuation.....	9
3.2. DCF valuation .....	10
4. Business and strategy .....	14
4.1. Portfolio and positioning.....	15
4.1.1. Preferred private label supplier for retailers.....	16
4.1.2. Co-packing solution for A-brand customers .....	16
4.2. Strategy.....	17
4.2.1. Low to mid-single digit organic volume growth.....	17
4.2.2. Continued buy-and-build strategy .....	18
4.2.3. Combining private label and co-packing.....	19
5. The global soft drinks industry .....	20
6. Key drivers.....	22
6.1. Private label growth in the US .....	22
6.2. Outsourcing packing by bottlers .....	24
6.3. M&A.....	26
6.3.1. Western European consolidation to accelerate.....	27
6.3.2. Opportunities in the US .....	29
6.3.3. Value creation by acquisitions .....	30
7. Results and profit forecasts.....	31
Bryan Garnier stock rating system.....	34

# 1. Investment Case

*Why the interest now?*



## The reason for writing now

Refresco is the leading European bottler of soft drinks and fruit juices for retailers (private label) and is the leading contract manufacturer for soft drinks for A-brand customers. Last year the company entered the US market. It was doing so because of an expected growth in the US private label soft drinks market, which only represents 10% of soft drinks volumes compared to 26% in western Europe. The driver for that should come from the company's existing western European clients: Lidl and Aldi. Indeed, last month Lidl entered the US and in the beginning of the year Aldi laid out its increased expansion plans for that market. However, growth in the US is not only going to be organic but also through acquisitions. But also in western Europe consolidation will continue. Those multiple opportunities on both sides of the Atlantic, would allow for an accelerated expansion of the company.

*Cheap or Expensive?*



## Valuation

At the current share price of EUR17.4, Refresco is trading on a 2017e P/E of 16.4x. We derive a DCF-based fair value of its existing operations of EUR19.1 (10% upside), but excluding any further M&A would be ignoring the reality of the market opportunities. Adding two years of acquisitions (to keep net debt/EBITDA at 2.5x) delivers our fair value of EUR21.8 (25% upside).

*When will I start making money?*



## Catalysts

Any further acquisitions are likely to be value creative. Given the multitude of opportunities the company is likely to be able to keep acquisition multiples at or below an EV/EBITDA of 7.5x. Furthermore, because of the company's size its operating margins of over 6% are well ahead of competitors' 2%, giving opportunities to extract significant synergies (4% of revenues).

*What's the value added?*



## Difference from consensus

We are lower on our 2017 forecasts as we prudently assume that the acquisition of Whitlock Packaging in the US, is not creating any synergies, given it is the first entry in a distinct new market and financial costs might well dilute net profit (our net profit of EUR86m compares with consensus of EUR96m). However, we do see much more opportunities in M&A than the current consensus.

*Could I lose money?*



## Risks to our investment case

Refresco as a small and mid-cap (EUR1.4bn market cap) company in which interest can be volatile. The take-over attempt from PAI is drawing attention to the company, but that could fade especially if the company does not manage to pull off additional value accretive acquisitions or if in the US.

## 2. Executive summary

Leading European private label bottler and co-packer expanding in the US

Refresco is the leading European bottler of soft drinks and fruit juices for retailers (private label) and is the leading contract manufacturer for soft drinks for A-brand customers such as PepsiCo, Coca-Cola, Suntory, Nestle and Monster. Last year the company entered the US market with the acquisition of Whitlock Packaging.

Plenty of acquisition opportunities on both sides of the Atlantic

Private label production of soft drinks in both western Europe and the US is still a highly segmented market, in which Refresco has become the most important player in western Europe. But even there its market share is still only 15% (26% excluding water) after 17 years of acquisitions. We believe the company will continue to seek opportunities to further consolidate the western European market and also has made it clear that it is looking for a similar consolidator role in the US. In addition to this, co-packing will continue to offer acquisition opportunities on both sides of the Atlantic. We calculate that the company could spend at least EUR1.9bn on acquisitions over the next five years (assuming a net debt/EBITDA ratio of 2.5x).

Given its reputation in the soft drinks industry, the company is an interesting investment vehicle for private equity. Back in 2015, Refresco's private equity shareholders were looking to divest the company through a sale or flotation, and in the end opted for the latter. However, three other private equity companies (PAI Partners, Pamplona Capital Management and Platinum Equity) were interested in acquiring the business for around EUR1.5bn. PAI Partners approached the company again in April 2017 and offered EUR1,404m (EUR17.3 per share), but this was rejected by Refresco's Executive Board and Supervisory Board. Potential private equity interest in the company should continue to support the share price.

Private label in the US is only 10% of soft drinks compared to 26% in western Europe

Refresco is gearing itself up for an expected surge in private label soft drinks in the US. Indeed, although discounters in the US have a food retail share level to that in western Europe (i.e. 22% v 23%), private label soft drinks only represent 10% of volumes compared to 26% in western Europe. However, as Aldi and Lidl are preparing for a strong US expansion, they would like Refresco to supply them in the US as well. On top of that, other retailers are likely to increase private label soft drinks in their assortment. With the potential for growth in the US private label soft drinks, Refresco is entering the market. Last year the group acquired Whitlock Packaging, which is primarily present in co-packing, but is on the look-out for further additions.

Co-packing growing by high single digits

Bottlers, A-brand owners and also small soft drink companies are increasingly looking to outsource manufacturing of their soft drinks. Co-packing is growing by about 9% p.a. in western Europe and is also continuing to grow in the US. The reasons for brand holders to outsource can be very diverse from wanting to focus on main production runs to improve efficiency, the lack of certain packaging lines (and A-PET), or working with an asset light model that allows them to focus on selling the beverage. With its modern manufacturing base (as investments are spread over different co-packing and private label customers), Refresco is well placed to take advantage of this growing trend. In western Europe, the company already has a 42% share of the market.

Private label flourishes when consumer wallets are under pressure

Refresco should benefit from a tougher macro-economic environment when consumer wallets are under pressure and private label offers a cheaper alternative to branded soft drinks. This was the case in 2008/09 when private label increased its share to 27% from 24% in 2007 and also in 2012 when it climbed to 28% of western European soft drink volumes. However, as economic situations have improved recently, private label soft drink penetration slid to 26% in 2016.

The company is best placed to take share in the private label soft drinks industry in western Europe and with its 15% share, is double the size of its next rival. Soft drinks and private label have become a mature business in western Europe with flattish and even declining volumes. However, given its industry leading margins, Refresco has the cash flow to continue investing in innovation and new packing lines, attracting more business from existing and new customers.

#### Immune to raw material price fluctuations

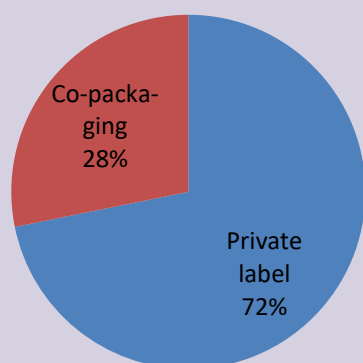
The private label and co-packing business is relatively immune to fluctuations in raw material prices. In private label manufacturing, contracts are concluded for one year at a fixed price, but Refresco immediately hedges the raw material cost. For co-packing the contracts last between three and five years and the brand-owner supplies the raw materials or instructs Refresco to buy them from a certain supplier, in which case, Refresco simply passes on the bill.

#### 16.4x current year earnings

At the current share price of EUR17.4, Refresco is trading on a 2017e P/E of 16.4x. We derive a DCF-based fair value of its existing operations of EUR19.1 (10% upside), but excluding any further M&A would be ignoring the reality of the market opportunities. Adding two years of acquisitions (to keep net debt/EBITDA at 2.5x) delivers our fair value of EUR21.8 (25% upside). At this fair value the stock would be trading on 20.6x earnings. At the current price of EUR17.4, the company yields a free cash flow of 6.3%.

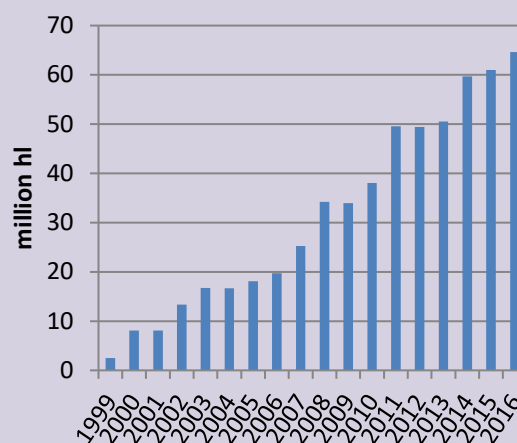
## 2.1. Key charts executive summary

**Fig. 1: 2017e volume by business operation**



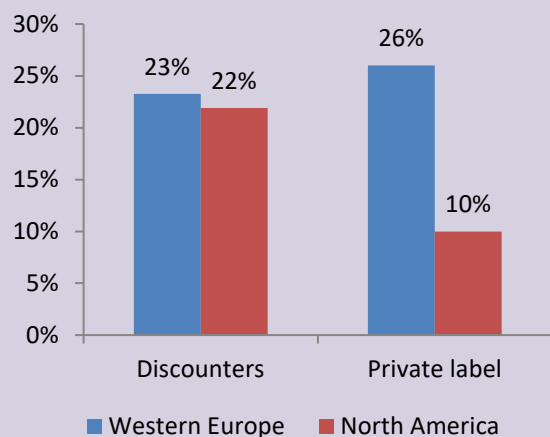
Source: Bryan, Garnier & Co ests.

**Fig. 2: 17 years of growing volumes**



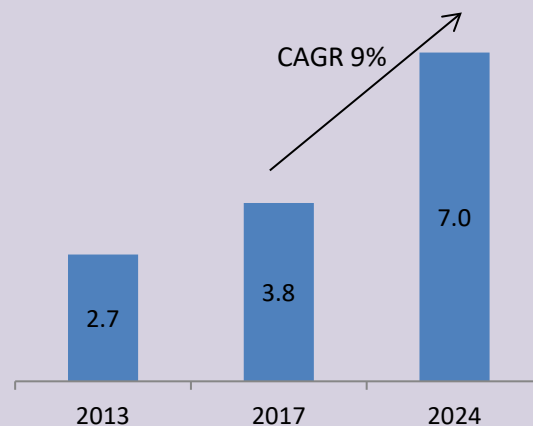
Source: Company data, Bryan, Garnier & Co ests.

**Fig. 3: Private label penetration US vs western Europe**



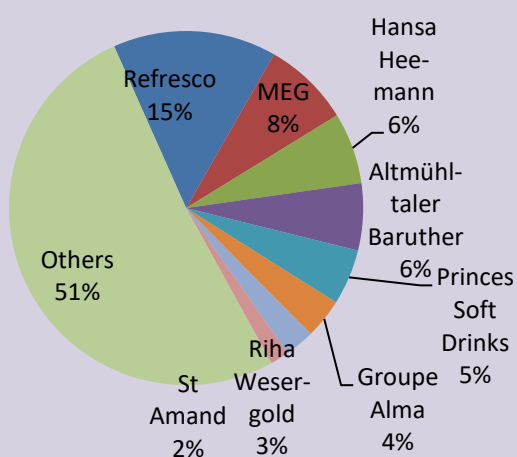
Source: Canadean

**Fig. 4: Rise in co-packing of soft drinks – total for Benelux, Germany, France, UK, Iberia, Italy**



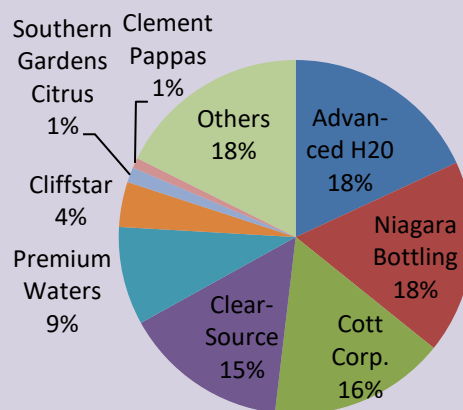
Source: Company data

**Fig. 5: Western European private label soft drinks (27bn litres, 2016)**



Source: Canadean, Bryan, Garnier & Co ests.

**Fig. 6: US private label soft drink market (11.6bn litres, 2016)**



Source: Canadean

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



## 2.2. SWOT analysis

Fig. 7: SWOT analysis Refresco

Strengths	Weaknesses
<p>From being a leading pan-European independent bottler, with market-leading positions in private label and co-packing, comes structural competitive advantages in terms of client relationship, innovation, cost benefits and profitability.</p> <p>An additional strength of the European-wide production platform is that it allows production close to the consumer across the region (there is a maximum range of 300/400km of product delivery) which is not only good for private label but equally allows flexibility for A-brand owners to launch new products (smaller batches) which sometimes its own bottlers are not willing/able to produce (e.g. Innocent for Coca-Cola).</p> <p>The group's track record in unlocking synergies from acquisitions is evidence of the success of its continuing consolidation strategy.</p>	<p>Shareholding structure: with no stable shareholder in a consolidating industry, the company is vulnerable to a potential bid, which might re-focus management's attention on the short term rather than the long term buy-and-build.</p> <p>The company's top three biggest customers (PepsiCo, Lidl and Aldi), generated 30% of the total volume. However, the company has multiple contracts with each of its customers that are country- and product-specific rather than a single contract with each customer, mitigating the risk of losing a customer's entire business.</p> <p>Margin upside is limited given the outsourcing nature (and the option to change supplier or retain production in house).</p>
Opportunities	Threats
<p>The trend to outsource production driven by the urge to improve production efficiency, is allowing some co-packers to bundle private labels with different A-brands manufacturing. Refresco has a 42% share in the western European co-packing market that is expected to grow by 9% p.a. in volumes</p> <p>Although the discount retail format has the same weight in the US as in western Europe, the share of private label in soft drinks is only 10% compared to 26% in western Europe. The arrival of Aldi and Lidl in the US is likely to change that, offering significant opportunities.</p> <p>Consolidation to continue: The need for efficiency in an overall flattish soft drinks market will drive consolidation. Refresco has grown through acquisitions to own 15% of the private label market in western Europe and 42% of the co-packing market and is looking to further its share in the area but also to replicate that in the US.</p>	<p>A changing industry: Changing life styles can put strain on the soft drinks market: On the one hand, rising health and nutrition awareness is driving a switch towards fruit juices and waters away from CSD. On the other hand, the increased search for convenience is driving "on-the-go" packaging and single-serve portions.</p> <p>With the decline in unemployment, western European end-consumer confidence and income is rising and as a result, the cheaper private label business has lost some momentum.</p> <p>Making soda at home instead of buying it in the off-trade could potentially put some pressure on the off-trade soft drinks market. However, options like Sodastream do not seem to have the same success as Nespresso (cluttering the kitchen?).</p>

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



## 3. Refresco valuation

### 3.1. Ratio valuation

In April 2017, PAI partners offered EUR17.3 per share

At the current share price of EUR17.4, Refresco is trading on a 2017e P/E of 16.4x, which is the highest level it has been trading on since its flotation. This has much to do with the fact that in April 2017 PAI Partners offered to take the company private at EUR17.3 per share, a proposal that was rejected by management (before it was trading at EUR15.0).

**Fig. 8: Stock market ratios (at a share price of EUR17.4)**

Stock market ratios	2015	2016	2017	2018	2019	2020	2021	2022
P/E average (x)	15.1	13.7	16.4	15.1	14.0	12.9	12.0	11.1
P/E high (x)	16.3	15.2						
P/E low (x)	13.9	12.2						
P/CF (x)	7.2	6.8	8.1	7.6	7.2	6.8	6.4	6.0
FCF yield (%)	4.1%	6.5%	6.2%	6.5%	7.0%	7.6%	8.2%	8.8%
P/BV (x)	2.3	2.2	2.4	2.2	2.0	1.8	1.6	1.5
EV/adjusted EBIT (x)	12.6	13.8	14.4	13.2	12.1	11.0	10.0	9.0
EV/EBITDA (x)	8.5	8.5	8.8	8.2	7.5	6.9	6.3	5.7
Net dividend yield	2.0%	2.2%	1.8%	2.0%	2.1%	2.3%	2.5%	2.7%
Total shareholder return	57.5%	11.0%	1.4%	10.4%	10.3%	10.4%	10.4%	10.5%

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

**Fig. 9: Peer comparison**

	Market cap (USD m)	EV/ Sales	EV/EBITDA				EV/EBIT			PE			FCF yield			Div yield
		2017	2017	2018	2019	2017	2018	2019	2017	2018	2019	2017	2018	2019	2017	2017
<b>Private label producers</b>																
Cott	2,049	1.0 x	8.8 x	8.2 x	7.2 x	23.9 x	20.1 x	17.9 x	81.0 x	29.3 x	27.1 x	6.3%	9.4%	9.2%	1.6%	
Dean Foods	1,397	0.3 x	5.5 x	5.1 x	3.9 x	9.3 x	8.4 x	6.3 x	11.7 x	10.9 x	10.4 x	15.5%	12.9%	14.8%	2.5%	
Greencore	2,097	0.9 x	11.3 x	9.1 x	8.1 x	16.1 x	12.8 x	11.1 x	14.7 x	13.3 x	12.0 x	0.1%	0.2%	0.3%	2.3%	
Greenyard	1,110	0.3 x	7.7 x	6.5 x	5.8 x	13.8 x	11.2 x	9.0 x	42.1 x	22.9 x	19.9 x	2.9%	3.7%	6.0%	0.9%	
McBride	432	0.6 x	6.9 x	6.3 x	-	10.0 x	8.7 x	-	13.8 x	11.8 x	10.6 x	9.8%	7.3%	9.8%	2.3%	
Ontex	2,988	1.3 x	10.6 x	9.6 x	8.5 x	12.9 x	11.5 x	10.2 x	15.9 x	14.3 x	12.9 x	2.0%	4.5%	5.9%	2.1%	
Pinnacle Foods	7,286	3.0 x	13.8 x	12.9 x	11.9 x	16.4 x	15.2 x	13.8 x	23.7 x	21.8 x	20.0 x	4.1%	3.4%	5.4%	2.1%	
<b>Refresco</b>	<b>1,643</b>	<b>0.9 x</b>	<b>8.8 x</b>	<b>8.1 x</b>	<b>7.5 x</b>	<b>14.3 x</b>	<b>13.2 x</b>	<b>12.0 x</b>	<b>16.3 x</b>	<b>15.0 x</b>	<b>13.9 x</b>	<b>6.3%</b>	<b>6.5%</b>	<b>7.0%</b>	<b>2.2%</b>	
Ter Beke	365	0.7 x	7.6 x	5.8 x	5.3 x	14.9 x	9.4 x	8.6 x	22.0 x	13.3 x	12.1 x	1.7%	5.7%	7.6%	2.1%	
<b>Average</b>		<b>1.0 x</b>	<b>9.0 x</b>	<b>7.9 x</b>	<b>7.3 x</b>	<b>14.6 x</b>	<b>12.3 x</b>	<b>11.1 x</b>	<b>26.8 x</b>	<b>17.0 x</b>	<b>15.4 x</b>	<b>5.4%</b>	<b>6.0%</b>	<b>7.4%</b>	<b>2.0%</b>	
<b>Bottlers</b>																
Coca Cola Eur P	20,343.0	2.1 x	11.8 x	10.9 x	10.1 x	15.4 x	14.1 x	13.0 x	17.3 x	15.5 x	14.0 x	3.8%	4.8%	5.1%	2.3%	
Coca Cola Icecek	2,944.9	1.5 x	9.8 x	8.3 x	7.2 x	15.9 x	13.0 x	11.1 x	26.4 x	19.6 x	15.9 x	(0.1%)	1.2%	0.2%	0.9%	
<b>Small soft drink brand owners</b>																
A.G. Barr	899.8	2.7 x	13.6 x	12.8 x	12.1 x	16.3 x	15.5 x	14.5 x	19.8 x	19.7 x	18.4 x	4.3%	4.5%	5.0%	2.3%	
Britvic	2,470.7	1.5 x	10.0 x	9.6 x	9.0 x	13.1 x	12.5 x	11.7 x	14.7 x	14.0 x	13.2 x	2.5%	3.3%	10.1%	3.5%	

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

## 3.2. DCF valuation

In developing a fair valuation based on a DCF model, we start by valuing the business as it exists today. For this we use the Bryan Garnier assumptions of a risk-free rate of 1.6% and a risk premium of 7%. We have then added an unleveraged beta of 1.0x (which stems from a leveraged beta of 1.2x given that about 30% of the company's market value of invested capital is financed with debt – net debt/EBITDA of 2.5x) resulting in a leveraged cost of equity of 10.1%. Given the net debt/EBITDA target of 2.5), the WACC that we apply in our DCF model is 7.8%.

In terms of long term growth rate, we use 2.4% derived from the company's investment programme. Every year, the company invests about the same amount as its depreciation level. According to the company, only half of that amount is maintenance capex and the other half is growth capex. If we take a more prudent view and earmark only 1/3 as growth capex and apply to that the company's ROCE of 11.2% (2016), then we look at an annual growth in operating profit of 2.4%. This kind of fits with our current forecasts for the next five years, looking for average volume growth of 2.5%. Furthermore, we add some price inflation of 1.7% p.a. as the mix improves and the company returns to previous gross profit per litre, but for the long term, we assume gross profit per litre to remain flat at 14.8 Eurocents. Working capital is not really an issue or an opportunity at the company, so it hardly impacts valuation.

DCF based fair value of  
current operations at  
EUR19.1

**Fig. 10: DCF valuation current operations**

EUR m	Dec-17e	Dec-18e	Dec-19e	Dec-20e	Dec-21e	Dec-22e	Dec-23e
Sales	2,306	2,401	2,501	2,606	2,606	2,606	2,647
EBIT	140	148	157	166	176	186	189
Taxes	-39	-42	-44	-47	-49	-52	-53
Operating profit after taxes	101	107	113	120	127	134	136
+ Depreciations	89	91	95	99	103	108	
-Investments in fixed assets	-88	-91	-95	-99	-103	-108	
Total net investments in fixed assets	1	0	0	0	0	0	0
Net capex % revenue	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
-Investments in working capital	1	-2	-2	-2	-3	-3	-3
WC investment % revenue	0%	0%	0%	0%	0%	0%	0%
=Operating cash flow	103	105	111	117	124	131	134
Discount factor	0.98	0.91	0.84	0.78	0.73	0.68	0.63
Present value of free cash flow	101	95	93	92	90	89	84
Cum. present value of FCF	643		Long term assumptions				
+Present value of terminal value	1,578		Risk free			1.6%	
=Enterprise value	2,221		Equity premium			7.0%	
Adjusted net debt incl pension provisions (restated cash)	-668		Unlevered Beta			1.00	
=Fair value	1,553		Leveraged Beta			1.21	
Fair value fully diluted per share	19.1		Company debt spread			1.0%	
=Fair value	1,553		RRE			10.1%	
			LT Growth			2.4%	
			Target Debt/IC			30%	
			LT WACC			7.8%	

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

However, valuing the company as it is today significantly underestimates the value creation that could unfold as the company consolidates private label and co-packing of soft drinks in western Europe and

the US. If we add acquisitions potential, assuming that net debt/EBITDA stays at 2.5x, acquisitions are based on EV/EBITDA of 7.5x, EBITDA margin at the target companies is 8% and the company is able to achieve synergies of 3% of revenues the year after the acquisition (below the 4% aim which is also their historic achievement), then the company would be able to make EUR1.9bn in acquisitions and would add EUR348m in EBITDA (post synergies).

**Fig. 11: Potential acquisitions programme**

	2017	2018	2019	2000	2021	2022	2023
Investment		200	300	400	450	550	
Revenues		333	500	667	750	917	
EBITDA		27	40	53	60	73	
EBIT		13	20	27	30	37	
Synergies			10	15	20	23	28
Cumulative							
Investment		200	500	900	1,350	1,900	1,900
Revenues		333	833	1,500	2,250	3,167	3,167
EBITDA		27	67	120	180	253	253
EBIT		13	33	60	90	127	127
Synergies		-	10	25	45	68	95
Net debt	(566)	(653)	(811)	(1,035)	(1,265)	(1,546)	(1,256)
net debt/EBITDA	2.5	2.5	2.5	2.5	2.5	2.5	1.9

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

Leaving all other assumptions unchanged, our Fair Value jumps to EUR29.0 per share. Indeed, the higher growth rate that the acquisitions bring in the first years is consistent with a growth rate derived from the company's retention rate and ROE. Applying an ROE of 14.5% on a retention rate of 65% leads to a growth rate of 9.5%.

DCF based fair value  
assuming 5 years of  
acquisitions at EUR29.0

**Fig. 12: DCF valuation assuming the company follows an aggressive acquisition plan for five years**

	Dec-17e	Dec-18e	Dec-19e	Dec-20e	Dec-21e	Dec-22e	Dec-23e
Sales	2,306	2,401	2,834	3,439	4,106	4,856	4,953
EBIT	140	162	200	251	311	380	411
Taxes	-39	-45	-56	-70	-87	-107	-115
Operating profit after taxes	101	116	144	181	224	274	296
+ Depreciations	89	105	128	159	193	234	239
-Investments in fixed assets	-89	-105	-128	-159	-193	-234	-239
Total net investments in fixed assets	0	0	0	0	0	0	0
Net capex % revenue	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
-Investments in working capital	1	-3	-3	-4	-4	-5	-6
=Operating cash flow	102	113	141	177	220	269	290
Discount factor	0.98	0.91	0.85	0.79	0.74	0.69	0.64
Present value of free cash flow	100	103	120	140	162	185	185
Cum. present value of FCF	996		Long term assumptions				
+Present value of terminal value	3,494		Risk free		1.6%		
=Enterprise value	4,490		Equity premium		7.0%		
Adjusted net debt incl pension provisions (restated cash)	-668		Unlevered Beta		1.00		
Additional acquisitions	-1,465		Leveraged Beta		1.21		
=Fair value	2,357		Company debt spread		1.0%		
Fair value fully diluted per share	29.0		RRE		10.1%		
			LT Growth		2.4%		
			Target Debt/IC		30%		
			LT WACC		7.8%		

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

However, investors are unlikely to pay for acquisitions potential over the next five years (although the scenario is extremely likely in our view). Hence, we have decided to assume a more moderate acquisitions scenario whereby the company invests about EUR500m in 2018/2019. Following this scenario, we derive a Fair Value for the company of EUR21.8.

EUR21.8 DCF fair value  
assuming 2 years of  
acquisitions

**Fig. 13: DCF valuation assuming the company follows an aggressive acquisition plan for two years**

	Dec-17e	Dec-18e	Dec-19e	Dec-20e	Dec-21e	Dec-22e	Dec-23e
Sales	2,306	2,401	2,834	3,439	3,439	3,439	3,521
EBIT	140	162	200	225	234	245	248
Taxes	-39	-45	-56	-63	-66	-68	-69
Operating profit after taxes	101	116	144	162	169	176	178
+ Depreciations	89	105	128	132	137	141	144
-Investments in fixed assets	-89	-105	-128	-132	-137	-141	-144
Total net investments in fixed assets	0	0	0	0	0	0	0
Net capex % revenue	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
-Investments in working capital	1	-3	-3	-4	-4	-5	-6
=Operating cash flow	102	113	141	158	165	171	172
Discount factor	0.98	0.91	0.85	0.79	0.74	0.69	0.64
Present value of free cash flow	100	103	120	125	122	118	110
Cum. present value of free cash flow	797		Long term assumptions				
+Present value of terminal value	2,076		Risk free		1.6%		
=Enterprise value	2,874		Equity premium		7.0%		
Adjusted net debt incl pension provisions (restated cash)	-668		Unlevered Beta		1.00		
Additional acquisitions	-437		Leveraged Beta		1.21		
=Fair value	1,769		Company debt spread		1.0%		
Fair value fully diluted per share	21.8		RRE		10.1%		
			LT Growth		2.4%		
			Target Debt/IC		30%		
			LT WACC		7.8%		

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

PAI could boost leverage  
to 4x and Fair Value to  
EUR40 per share

Refresco was recently the target of private equity company PAI Partners, that was planning to offer EUR17.3 per share. Under private equity ownership, the company would be able to leverage itself significantly allowing even further acceleration in market consolidation. Levering the company to a net debt/EBITDA ratio of 4.0x for only three years could potentially free up EUR3.8bn for acquisitions and could propel Fair Value to EUR40 per share. It is no surprise that Refresco's management does not even want to discuss the proposal.

## 4. Business and strategy

The leading European bottler of private label soft drinks and contract manufacturer of A-brands

Refresco is the leading European bottler of soft drinks and fruit juices for retailers (private label) and is the leading contract manufacturer for soft drinks for A-brand customers such as PepsiCo, Coca-Cola, Orangina Schweppes (Suntory), Nestle and Monster. It has 27 European manufacturing sites in the Netherlands, Belgium, Germany, France, Spain, Italy, Poland, Finland and the UK. Last year, the company entered the US market where it now has three sites. In 2016, the company reached EUR2.1bn in revenues on production of 6.5bn litres.

The manufacturing footprint is the broadest in Europe.

The company was founded in 1999 with a management buyout of Menken Drinks and Refrescos after the Dutch dairy group Campina Melkunie gained full control of another Dutch dairy group Menken.

The original private-equity holders still own 27.8% of the company. The executive board holds 1.9% of the shares through Okil (CEO Roelofs and CFO Duijzer hold respectively 25.0% and 28.5% of Okil).

**Fig. 14: Shareholding structure**

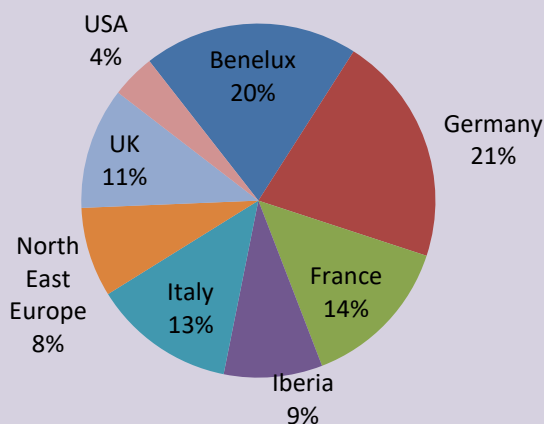
Company	Shareholding
Ferskur	14.5%
Tamoa	8.1%
3i	5.2%
Free float	72.2%
of which	
Mondrian	5.2%
Norges	4.9%
Capital	3.5%
BDL	3.2%
Okil	1.9%

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

18 acquisitions since 1999

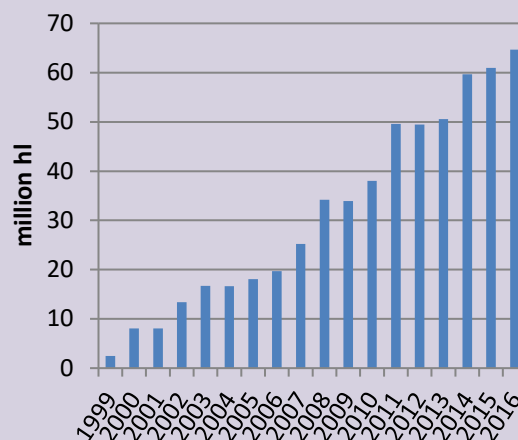
Since 1999, the company has acquired and consolidated 18 companies or production units (and sold one) and today the manufacturing footprint for private label and co-packing is the broadest in Europe. In 2012, the company acquired Taja, a Polish private label manufacturer of CSD and bottled water. In 2013, the company combined its business with Gerber, which took two years to digest but in 2016, the company announced four transactions. In the US, it entered the market with the acquisition of Whitlock Packaging. In Europe, it acquired DIS in the Netherlands and bought a production facility from Pepsi in Germany. Furthermore, Refresco announced the purchase of Sanpellegrino's (Nestle) Recoaro bottling facility in Italy (transaction closed in March 2017). Earlier, in March 2015, Refresco was listed on the Amsterdam stock exchange.

**Fig. 15: Volume by country**



Source: Company Data

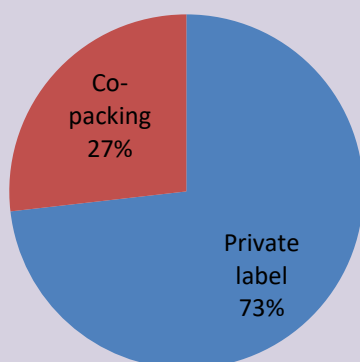
**Fig. 16: 17 years of growing volumes**



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

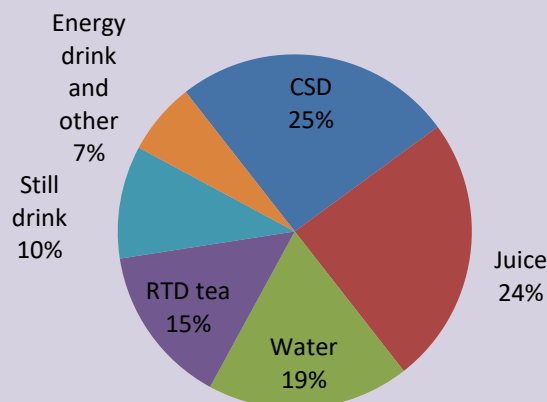
The company manufactures and/or bottles a broad variety of products for its private label and co-packing customers: fruit juices, carbonated soft drinks, ready-to-drink teas, still drinks, energy drinks, sport drinks, water, beer and specialty drinks. It also offers a wide range of packaging types and sizes, including PET, Aseptic PET (A-PET), cartons, cans and glass.

**Fig. 17: 2016 volume by business segment**



Source: Company Data

**Fig. 18: 2016 volume by product category**



Source: Company Data

## 4.1. Portfolio and positioning

Continuing investments in technology and production lines secures high renewal rates

The company operates a flexible bottling platform and offers its customers efficient bottling processes and end-to-end supply chain solutions. Continuing investments in technology and production lines secures high standards and contract renewal rates with its private label and co-packing customers.



#### 4.1.1. Preferred private label supplier for retailers

Market leader in private label soft drinks in western Europe with a 15% share

Main private label clients are Aldi and Lidl

Aiming for a gross margin of 8 to 20 Eurocent per litre

Refresco manufactures private label soft drinks for retailers and discounters. Its products range from lower-priced retailer brands to more exclusive, higher-end, high-quality brands. The company is market leader in private label soft drinks in western Europe with an estimated market share of 15%.

Its main private label customers include Lidl, Aldi, Dia, Ahold Delhaize, Jumbo, Rewe, Carrefour, Edeka, Morrisons and Tesco. Private label production requires a high level of coordination with retailers in areas such as product development, packaging designs and manufacturing, supply chain processes.

Private label contracts are typically one-year, fixed-price agreements based on volume estimates (guidance is provided by historic data or forecasts). Given the fixed-price nature of the contracts, the company bears commodity price risk for which it hedges itself as soon as it enters into a contract. The prices that it charges are mostly based on raw material prices with the company looking to achieve a certain gross margin per litre in euro cents (the companies average is 14 euro cents per litre but the range spans from 8-20 cents depending on the type of contract and product).

Refresco also manufactures and sells its own country-specific value brand Wicky fruit drink in the Netherlands, but this business is relatively small (about 1% of sales volumes) and there is no plan to expand the product category to avoid competing with its private label or A-brand customers.

#### 4.1.2. Co-packing solution for A-brand customers

Co-packing market share in western Europe of 42%

PepsiCo is the company's biggest client with a 10% share in group volumes

Co-packing or "contract manufacturing", is the process of manufacturing soft drinks for A-brand customers, such as PepsiCo, Coca-Cola, Suntory, Nestle and Monster. After the acquisition of DIS, it has an estimated market share in soft drink co-packing in western Europe of 42%.

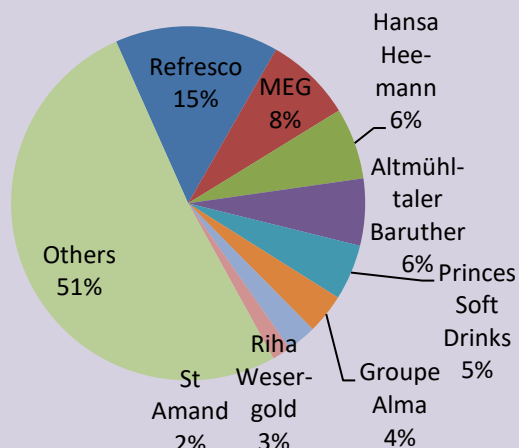
The company provides its A-brand customers with production flexibility that enables them to better utilise their assets, expand their packaging mix and lower their production costs. The company has multi-year contracts with its co-packing customers, which typically last for three to five years. However, some have a duration of up to 10 years when specific investments are required.

The key difference between the company's private label and co-packing activities is that large co-packing activities source themselves, i.e. activities are carried out on behalf of the customer, and private label activities are carried out with the company bearing the cost and risk. For its co-packing activities, the larger co-packing customers provide the required raw materials and packaging materials themselves. If this is not the case, the company sources the required raw materials back-to-back for the relevant co-packing customers. In addition, some of its co-packing customers direct the company to purchase raw materials and packaging materials on their behalf and in accordance with their specifications, including vendor selection and pricing terms. As a result, the company does not bear this commodity risk in respect of most co-packing contracts. This is different from the company's private label activities for which raw materials are sourced from commodity producers and traders.

Most co-packing clients pay a filling fee

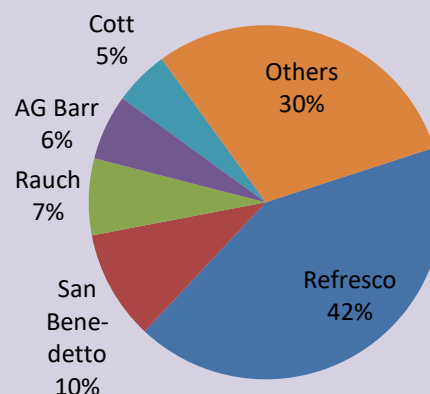
In addition, most co-packing customers pay a fixed fee per unit and agree to purchase a minimum volume of units. If the co-packing customer purchases less than the agreed minimum volume, a penalty applies. Private label customers often hold tenders, and the company agrees with them on a fixed fee per unit, with no minimum volume guarantee.

**Fig. 19: Main producers of western European private label soft drinks (26.8bn litres, 2016)**



Source: Canadean, Bryan, Garnier & Co ests

**Fig. 20: Main co-packers for off-trade soft drinks ex water in Benelux, Germany, France, UK, Iberia, Italy, (3.4bn litres, 2016e)**



Source: Refresco, Bryan, Garnier & Co ests

## 4.2. Strategy

Through executing its organic growth and acquisitions strategy, the company aims to achieve:

Low to mid-single digit organic volume growth

- 1) Average annual organic volume growth in the low to mid-single digits, and average annual organic revenue growth in line with volume growth at constant raw material prices and excluding product mix effects. Assuming 1% organic volume growth in private label (a decline in western Europe and growth in the US, and 5% organic growth in co-packing (high single-digit in western Europe and flat in the US), we derive organic volume growth of 2.5%.
- 2) Gross profit margin per litre is targeted to decrease marginally due to product mix effects (at the group level after the dilutive impact of Whitlock Packaging, we have growth from 13.9 euro cents in 2017 to 14.3 in 2019),
- 3) Furthermore, the company targets average organic operating expense growth lower than volume growth driven by product mix effects, operating leverage, footprint optimisation and efficiency improvements.
- 4) Refresco targets capital expenditure of 3-4% of the company's annual revenues. Although this is only equal to depreciation levels of 3.8% of revenue, depreciation is both on buildings and machinery & equipment whereas the investments are only on machinery & equipment (half of which is maintenance capex and half expansion capex).

Outgrowing the western European private label market

### 4.2.1. Low to mid-single digit organic volume growth

**Above market growth in private label:** Refresco has built a network of production facilities in Europe resulting in market leading scale (with an estimated market share of 15%, it is nearly twice as big as MEG which has an 8% share) and profitability (its EBITDA margin is over 10% whereas this is mostly only 6-8% at the companies that it acquires). The group aims to leverage this platform to gradually increase market share (only gradually in order not to disrupt the market) focusing on 1) completing its portfolio across products, packaging and regions, 2) driving share in the hard discount segment and, 3) continuing a high level of innovation and new product development, including growth in A-PET technology, sports and energy drinks and ready-to-drink tea.

## Improving flexibility and cost structure

**Aggressive expansion in co-packing with existing and new customers:** With existing customers, the group aims to leverage its current relationships to capture additional outsourced volumes and to grow with the expansion of its overseas customers in Europe. Refresco also aims to gain additional outsourced volumes from its existing customers and win contracts with new customers by launching new innovative products and expanding its offering throughout Europe. The company also seeks to enter into strategic bilateral agreements with A-brand owners.

**Operational excellence:** Refresco plans to continue investing in improving production flexibility and cost efficiencies in its manufacturing and warehousing operations. A major component of operational excellence is the group's focus on footprint optimisation, especially in the event of further acquisitions. The recent closure of the Heerlen facility (2014), the closures of St. Andrea (2015) and the closing of the Nieszawa facility in Poland (2016) are examples of how the company aims to maximise its efficiency through managing its footprint. However, no further closures have been announced. In addition, Refresco aims to reduce its overall cost base through a variety of cost-saving initiatives. These include, for example, investments in new fully-automated and higher-speed production lines and specific targets for reducing energy, waste and water usage with increased recycling rates. The company's cost base is also expected to benefit from a procurement roadmap aimed at maximising the gross profit margin per litre. This series of operational excellence initiatives should allow the company to improve its operating profit margin to 8% (from 6.4% in 2016) and its EBITDA margin to 12% (from 10.3%) over time.

### 4.2.2. Continued buy-and-build strategy

Refresco's management plans to continue its "buy-and-build" strategy. The Company's focus areas for acquisitions are:

## Acquisitions on both sides of the Atlantic

1. Europe (both existing and adjacent countries such as Norway, Sweden, Denmark, Switzerland, Austria, Czech Republic) and North America. The total soft drinks volume in those adjacent European markets (ex. Russia) is 33.2bn litres of which 5.0bn litres is comprised of private label volume (representing a penetration of approximately 13%) and the remaining 28.2bn litres is comprised of branded volume.
2. Juices and ready-to-drink/sport and energy categories; In western Europe the strongest growing category over the past five years (according to Canadean) has been private label sport and energy drinks where volumes have grown by an average of 4%, while water was the second fastest growing category (2% average growth), but fruit juices were one of the worst-performing categories with an annual decline of 4%.
3. Carton, PET, A-PET (aseptic PET) and cans;
4. Off-trade private label and co-packing.

## Acquisition prices at and EV/EBITDA of max 7.0-7.5x

In pursuing acquisition targets, Refresco assesses 1) the possibility of exploiting synergies (procurement, operations, overheads), 2) the extent to which the target's business complements the product and packaging offering, and 3) whether acquiring the target would reinforce the group's leading local position. The financial metrics it uses are 1) an adjusted EBITDA multiplier before and after expected synergies (before synergies the multiple seems to be between 7.0x and 7.5x), 2) growth opportunities, 3) an increase in the company's ROCE to more than 10% (this was already 11.2% in 2016), and 4) an increase of the company's EBITDA margin to more than 10% (this was already 10.3% in 2016 but we expect it to dip again to 9.9% in 2017).

Ideal 60/40 distribution in volumes between private label and co-packing

### 4.2.3. Combining private label and co-packing

Refresco's business model combines manufacturing for retailers with private label offerings and co-packing for branded beverage companies. Its goal is to achieve a 60/40 balance per production unit between private label and co-packing as it believes that this provides several structural advantages. Firstly, it helps combine flexibility, quality and high standards under one roof. Secondly, by working for a high number of customers and products, it can run production facilities more efficiently. Indeed, production for private label and co-packers can be carried out on the same line. For retailers with a private label range, Refresco offers an end-to-end solution that covers every step of the process. Branded beverage companies seek co-packers that have sufficient scale and geographic scope to provide production flexibility that meets their requirements in multiple markets.

We believe that Refresco achieves this 60/40 balance in France and Iberia, but for the remaining countries still a lot of work cut out.

**Fig. 21: Refresco's share of private label and co-packing volumes by region, 2016e**

	Private label	Co-packing
Benelux	91%	9%
Germany	92%	8%
France	62%	38%
Iberia	65%	35%
Italy	48%	52%
North East Europe	73%	27%
UK	83%	17%
Western Europe	76%	24%
USA	0%	100%
Group	73%	27%

Source: Bryan, Garnier & Co ests.

## 5. The global soft drinks industry

The global soft drinks market totals 790bn litres, 42% of which is water (tap water is another 5,000bn)

According to Canadean, the global drinks industry measures 1,860bn litres, 42% or 790bn litres of which are soft drinks (tap water and other drinking water accounts for another estimated 5,000bn litres). The soft drinks market can be divided into different product categories:

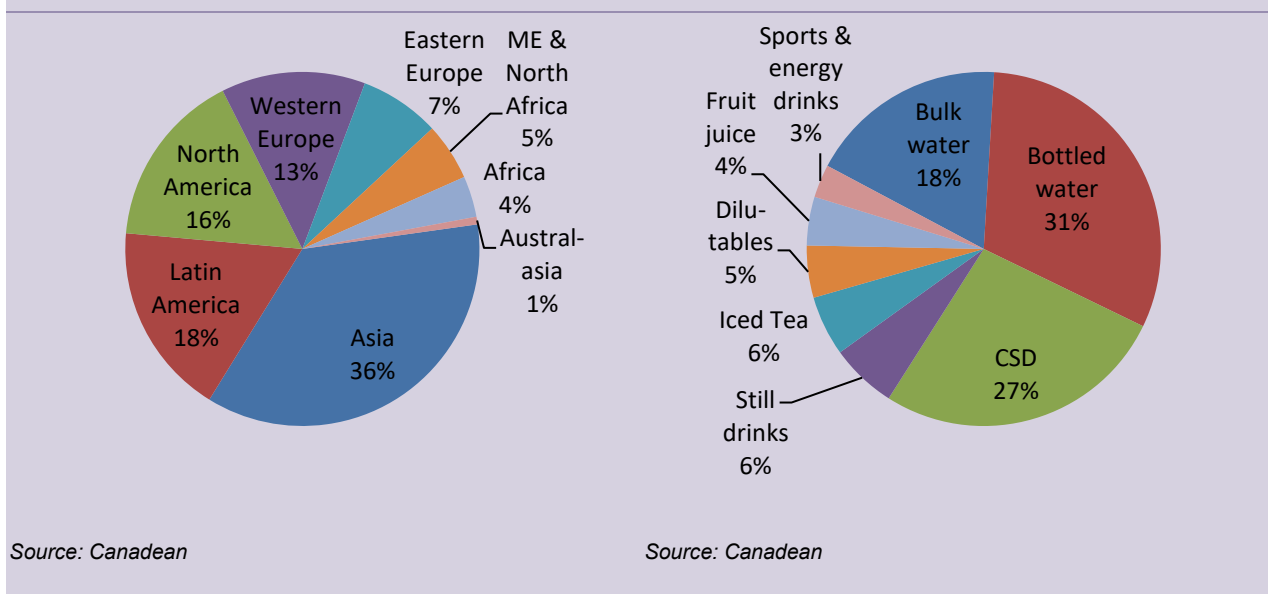
- Water accounts for 49% of the soft drinks market. Bottled water (still and sparkling bottled water, including flavoured and functional water) is the largest category accounting for 31% of volumes. The Bulk/HOD water market (drinking water sold in packs of over 10 litres for use in dispensers and the Home and Office Delivery water) represents another 18% of the soft drinks market.
- The carbonated soft drinks (CSD, sweetened, non-alcoholic drinks containing carbon dioxide, excluding carbonated bottled water and still drinks such as ready-to-drink tea) is the second largest soft drinks category and accounts for 27% of the global soft drinks market.
- Still drinks comprise still juice drinks and juice flavoured drinks. Still juice drinks are made with fresh juice or concentrate and the juice content does not exceed 24%. Still drinks make up for 6% of global soft drinks volumes.
- Ready-to-drink tea (incl. carbonated) and coffee are also drinks, but we have displayed them here separately, making up 6% of global soft drink volumes.
- Dilutables comprise concentrates, syrups and squashes, which must be diluted with water before consumption. Dilutables account for 5% of global soft drinks volumes.
- Fruit and vegetable juice represents 4% of the global soft drinks market and comprises juice not from concentrate (NFC) and juice reconstituted from frozen concentrate, and nectars.
- Sports and energy drinks (sports drinks usually depend on the provision of fluids, carbohydrates or both while energy drinks are designed to boost energy levels and usually contain high levels of caffeine and taurine). Sport and energy drinks represent 3% of the global soft drinks market.
- Piped water drawn from a tap or POU system (point of use). Estimated average human consumption of fluid is around two litres/day, but varies according to geography and climate. Tap water consumption is not included in Canadean data.

**Fig. 22: Drinks volumes in billion litres, 2016**

	Africa	Asia	Austral- asia	East Europe	Latin America	Middle East, North Africa	North America	western Europe	Global
Soft drinks	30	285	5	58	139	41	128	104	790
Hot drinks	16	319	5	82	31	22	22	52	547
Dairy, soy drinks	13	124	3	19	34	12	25	29	260
Beer & Cider	9	69	2	22	32	1	26	28	189
Spirits	1	36	0	2	3	0	3	2	47
Wines	1	3	1	3	2	0	4	13	26
Total	69	835	17	186	241	77	207	228	1860

Source: Canadean

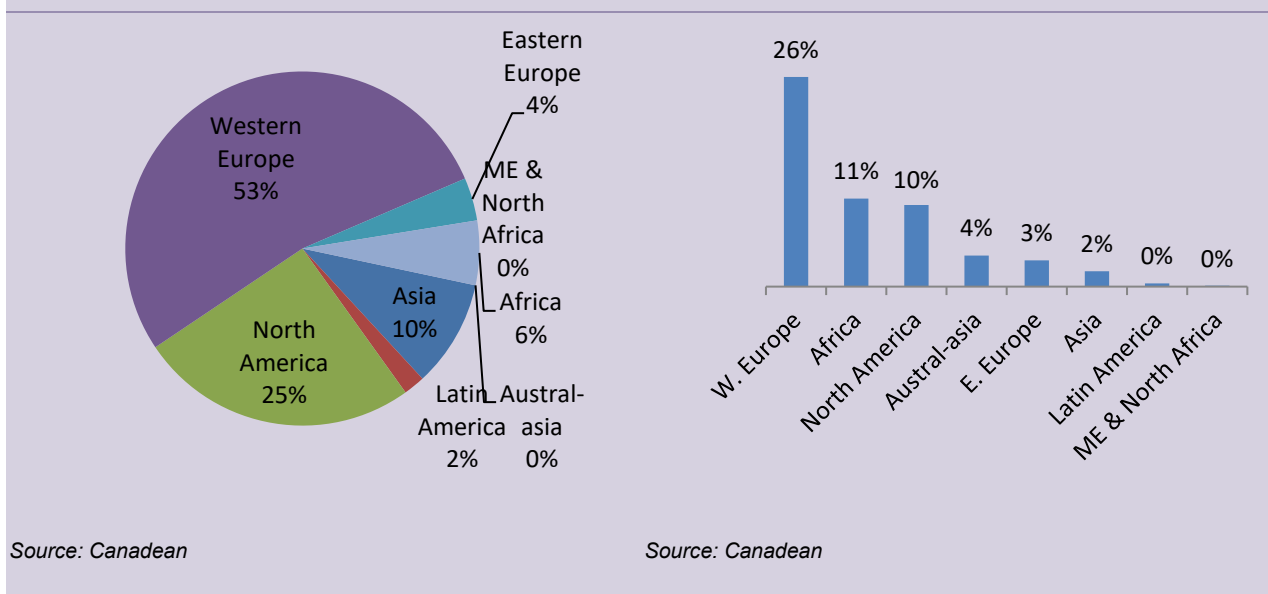
**Fig. 23: 2016 global soft drinks market by region (790bn litres)** **Fig. 24: 2016 global soft drinks market by category (790bn litres)**



The private label soft drinks market represents 51bn litres, more than half of which is in western Europe

Soft drinks can be categorised as either private label or branded. Private label products are products that are sold by a retailer under its own brand name, such as “Aldi’s River Cola” sold by Aldi. Branded products are products sold under a brand name not related to the distribution channel, such as “Coca-Cola”. Unlike private label products, branded products are typically promoted through advertising and promotional campaigns to raise brand awareness and loyalty. On average, branded products are positioned at a higher price point than private label products. Private label soft drinks account for an estimated 51bn litres worldwide, but the majority is in western Europe and North America.

**Fig. 25: 2016 global private label soft drinks market (51bn litres)** **Fig. 26: 2016 private label penetration soft drinks (51bn litres)**



## 6. Key drivers

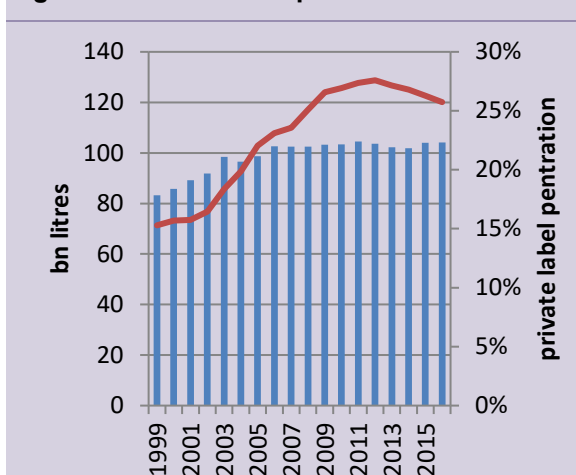
### 6.1. Private label growth in the US

Growth in the western European private label soft drinks industry surged during the 2008/2009 financial crisis as consumers looked to maximise purchasing power and there were further increases in private label soft drinks until 2012. In western Europe, overall private label penetration in fast moving consumer goods achieved a value market share of 38% in 2016 (IRI), whereas this only stood at 16% in the US. Based on these figures, substantial room for additional penetration in the US markets clearly exists.

In the US private label is only 10% of soft drink volumes compared to 26% in western Europe

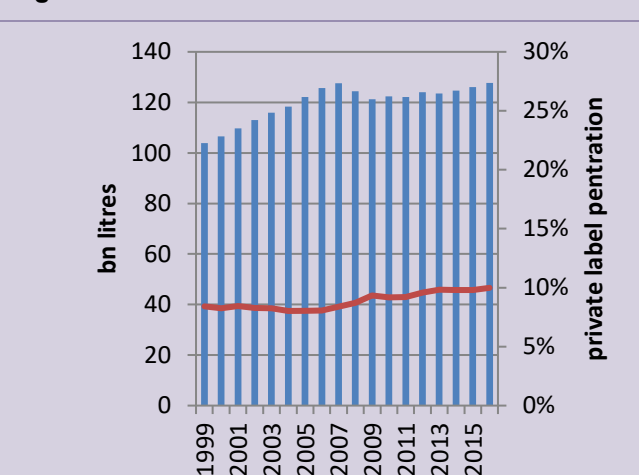
More specifically for soft drinks, private label reached 26.8bn litres or 28% of total soft drinks volumes in 2012. Since then, this share has fallen back to 26% as the finances of western European consumers have gradually improved and most retailers are hitting high levels of private label penetration. However, this is not the case in the US, where private label penetration in soft drinks reached only 10% in 2016, indicating scope for further growth.

**Fig. 27: Western European soft drinks market**



Source: Canadean

**Fig. 28: North American soft drinks market**



Source: Canadean

Indeed, the discount market seems well developed with discounters accounting for 22% market share in US off-trade sales of soft drinks compared with 23% in western Europe. However, US discounters use more branded products in their offering than their western European counterparts. We believe that will change in the coming years as hard discounters Aldi and Lidl are set to step up competition in the US. Aldi already had 1,600 stores at the start of 2017 and is planning to open another 400 by the end of 2018 and targets a US store base of 2,500 by 2022. Rival Lidl opened its first 10 US stores in June 2017 and is planning a total of 100 stores by the summer 2018.

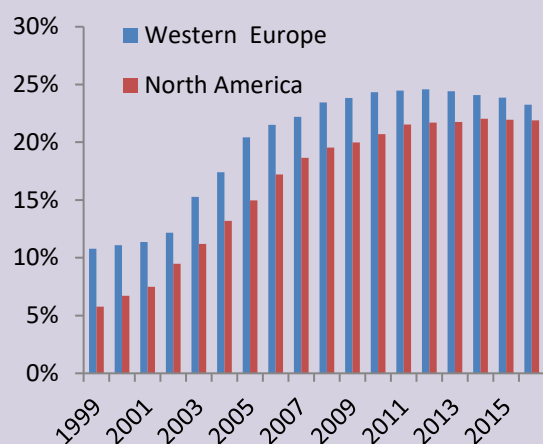
Expansion at Aldi and Lidl in the US is likely to drive private label volumes

Both Aldi and Lidl are set to add even more price competition in an industry that already suffers intense competition (by June 2017, US food prices had dropped for 17 straight months, the longest streak in more than 60 years). Aldi's prices are up to 50 percent lower than traditional grocery chains (Reuters interview with Aldi Chief Executive Jason Hart in May 2017) and that looks like to be followed by Lidl, which has stated that it would price products up to 50 percent lower than rivals. An



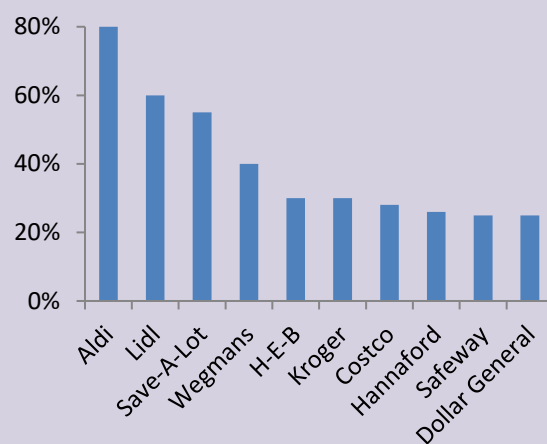
important element to drive pricing lower is the share of private labels in total store sales. In the US, the private label share of store sales at Aldi is around 80% and in western Europe, private label sales are over 60% at Lidl (Lidl typically carries one private label and one national brand in a given category). Furthermore, because of the more limited range of sku's (700 to 1,200), their purchasing power is often greater than other super and hypermarkets that carry 20,000 to 125,000 sku's.

**Fig. 29: Share of off-trade soft drinks sales volumes through discounters**



Source: Canadean

**Fig. 30: Private label share of store sales in selected US chains**



Source: Bryan Garnier estimates based on Nielsen Homescan Panel

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

Proof that the hard-discount formula can quickly gain traction and further disrupt the market is found in the United Kingdom, where the hard-discount format is relatively new compared with markets like Germany. In the UK, the combined share of Aldi and Lidl reached 11.9% in June 2017 compared with 6.7% four years earlier. Their rapid growth has triggered a price battle among traditional supermarket operators in the UK and has underpinned growth in private label offerings.

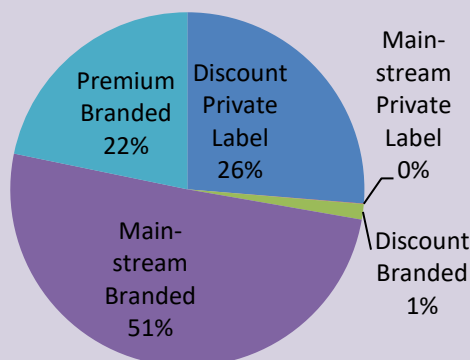
Private label soft drinks are mainly a discount proposition

The private label category has traditionally been focused on commodity categories that feature little product differentiation, high price sensitivity, high purchase frequency and limited innovation. However, the category has evolved to include more innovative premium and specialty categories that retailers and their consumers are demanding. Indeed, retailers are finding success creating multiple private-label brands targeting specific consumer needs such as organic, gluten-free, clean label, all natural, low-calorie or preservative-free. However, this is not the case for private label soft drinks, which according to Canadean are present for 99.8% in the discount segment in western Europe,.

However, the expansion of other food products into premium products and speciality categories beyond the traditional private-label categories has been such that in western Europe, perceptions of private label products are overwhelmingly positive, with 70% of respondents in a recent Nielsen global survey saying that private label is a good alternative to branded products, and 69% indicating that private label offers good value for the money. In North America as well, Nielsen found that the majority of shoppers were pleased with private-label products, calling them a good alternative to brand food products (75% of Americans, 73% of Canadians), good value (74% of Americans, 66% of

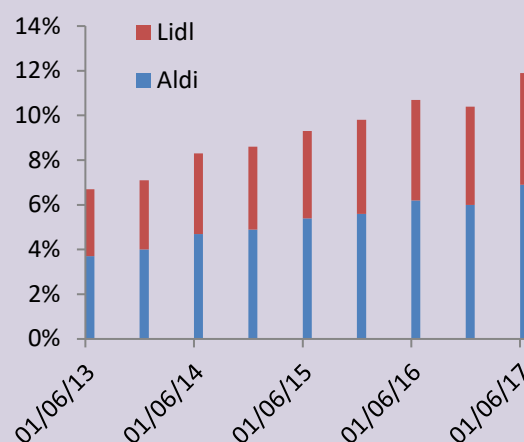
Canadians) and at a parity with brand food products in terms of quality (67% of Americans, 61% of Canadians).

**Fig. 31: Western European soft drinks market according to price position and private label (2015)**



Source: Canadean

**Fig. 32: Aldi and Lidl UK market share**



Source: Kantar

## 6.2. Outsourcing packing by bottlers

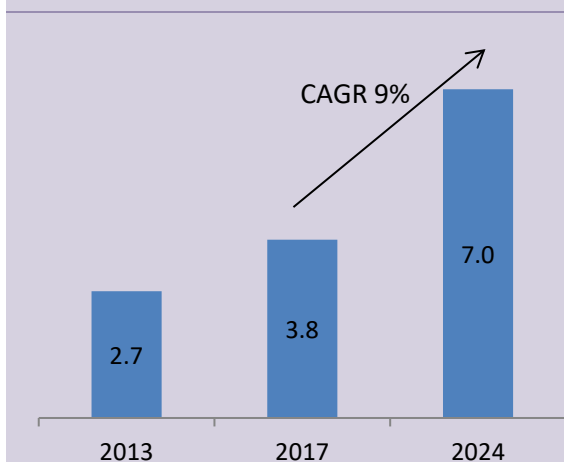
The co-packing market is the outsourced segment of the branded soft drinks market. Increasingly, branded-product manufacturers outsource some of their production to improve efficiency. There are different situations in which co-packing is considered:

- When a group aims to reach higher capacity utilisation and outsource the more volatile part of production or because it lacks sufficient scale in a certain region (e.g. Coca Cola, PepsiCo or Suntory).
- The brand owner would like to focus on the larger brands and is less interested in developing new packing lines for smaller (newer) brands (e.g. Innocent, Finley, Tropicana). The same goes for products that require new technology in which the brand owner does not want to invest.
- Brand-owners could choose an asset-light model and focus on branding, selling and distributing rather than on manufacturing (e.g. Monster, Ferrero, Arizona).

Co-packing market in Refresco's six key regions to grow by 9% p.a.

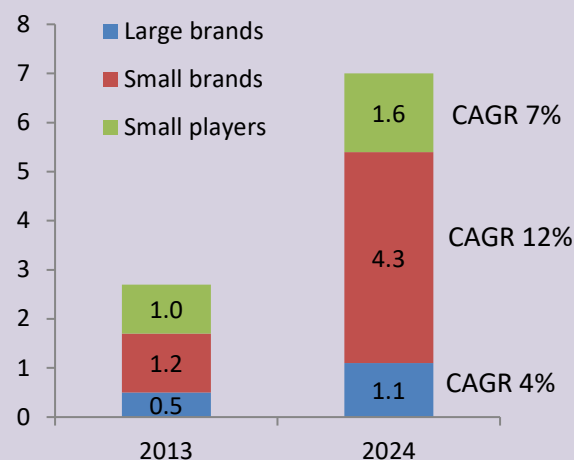
Refresco estimates that in its six major countries/regions (Benelux, Germany, France, UK, Iberia, Italy) the total size of the branded soft drinks market excluding water (since it is bottled at source and hence cannot be co-packed elsewhere), is 51bn litres, the majority of which is manufactured by brand owners themselves. However, according to the company, in 2013, co-packing volumes were approximately 2.7bn litres or 12% of production in the total branded soft drinks market (excluding water, i.e. 22.0bn litres) and this is expected to increase to approximately 3.8bn litres or 16% in 2017 and to a volume of approximately 7.0bn litres or 30% of production of the total branded soft drinks market (excluding water) in 2024. This represents a prospective CAGR of 9%.

**Fig. 33: Growing co-packing market (bn litres)**



Source: Company Data

**Fig. 34: Lower-volume brands at larger producers to grow strongest (bn litres)**



Source: Company Data

In 2013, penetration was estimated at approximately 4% for large brands within large groups, approximately 13% for lower volume brands within large groups, and approximately 42% for smaller local players. By 2024, the Company expects that large brands within large groups will comprise approximately 1.1 billion litres, lower volume brands within large groups will comprise 4.3 billion litres, and smaller local players will comprise approximately 1.6 billion litres.

In choosing a co-packing production partner, brand owners look for those with high quality standards, sufficient scale and geographic scope and who can provide production flexibility and reliability and meet their requirements across a multitude of markets.

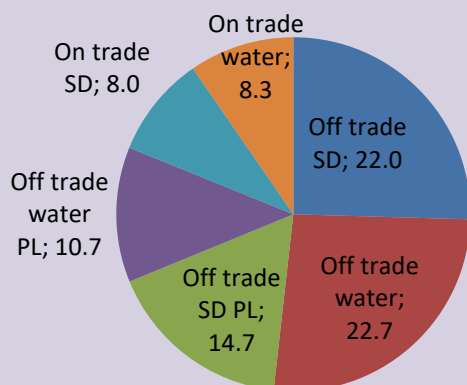
Refresco is well positioned to tap into the growth potential harboured in this segment as brand owners typically look for high quality standards, sufficient scale, geographic scope and flexibility and reliability in the production process. Refresco fulfils all these criteria:

- It is the clear market leader in co-packing with market share of approximately 42% in the countries where it operates, more than four times the size of the no. 2 player San Benedetto (10% share). Other competitors are Rauch (7%), AG Barr (6%) and Cott (5%).
- Refresco operates 27 production facilities in Europe and three in the US with 172 bottling lines. It currently offers some 6,000 SKUs, illustrating the flexibility in its production process.
- Service levels are 99.5% with delivery within days of ordering.

Co-packing is interesting for Refresco given that on top of the high growth rate, it concerns long term contracts and fills capacity or utilisation rates

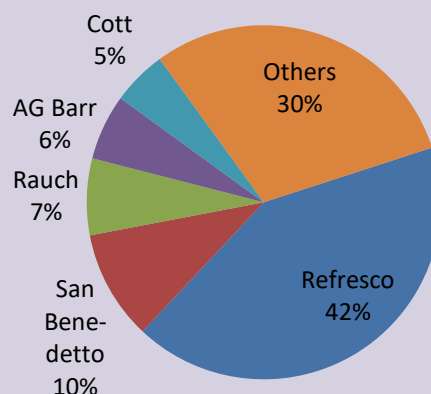
On the back of its experience and production knowledge in private label manufacturing, the company has developed a co-packing business that offers various advantages. Firstly, in western Europe, the growth rate in co-packing is significantly higher (i.e. CAGR 9% for 2017-2024) than that for private label (CAGR 1%). Secondly, it fills capacity enabling it to reach a better cost per litre for both the private label and co-packing businesses. Thirdly, co-packing contracts run for 3-10 years, delivering more revenue visibility. Fourthly, the longer production runs make it more efficient and fifthly, raw material exposure is limited as sourcing is undertaken by the customer and as a result, working capital requirements are also low.

**Fig. 35: Soft drink market in Benelux, Germany, France, UK, Iberia, Italy by volume, (bn litres, 2016e)**



Source: Canadean, Bryan, Garnier & Co ests.

**Fig. 36: Market share in off-trade co-packing volume in Benelux, Germany, France, UK, Iberia, Italy, 2016e**

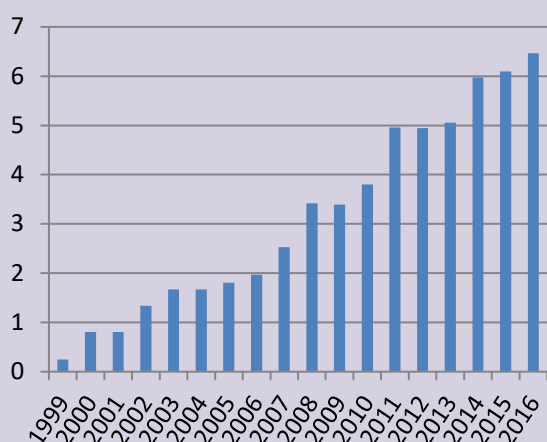


Source: Company Data; Bryan, Garnier & Co ests.

## 6.3. M&A

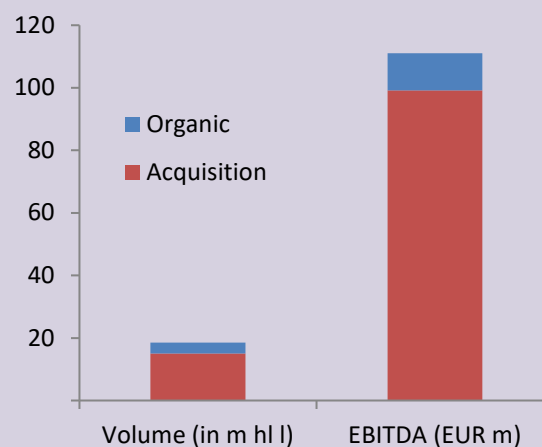
Refresco has grown from volumes of 0.25bn litres in 1999 to 6.5bn litres in 2016. The main driver behind this has been the 18 acquisitions undertaken over the period. Indeed, over 2011-2016, we calculate that the company grew volumes by 30% but that only 20% of that 30% stemmed from organic growth. This works out to an organic volume growth rate of just over one percent annually (private label in decline and high single digit growth for co-packing) out of total growth of 5% p.a.

**Fig. 37: Refresco volumes (bn litres, 1999-2016)**



Source: Company Data; Bryan, Garnier & Co ests

**Fig. 38: Cumulative organic and acquisitions growth in volumes and adjusted EBITDA (2011-2016)**



Source: Company Data; Bryan, Garnier & Co ests

The impact on profitability has even been more profound with organic growth standing at around 4% p.a. but overall growth reaching 15% p.a. (doubling over five years). This strong growth has mainly come on the back of synergies from acquisitions, with the merger between Refresco and Gerber in 2013 being an important catalyst for margins. We estimate that on average, the company can reach cost synergies of 4% of acquired revenues.

**Fig. 39: Acquisition synergies**

	% acquired revenue
Procurement	2%
Operations	1%
Overhead 0.5% - 1.0%	1%
Total	4%

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

Looking forward we are identifying plenty of additional acquisition opportunities for the company. Some of these are situated in Western Europe and others are in the US, in both private label and co-packing.

### 6.3.1. Western European consolidation to accelerate

A few pockets of growth but overall, little growth to be expected in the western Europe private label soft drinks

Overall, the western European soft drinks market has slowed during the past five years to an annual growth rate of barely 0.1% p.a. Given that over the period, the macro-economic situation in western Europe was improving, the need for private label products diminished and the private label soft drinks category experienced a slight annual decline of 0.4%. Nevertheless, there have been some pockets of growth in private label water, as well as in sports and energy drinks but all other categories have been in decline. For the years ahead, a similar scenario is to be expected and the only soft drinks categories that are expected to show some growth are waters, iced tea and sports and energy drinks. Within that framework, Refresco is focusing on sports and energy drinks and iced teas, in a search for higher price points and added value.

**Fig. 40: Western European soft drinks market historic evolution and projections**

	2000	2005	2010	2015	2020	CAGR 00/05	CAGR 05/10	CAGR 10/15	CAGR 15/20
<b>Soft drinks</b>									
Water	37,017	46,754	48,032	50,880	55,569	5%	1%	1%	2%
CSD	28,336	28,872	30,631	29,329	27,624	0%	1%	-1%	-1%
Still drinks	2,428	2,755	3,033	2,770	2,534	3%	2%	-2%	-2%
Iced tea/coffee	1,807	2,548	2,972	3,144	3,539	7%	3%	1%	2%
Dilutables	6,132	6,461	6,702	6,577	6,139	1%	1%	0%	-1%
Fruit juice	9,442	10,098	9,996	8,587	7,852	1%	0%	-3%	-2%
Sports and energy drinks	646	1,250	2,068	2,727	3,146	14%	11%	6%	3%
Total soft drinks	85,807	98,738	103,434	104,014	106,403	3%	1%	0%	0%
<b>Private label soft drinks</b>									
Water	3,573	8,464	11,550	12,608		19%	6%	2%	
CSD	3,164	4,902	6,619	6,006		9%	6%	-2%	
Still drinks	563	677	861	719		4%	5%	-4%	
Iced tea/coffee	347	928	1,162	1,092		22%	5%	-1%	
Dilutables	2,143	2,337	2,463	2,361		2%	1%	-1%	
Fruit juice	3,612	4,245	4,623	3,841		3%	2%	-4%	
Sports and energy drinks	74	213	578	713		24%	22%	4%	
Total private label soft drinks	13,476	21,767	27,857	27,341		10%	5%	0%	

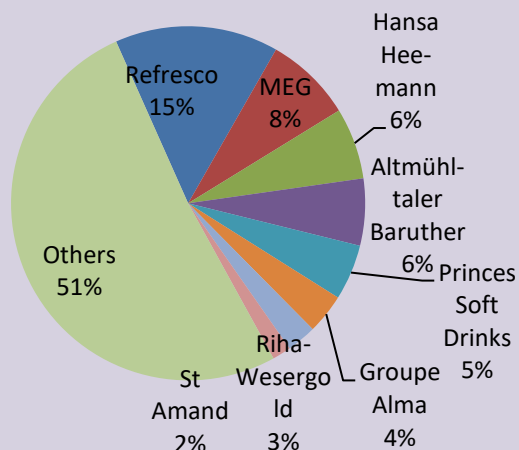
Source: Canadean; Bryan, Garnier & Co ests.

Refresco is the largest European private label producers, but the top 5 private label producers only account for 40% of the market

Within the low-growth environment, we are expecting consolidation moves to pick up. Indeed, there are still plenty of opportunities left with the top five players only accounting for 40% of the private label soft drinks market (55% if water is excluded). Refresco is the largest private label soft drinks producer in western Europe with a 15% market share (26% including water), but there are plenty of other well-funded groups (mostly German):

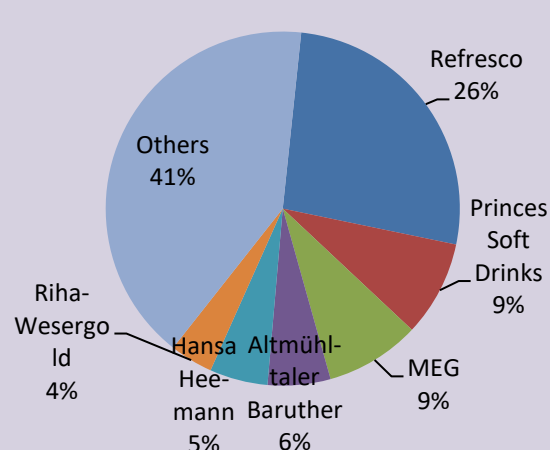
- The German Mitteldeutsche Erfrischungsgetränke GmbH & Co. KG (MEG) is the second largest group and is part of the Schwarz Group that also owns the Lidl and Kaufland supermarket chains.
- Princess Softdrinks has been owned by Mitsubishi Corporation since 1989.
- Another German soft drinks producer, Altmühltaler Baruther, has been owned by the Shaff Gruppe (a multi beverage company from South Germany) since 2016 and works mainly for Aldi, Edeka, Penny, Netto and Rewe.
- Hansa Heeman had been 34.9% owned by the Lange family since the 1980s but increased its share to 100% in 2004 when Holsten (Carlsberg) sold the other 65.1%.

**Fig. 41: Main producers of western European private label soft drinks (26.8bn litres, 2016)**



Source: Canadean; Bryan, Garnier & Co ests.

**Fig. 42: Main producers of western European private label soft drinks ex. Water (14.5bn litres, 2016)**



Canadean; Bryan, Garnier & Co ests.

Given Refresco's market share of 49% in the Benelux region, we would not expect much more M&A from the company in the area, although outside those two countries, there are still plenty of opportunities everywhere else in western Europe, including some areas like the Nordics and Switzerland/Austria, where the company is not present.

**Fig. 43: Refresco's share in the western European private label market.**

	Size of the private label market	Refresco private label volumes	Market share
Benelux	2353	1,153	49%
Germany	10,389	1,250	12%
France	3,779	567	15%
UK	3,321	598	18%
Iberia (Spain and Portugal)	2,700	378	14%
Italy	2,007	401	20%
Six main regions/countries	24,550	4,347	18%
Poland	2,474	379	15%
Finland	124	10	8%
Group	27,148	4,736	17%

Source: Canadean; Bryan, Garnier & Co ests.

### 6.3.2. Opportunities in the US

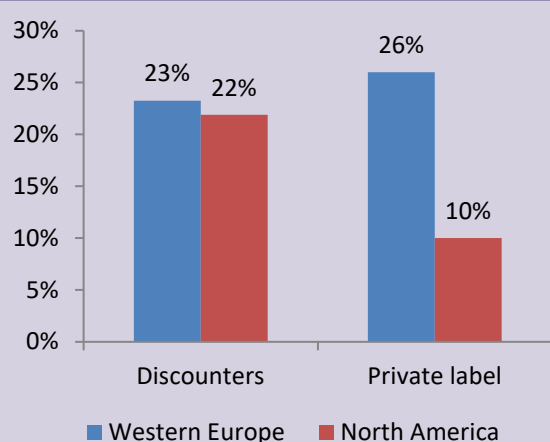
Top five US private label producers represent 76% of the market

Although there are plenty of opportunities in western Europe, we believe that it is more likely that Refresco will focus on the US, where private label growth is expected to accelerate and the number of private label manufacturers is more limited. Indeed, the top five largest private label soft drinks producers represent 76% of the market.

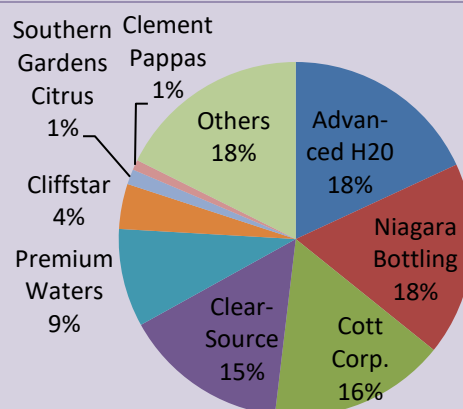


Refresco's strategic criteria for acquisitions include the attractiveness of the target's market and the value that the target brings to Refresco's positioning, product or customer portfolio. The US is a high priority with the group entering the market in 2016 via the acquisition of Whitlock Packaging, which is mainly a co-packing company. We understand that Refresco will mainly focus on adding private label alongside co-packing as the company hopes to serve its European hard discount customers (Aldi and Lidl) with private label and also offer the service to other US retailers. Financial criteria are mainly defined in terms of margins, ROCE (higher than 10%) and acquisition multiples pre- and post-synergies (less than 7.5x and less than 6.0x).

**Fig. 44: Penetration of discount retail format and Fig. 45: US private label market (11.6bn litres) private label**



Source: Canadean



Source: Canadean

### 6.3.3. Value creation by acquisitions

In terms of financial resources, the company has covenants of 4.0x net debt/EBITDA, but management has self-imposed a bracket of 2.5-3.0x. Still, using net debt/EBITDA of 2.5x as a maximum limit (and management lets itself go up to 3.0x) the company would be able to pay out just over EUR1.9bn on acquisitions by 2022, thereby adding EUR350m in EBITDA post synergies (see our DCF valuation section with a scenario of five years of acquisitions growth). With an amount of EUR1.9bn, Refresco would probably be able to buy a 35% share of the US private label market, increase its share in western Europe private label to 30% and would be able to expand further in co-packing.

In view of prospective synergies (up to 4% of acquired revenue), financial leverage and the predictability of the industry, these acquisitions could create significant value over and above the standalone value of the company.

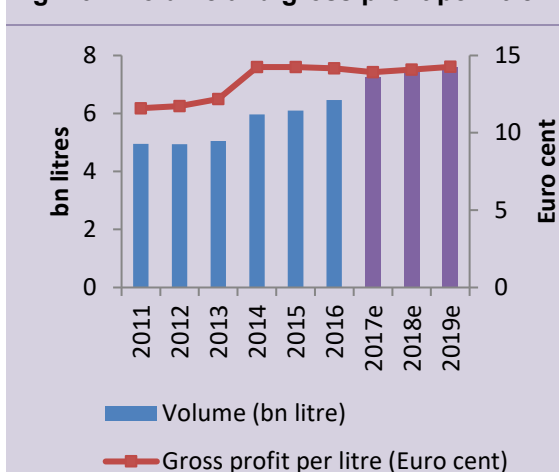
## 7. Results and profit forecasts

After flattish net profit in 2017 (higher financial costs and tax offsetting higher operating profit), we are looking for growth of just over 8% in coming years.

Organic volume growth of around 2.5% p.a.

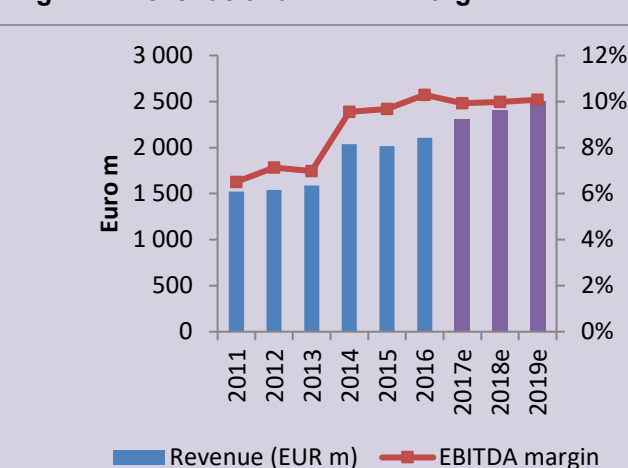
In computing our forecasts for the company, we assume that the private label business will grow by about 1% p.a. stemming from a decline in western Europe and some growth in the US (where Whitlock Packaging is branching out to private label – from co-packing). However, in order to accelerate private label growth in the US, we believe that the company will need to acquire an existing player alongside Whitlock Packaging. However, in the co-packing business we are looking for volume growth of about 5% p.a. driven by high single-digit growth in western Europe and flattish business in the US (as the company will prefer to get into private label in the US, in order to better balance the business). As a result, we look for volume growth for the group of around 2.5% p.a..

**Fig. 46: Volume and gross profit per litre**



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

**Fig. 47: Revenue and EBITDA margin**



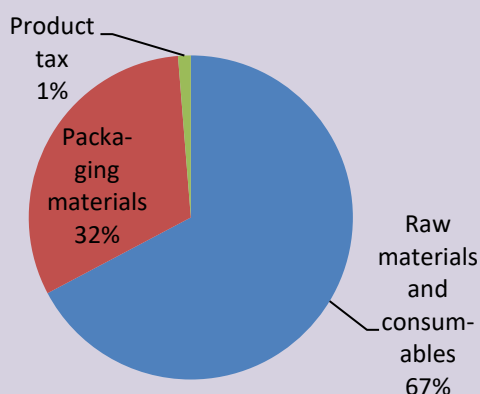
Source: Company Data; Bryan, Garnier & Co ests.

Gross profit per litre to fluctuate around 14 euro cents per litre but trending upwards

In terms of gross profit per litre we do not expect much of a change and are looking for a level of 14.3 euro cents in 2019, the same as in 2015. In 2016, this level dipped down to 14.2 euro cents and we expect 13.9 in 2017 as the acquisition of Whitlock Packaging is set to have a dilutive impact initially. However, there is little fluctuation in gross profit. Indeed, for its private label customers, Refresco has a forward purchasing policy for raw materials and packaging to cover sales positions with customers (including USD hedging). For its co-packing customers, most of the raw materials are also delivered or negotiated by the A-brand owner and Refresco charges a fee for making the beverage or filling packs. Nevertheless, about 10% of raw materials are bought on the spot market, which leaves some exposure to commodity price fluctuations although this should even out over the years (private label contracts are agreed annually).

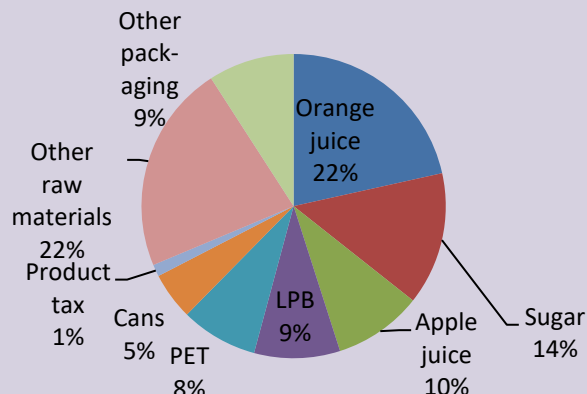
The main input materials for Refresco are orange juice (32% of raw materials), sugar (21%), apple juice (14%), aluminium cans (16% of packaging spend), liquid paperboard (29%) and PET (26%). In 2016, raw materials, consumables and product tax accounted for 68.5% of total spend, while packaging materials accounted for 31.5%.

**Fig. 48: COGS breakdown, 2016**



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

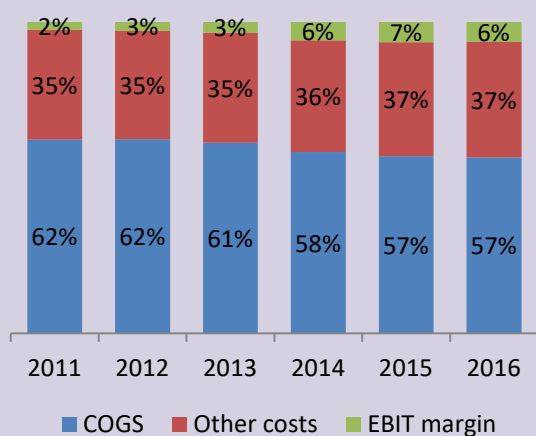
**Fig. 49: COGS breakdown, 2016e**



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

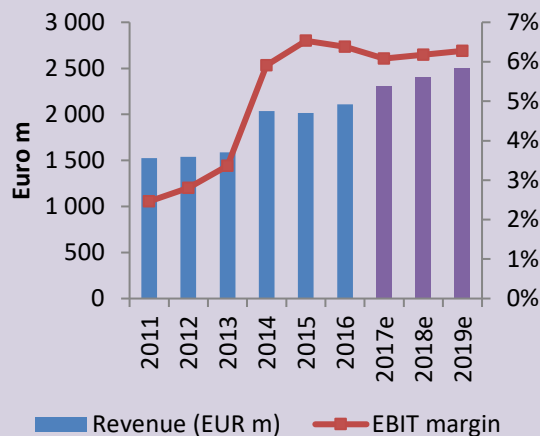
The strong growth in gross margin, EBITDA margin and EBIT margin in 2014 resulted from the significant synergies unlocked by Refresco's merger with Gerber Emig in November 2013. The merger expanded the company's manufacturing footprint (more markets, products, packaging formats) while at the same time enabling it to generate scale and efficiency synergies, cost advantages and commercial opportunities. On the back of scale benefits in purchasing, the consolidation of manufacturing capacity in the UK from two factories to one, closure of a Dutch manufacturing site in Heerlen, divestment of the Waibstadt manufacturing site and the closing of overlapping formats, EBIT margin widened 5.9% in 2014 and 6.5% in 2014 from 3.5% in 2013. Since then, margins have been stable and we expect the level to be maintained, although there is a temporary dilutive impact from Whitlock Packaging.

**Fig. 50: Gross margin has helped operating margin**



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

**Fig. 51: Revenue and EBIT margin**



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

Net profit growth of over 8% p.a. after a flattish net profit in 2017

Volume growth combined with a slight decline in gross profit per litre should result in operating profit of EUR140m in 2017, a 4% increase on 2016. With financial costs expected to remain at 3.2% and a tax rate of 28% (26.3% in 2016), we look for flat net profit in 2017. However, with organic growth in volumes of 2.5% and a slight increase in gross profit per litre (operating leverage and efforts to improve mix), organic operating profit growth is set to total 5.8% in the following years (CAGR 2018-2021), driving net profit growth of just over 8% during the period.

**Fig. 52: Refresco P&L highlights**

Eur m	Dec-14	Dec-15	Dec-16e	Dec-17e	Dec-18e	Dec-19e	CAGR 11/16	CAGR 17/22
Consolidated volume (m hl)	60	61	65	72	74	76	5%	2.5%
Net revenue	2,037	2,016	2,107	2,306	2,401	2,501	6.7%	4.2%
Reported growth	28.3%	(1.0%)	4.5%	9.4%	4.1%	4.2%		
Organic growth								
Other operating income		1	0	0				
COGS	(1,187)	(1,148)	(1,192)	(1,297)	(1,355)	(1,416)		
Gross profit	850	869	916	1,009	1,046	1,084	10%	4%
Employee costs	(227)	(222)	(244)					
Other operating expenses	(429)	(452)	(455)					
EBITDA	194.6	195.0	217	229	240	252	17%	5%
Adjusted EBITDA	208	216	222	229	240	252	15%	
Depreciations	(88)	(85)	(88)	(89)	(91)	(95)	4%	4%
EBIT	107	111	129	140	148	157	38%	6%
reported growth	337.7%	3.5%	17.0%	8.4%	5.8%	5.8%		
EBIT adjusted	120.4	131.7	134	140	148	157	29%	6%
adjusted growth	125.5%	9.4%	2.1%	4.3%	5.8%	5.8%		
Net financial income (expenses)	(49)	(50)	(19)	(21)	(19)	(17)		
Interest charge		-9.0%	-3.2%	-3.2%	-3.2%	-3.2%		
Other	2.2							
Tax	(21)	(19)	(29)	(33)	(36)	(39)		
Net profit	38.6	42.2	81.5	86	93	101		
Reported growth	(235.9%)	9.3%	93.1%	5.5%	8.4%	8.2%		
Net profit adjusted	47	78	86	86	93	101	(227%)	8%
Adjusted growth	(265.2%)	66.6%	11.1%	(0.4%)	8.4%	8.2%		

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

**Fig. 53: Per share data**

Eur	Dec-14	Dec-15	Dec-16	Dec-17e	Dec-18e	Dec-19e	CAGR 17/22
No. of shares, year end (m)	74	80	81	81	81	81	0%
Average no. of shares, diluted (m)	74	80	81	81.2	81	81	0%
EPS	0.52	0.53	1.00	1.06	1.15	1.24	8%
Adjusted EPS	0.63	0.98	1.06	1.06	1.15	1.24	8%
Adjusted EPS growth	na	55.6%	8.8%	(0.4%)	8.4%	8.2%	
Free cash flow	1.3	0.6	0.9	1.1	1.1	1.2	7%
Book value	4.8	6.5	6.6	7.3	8.1	8.9	10%
Net dividend	0.00	0.29	0.32	0.32	0.34	0.37	8%

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

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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 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.
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 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.

### Distribution of stock ratings

BUY ratings 50.6%

NEUTRAL ratings 32.9%

SELL ratings 16.5%

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