BRYAN, GARNIER & CO

INDEPENDENT RESEARCH

12th December 2017

Food & Beverages

Royal Unibrew

Extra Strong

Fair Value DKK350 vs. DKK306 (price DKK360.40) **SELL** vs. NEUTRAL

Bloomberg	RBREW DC
Reuters	RBREW.CO
12-month High / Low (DKK)	371.4 / 258.0
Market capitalisation (DKKm)	18,993
Enterprise Value (BG estimates DKKm)	18,867
Avg. 6m daily volume ('000 shares)	93.80
Free Float	100%
3y EPS CAGR	9.8%
Gearing (12/16)	34%
Dividend yields (12/17e)	1.78%

YE December	12/16	12/17e	12/18e	12/19e
Revenue (DKKm)	6,340	6,337	6,671	6,918
EBIT(DKKm)	1,001	1,054	1,149	1,214
Basic EPS (DKK)	14.62	16.05	17.77	19.34
Diluted EPS (DKK)	14.63	16.05	17.77	19.34
EV/Sales	3.03x	2.98x	2.75x	2.74x
EV/EBITDA	14.7x	14.0x	12.7x	12.6x
EV/EBIT	19.2x	17.9x	15.9x	15.6x
P/E	24.6x	22.5x	20.3x	18.6x
ROCE	23.5	25.7	26.6	26.7

Royal Unibrew is a very efficient and nimble operator which has managed to improve its margins and steal market share in its core Danish and Finnish markets. It is based on a sound financial footing allowing flexibility in case another transformational deal comes along. However, deal multiples seem well out of its disciplined approach. The stock is trading at the higher end of the beverages valuation range and, with a fair price of DKK350, we downgrade our recommendation to Sell from Neutral.

- Royal Unibrew has improved the efficiency of its operations and we believe that the company's West European EBIT margins are now at par with bigger brewers. With less opportunity to improve the cost structure further, the focus is moving to improving mix and growing volumes as drivers of profit growth. Growing volumes in mature markets does mean the company will need to keep outperforming its key markets. The track-record is impressive, however gaining share might become slightly more difficult as its main competitor Carlsberg has become more active in developing new products (e.g. Carlsberg 1883, organic beers, non-alcoholic beers, craft beers), properly integrating soft drinks and has with the DraughtMaster a key enabler to strengthen its on-trade position.

- In a world where Asahi is buying the Grolsh Peroni business at 22x EBITDA, Royal Unibrew's disciplined acquisitive approach (Hartwall at 8.8x EBITDA and Lemonsoda at 13.3x) doesn't make it very likely that it will be able to pull off another transformational deal anytime soon. In the meantime, the company will be able to pursue bolt-on acquisitions.

- Based on our DCF model that uses a risk-free rate of 1.6%, a risk premium of 7%, a target net debt/EBITDA of 2.5x and a levered beta of 1.15x, we value the stock at DKK350, which is 6% below the current share price. On 2019 multiples, the stock is trading at the higher end of the beverages valuation range.

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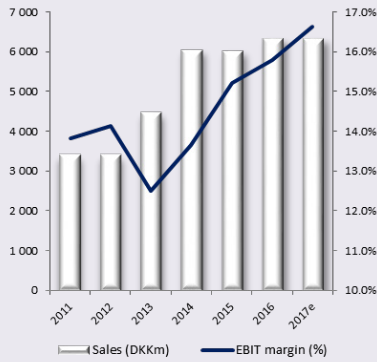

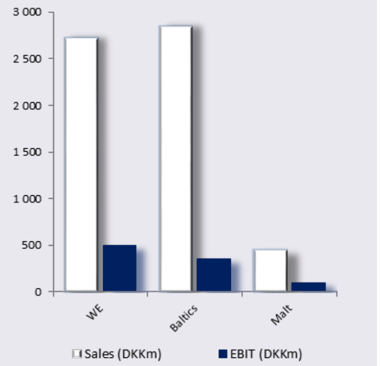

Company description

Royal Unibrew is the second largest brewery in Denmark, where its head office is also located. Its two most important markets are Denmark (36% of 2015 EBIT) and Finland (32%). Around 65% of its sales are generated in Western Europe, with Denmark, Italy and Germany as the most important markets. The Baltics account for another 5% of operating profit. Furthermore it has two export businesses: shipping Ceres strong Ale to Italy (16% 2015 EBIT) and exporting non-alcoholic malt beverages all over the world (11%).

Simplified Profit & Loss Account (DKKm)	**2014**	**2015**	**2016**	**2017e**	**2018e**	**2019e**
Revenues	6,056	6,032	6,340	6,337	6,671	6,918
Change (%)	*35.1%*	*-0.4%*	*5.1%*	*0.0%*	*5.3%*	*3.7%*
Adjusted EBITDA	1,130	1,225	1,306	1,348	1,444	1,508
EBIT	876	917	1,001	1,054	1,149	1,214
Change (%)	*56.5%*	*4.6%*	*9.1%*	*5.3%*	*9.1%*	*5.6%*
Financial results	(60.4)	(45.7)	(30.9)	(26.1)	(43.1)	(44.7)
Pre-Tax profits	816	871	970	1,027	1,106	1,169
Exceptionals	0.0	0.0	0.0	0.0	0.0	0.0
Tax	(176)	(191)	(214)	(220)	(237)	(251)
Profits from associates	34.8	31.1	27.8	28.6	29.5	30.4
Minority interests	0.0	0.0	0.0	0.0	0.0	0.0
Net profit	674	711	784	836	899	949
Restated net profit	662	711	784	836	899	949
Change (%)	*38.0%*	*7.5%*	*10.2%*	*6.6%*	*7.5%*	*5.6%*
Cash Flow Statement (DKKm)						
Operating cash flows	1,140	1,235	1,316	1,348	1,444	1,508
Change in working capital	(34.2)	169	(93.4)	(0.41)	47.5	35.0
Capex, net	(95.5)	(155)	12.5	(234)	(247)	(256)
Financial investments, net	2.0	5.3	0.15	0.0	(600)	0.0
Dividends	0.0	(374)	(386)	(462)	(496)	(524)
Other	(186)	(508)	(657)	(778)	(811)	(825)
Net debt	826	372	192	(126)	(662)	(61.3)
Free Cash flow	824	1,032	1,022	896	994	1,023
Balance Sheet (DKKm)						
Tangible fixed assets	2,570	2,438	2,142	2,082	2,334	2,296
Intangibles assets	2,941	2,920	2,884	2,884	3,184	3,184
Cash & equivalents	491	333	6.9	6.9	6.9	6.9
current assets	868	909	889	888	935	970
Other assets	153	147	154	154	154	154
Total assets	7,024	6,748	6,076	6,015	6,614	6,610
L & ST Debt	2,044	1,517	998	1,124	1,786	1,848
Others liabilities	2,161	2,296	2,167	2,166	2,260	2,330
Shareholders' funds	2,818	2,935	2,911	2,726	2,568	2,433
Total Liabilities	7,024	6,748	6,076	6,015	6,614	6,610
Capital employed	4,691	4,373	4,134	4,074	4,579	4,505
Ratios						
Operating margin	13.64	15.20	15.78	16.62	17.23	17.54
Tax rate	22.04	21.15	21.44	21.44	21.44	21.44
Net margin	10.93	11.79	12.36	13.19	13.47	13.72
ROE (after tax)	23.48	24.24	26.92	30.67	34.99	39.00
ROCE (after tax)	17.34	20.23	23.53	25.67	26.57	26.72
Gearing	55.09	40.34	34.04	40.99	69.30	75.67
Pay out ratio	58.66	57.27	57.32	57.14	57.14	57.14
Number of shares, diluted	55.49	55.02	53.59	52.08	50.57	49.06
Data per Share (DKK)						
EPS	12.15	12.93	14.62	16.05	17.77	19.34
Restated EPS	11.92	12.93	14.63	16.05	17.77	19.34
% change	*38.0%*	*8.5%*	*13.1%*	*9.7%*	*10.7%*	*8.8%*
EPS bef. GDW	11.92	12.93	14.63	16.05	17.77	19.34
BVPS	51.06	53.64	54.63	52.64	51.09	49.90
Operating cash flows	20.54	22.45	24.55	25.89	28.56	30.75
FCF	14.85	18.75	19.07	17.20	19.66	20.84
Net dividend	4.90	5.18	5.87	6.42	7.11	7.74

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

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1. Investment Case

Why the interest now?

The reason for writing now

We are updating our model to include the Lemonsoda acquisition for DKK0.6bn, which increases revenues/EBIT/net profit by 3%/4%/3% respectively. At the same time, we also check out the company's strategy now that it has changed its CEO (twice). The new CEO Hans Savonije was previously COO of the company and, together with ex-CEO Henrik Brandt and CFO Lars Jensen, formed the leadership that has given the company new impetus since 2008. As a result, there is no change in management's strategy to first build a cost-efficient, agile platform and, from that, build a commercial agenda with the retailers with the aim to increase volumes (and hence operating leverage).

Cheap or Expensive?

Valuation

The shares are valued at the top end of the beverages sector, but given its mature market focus, the company's top and bottom line growth is at the lower end of the spectrum. Also, in terms of DCF, the shares are trading ahead (6%) of our DKK350 fair value.

When will I start making money?

Catalysts

Now that the big efficiency improvements are done, the company will need to find earnings growth from mix improvements and volume growth. This means that it will need to increase market share in the Danish and Finnish markets. It has done so over the past five years, but Carlsberg seems to have become a tougher competitor. Furthermore, the company's strong surge in profitability is coming to an end as most of the efficiency improvements have already been achieved.

What's the value added?

Difference from consensus

Our 2018 numbers for revenue/EBIT/EPS are 2.4%/4.0%/3.8% higher than consensus of DKK6,512m/DKK1,105m and DKK17.13.

Could I lose money?

Risks to our investment case

The low financial gearing and the share buy-back programme do support the share price. Any signs that the company is still gaining share, could further strengthen its valuation. Also, in the absence of any bigger deal, the company could be increasingly looked at as a target, offering not only a strong management team, but also the opportunity to extract more value from the company using global cost efficiencies and introducing owned international brands.

2. Key investment considerations

2.1. Improving efficiency

Royal Unibrew's management team, which has been in place since 2008, has a proven track record of running the brewer efficiently. Management's strategy was to first build a cost-efficient, agile platform and from that, build a commercial agenda with the retailers with the aim to increase volumes (and hence operating leverage).

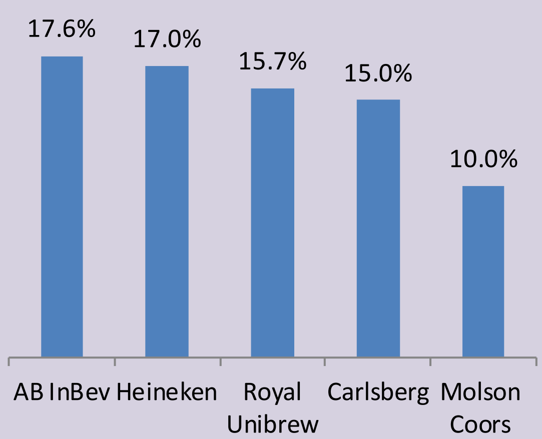
Strong improvements in efficiency

When the new management team took control of Royal Unibrew, it was very quick to improve the efficiency and agility of the Danish organisation by concentrating production on two breweries (the site of the third one has been developed and sold), warehouse and logistics were improved (new distribution terminals and fewer distribution points). In Latvia and Lithuania, the management structures were combined. With the acquisition of Hartwall (from Heineken), the group's margin was diluted as Hartwall was running at an EBIT margin of 8.8%. Royal Unibrew's full management team relocated to Finland for the first couple of years to steer the efficiency drive and, indeed, significant improvements were achieved. After the latest step up in efficiency with the implementation of the group's SAP ERP system in Finland, we estimate that the Finnish margin is now 15%. The group's EBIT margin stood in 2016 at 15.8%, up from 3.2% in 2008. It is these strong performances that has earned management the reputation of being efficient operators.

But in the end profitability levels are in line with others.

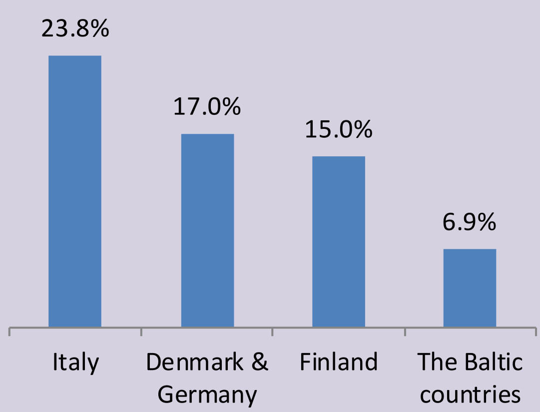
However, the company is a small brewer leading to lesser scale benefits, remains a distant number two in the Danish market, depends on Finnish consumers who seem very much driven by promotions, and operates in a difficult economic backdrop in the Baltics. The result is that, on average, Royal Unibrew's European operating profit margin of 15.7% (17.0% excluding the Baltic countries) is only in line with the margins of other quoted European brewers. According to our calculations, the company beats the 15% margin from Carlsberg, but lags behind the 17.0% from Heineken and 17.6% from AB InBev.

Fig. 1: European brewers' margins compared, 2016e



*Source: Company data; Bryan, Garnier & Co ests * WE and EE together but excluding the distribution business at Heineken*

Fig. 2: Royal Unibrew's margins by geography, 2016e



Source: Company data; Bryan, Garnier & Co ests

Future margin expansion to be driven by mix and volume growth

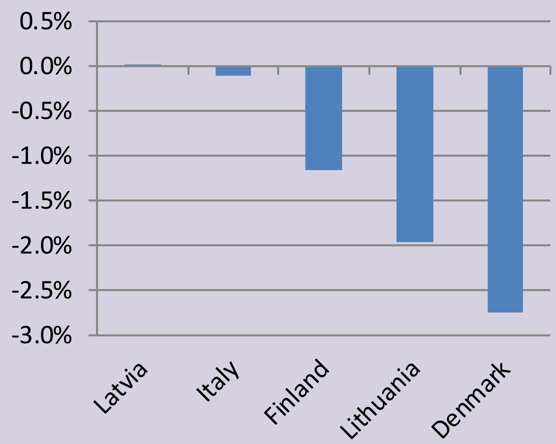
Now that margins at Royal Unibrew are in line with those of other brewers, cost efficiency improvements are going to become far less spectacular. Instead, the company will be looking to increase mix and grow volumes to stimulate margin expansion.

2.2. Gaining share in declining markets

Royal Unibrew's markets are in structural decline

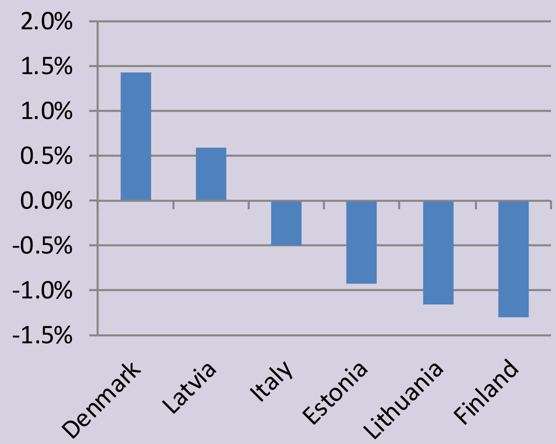
Royal Unibrew generates more than 80% of its revenue in mature West European markets, where overall revenue growth is slow/declining, volumes tend to decline and price competition causes deflation.

Fig. 3: Volume growth in selected beer markets – CAGR 2006-2017



Source: Canadean; Bryan, Garnier & Co ests

Fig. 4: Volume growth in selected soft drink markets – CAGR 2006-2017



Source: Canadean; Bryan, Garnier & Co ests

However, in the past years, the company has been very good at improving its market share in these declining markets. Once the company has established a profitable stable platform in the countries where it is active, it then increases its focus on the commercial agenda in order to get some volume growth and, through operating leverage, improve profitability further.

Indeed, the company always looks for opportunities to reinforce its market positions, organically (e.g. the deal with SOK in Finland) or through additional distribution rights (e.g. distribute PepsiCo's soft drinks products in Latvia, Lithuania and Estonia or PepsiCo's snacks in Denmark) or through acquisitions (e.g. the acquisition of Lemonsoda in Italy). And, as a result, Royal Unibrew's management has succeeded in gaining share in both beer and soft drinks. In Denmark, the company in 2016 held a 21% beer market share, up from 16% in 2011, and in Finland it held a beer market share of 26.6%, up from 22.5% in 2013.

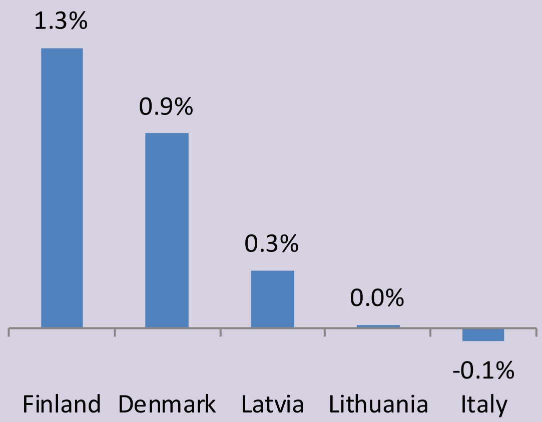
How long is gaining market share going to continue?

There is a chance that gaining market share continues and it is definitily in the company's strategy to do so. In Denmark, the company is still relatively small (21% market share) compared to Carlsberg (53%) and, in Finland, none of the three players has the lead (Royal Unibrew owns 26.6% of the market compared to 28.1% for Carlsberg and 26.9% for Olvi). However, it might get tougher to do so as Carlsberg also seems to be more active in developing new products (e.g. Carlsberg 1883, organic beers, non-alcoholic beers, craft beers) and has with the DraughtMaster a key enabler to regain on-trade momentum. Indeed, crucial to the increase in Royal Unibrew's market shares was (and is) the strong relation that the company has with its on- and off-trade customers and that goes from having an efficient distribution model, to helping the retailers using beer to attract footfall (discounting), to bring innovations to keep its brands new and relevant for consumers (craft/speciality brews, functional beverages) and adding international brands (Heineken, Pepsi). All points on which also Carlsberg starts scoring. And, in Finland, Olvi has been gaining significant share in the past 18 months on the back of a strong presentation of its brands and its involvement in the private-label beer business.

A full beverage company

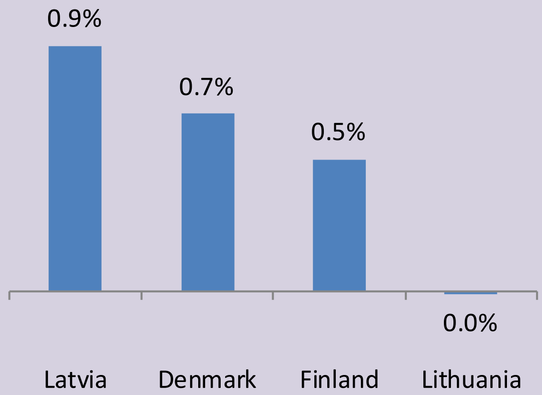
Furthermore, in the past, Royal Unibrew has been particularly successful in profiling the group as a full beverage company rather than regarding soft drinks as an add-on, which is what most brewers tend to do. But, also on this point, Carlsberg, which holds the Coca-Cola licence in both Denmark and Finland, seems to be moving towards a more integrated portfolio.

Fig. 5: Royal Unibrew - Annual market share gain/losses over the past 5 years in selected beer markets



*Source: Canadean; Bryan, Garnier & Co ests; * For Finland since its acquisition in 2013*

Fig. 6: Royal Unibrew - Annual market share gain/losses over the past 5 years in selected soft drink markets



*Source: Canadean; Bryan, Garnier & Co ests; * For Finland since its acquisition in 2013*

2.3. Waiting for the next big deal

The main attraction of Royal Unibrew's markets is their stability of revenues and free cash flows, which provides a good base for an acquisition-driven strategy. And, indeed, next to improving the profit margin, management has also worked hard to improve the capital that is tied up in the business. Not only has it been developing/selling the Aarhus brewery site in Denmark (cashing in close to DKK500m after tax) but it has also been selling some country operations. The Polish business was first merged with Van Pur (2010) and the 20% stake in the new group was subsequently sold (2012). The three breweries that the company owned in the Caribbean were sold (2009). Furthermore, management has worked hard to reduce working capital from 7.1% of revenues in 2008 to -14.2% in 2016, freeing up more than DKK1.3bn. But also, capital expenditure has been kept under control with the company spending less than 4% of revenues (and below depreciation levels).

Net debt/EBITDA of max 2.5x, but only 0.8x at the end of 2016

The company's target is to have a net debt/EBITDA of a maximum 2.5x and an equity ratio of at least 30% - at the end of 2016 its net debt/EBITDA stood at 0.8x and its equity ratio (equity/total liabilities) at 48%.

With the acquisition of Hartwall in 2013, Royal Unibrew temporarily increased the debt level beyond the 2.5x ratio, but the cash generation since then has brought that net debt/EBITDA ratio back down to 0.8x at the end of 2016 (and the equity/total liabilities to 48%). In the absence of any further M&A, the company has been executing share buy-back programmes (the latest one is a DKK560m programme covering the period to 28 February 2018). Except for in 2014, the total distributed profit in the past five years has been about the level of the net profit.

Fig. 7: Historic profit distribution

DKK m	2012	2013	2014	2015	2016
Dividend	199	242		374	386
Share buy-backs	200	110		293	443
Total distribution	399	352	0	667	829
Net profit	371	480	624	711	784
Distribution %	107%	73%	0%	94%	106%

Source: Company; Bryan, Garnier & Co ests

But the main aim is still to find further acquisition targets with a strong local position and at a relatively cheap price. Nevertheless, the same type of value-creative deal as the Hartwell transaction is unlikely in the near term as there seems to be a scarcity of assets for sale within the company's remit of type (and price!). Hartwall was bought for DKK2.8bn (EV of DKK3.3bn, EV/revenues 2013 1.4x, EV/EBITDA 2013 8.8x, EV/EBIT 2013 15.9x). The leveraging/ deleveraging and efficiency improvements at Hartwall nearly doubled Royal Unibrew's EPS to DKK12.9 in 2015 from DKK6.9 in 2012!).

Smaller add-ons until another bigger deal come along.

In the absence of another bigger deal, there will most likely be add-on acquisitions which reinforce its existing market positions in smaller markets, like the PepsiCo deal in Denmark and the Baltics last year and the Lemonsoda deal in Italy this year. However, in the longer term, opportunities still exist including a further consolidation of the Nordic market. Currently, Royal Unibrew still holds 25% in Hansa Borg, Norway's second largest brewer. Other potential Nordic partners include Olvi (no. 3 in Finland and Lithuania and market leader in Latvia and Estonia, or Danish Harboes (no. 3 in Denmark and Estonia), but family owners seem, currently, unlikely sellers and the relatively small weight of these countries makes a merger of operations (e.g. Estonia) unlikely.

Royal Unibrew could attract interest from a bigger brewer

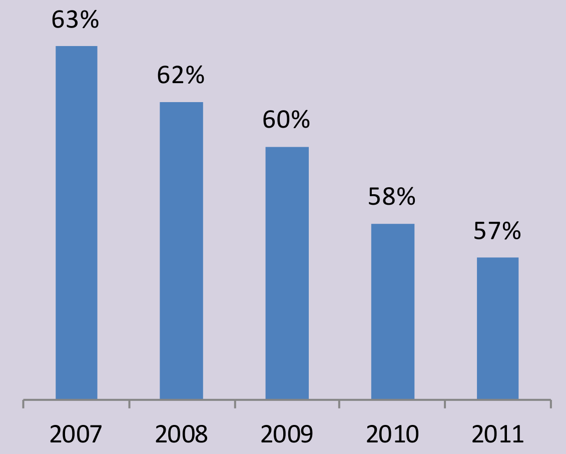
Options in Italy are limited in view of the attraction of such assets (purchase multiples e.g. the Peroni sale) and this seems also to be the case for malt beverages, which limits expansion outside its core Nordic market. Indeed, although the company has the ability to manage local small operations, management seems reluctant to venture away from the mainstream and its Nordic region, which might indicate that the ultimate goal is to be taken-out by a bigger international player. Indeed, this would allow for additional cost synergies and revenue synergies using the Royal Unibrew distribution platform. Furthermore, profits from selling an owned international brand (EBIT margins of 40%), should be well ahead of our estimates for the licenced-in brand margins (15%). We believe the business could fit well with MolsonCoors, AB InBev or Asahi. Until Heineken sold its Finnish business to Royal Unibrew, speculation would occasionally surface about the benefits for Heineken to acquire Royal Unibrew. But this speculation, and the speculation about any other candidate, has died down since 2013, when Heineken sold its Finnish business to Royal Unibrew and Royal Unibrew managed to improved EBIT margins from an estimated 8.8% in 2013, under Heineken's management, to 15.0% in 2016 (BG estimate), proving that sometimes bigger structures are not most optimal for small operations.

2.4. CEOs come and go

The Royal Unibrew management team that was in place since 2008 was spearheaded by its CEO, Henrik Brandt, who, after eight successful years, decided that it was time to move on (and focus on non-executive directorships and advisory roles). He was replaced by Jesper B Jørgensen, who had been CEO of Carlsberg Turkey (January 2006 to December 2006) and Managing Director of Carlsberg Denmark (January 2007 to September 2011) during which period he oversaw one of the fastest rates of market share losses in Denmark. That puzzled us a little. However, not even five months into the job he was replaced as he did not seem to fit in with the Royal Unibrew's culture. On 18th September, Johannes Hans Savonije became the latest CEO, who had been Royal Unibrew's COO since September 2008.

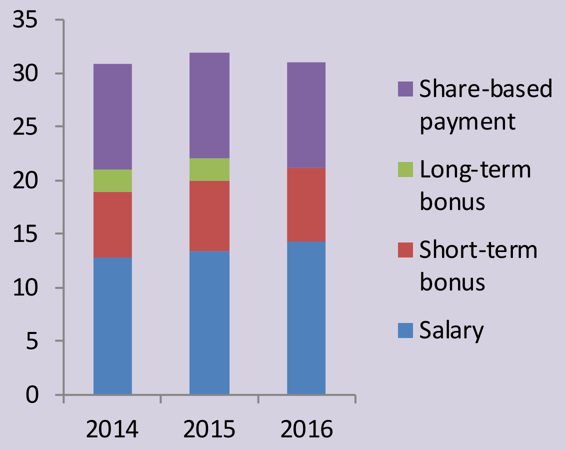
Top management at Royal Unibrew has two different incentive programmes: a short term – 1 year programme and a longer term – 3 year programme. But for each programme the incentive is based on EBIT, EBITDA and Free Cash Flow. In the past, these short-term and long-term incentives were together roughly equal to their annual salaries which on average was close to EUR0.7m.

Fig. 8: Carlsberg Danish market share under Jesper B Jørgensen



Source: Canadean

Fig. 9: Executive Board remuneration – Totals for CEO, CFO and COO (DKK m)



Source: Company

3. Valuation

3.1. Peer group comparison

Valued at the higher end of the sector, but earnings growth at the lower end

On the different valuation ratios, Royal Unibrew trades in line with the sector. Its 2017e P/E of 22.7x compares with the sector at 22.3x but its 5-year EPS growth of 8% is at the lower end in the sector, given the maturity of its operations. Its 2019 P/E multiple of 19.2x is higher than any of the other Europe-based brewers. However, the company is far less geared than the other brewers. Its net debt/EBITDA ratio stands at 1.2x for 2017e compared to 2.9x for the sector. Furthermore, if we take into account the value of its stake in Hansa Borg, net debt/EBITDA falls to 0.3x. This indicates the significant value creation that the company could achieve if it were to find an attractive acquisition target or buy back up to 20% of its shares. In terms of EV/EBIT, Royal Unibrew is at 19.2x, which is ahead of the sector trading at 18.2x on 2019e numbers.

Fig. 10: Ratio valuation

	local c'cy	Share price	Market Cap (EUR bn)	P/E			EV/EBIT		FCF yield		Net debt/ EBITDA		Div. yield		5yr EPS CAGR	PEGD
				2017	2018	2019	2017	2018	2017	2018	2017	2018	2016	2017		
AB InBev	EUR	94.4	209.0	24.7	21.2	18.9	19.9	17.9	4.4%	5.1%	4.7	4.2	2.5%	2.6%	10%	1.96
Carlsberg	DKK	732.0	15.0	22.6	20.1	18.0	18.7	16.8	5.7%	6.0%	1.6	1.3	1.2%	1.4%	11%	1.85
Heineken	EUR	85.6	48.8	22.6	20.8	18.7	18.1	16.3	4.2%	4.7%	2.5	2.1	1.5%	1.3%	10%	2.08
Molson Coors	USD	80.1	16.4	18.1	16.5	15.1	17.1	15.5	6.6%	8.5%	4.7	4.1	1.7%	2.3%	7%	1.89
Royal Unibrew	**DKK**	**370.6**	**2.1**	**23.1**	**20.9**	**19.2**	**18.8**	**17.3**	**4.6%**	**5.3%**	**0.8**	**1.2**	**1.7%**	**1.9%**	**8%**	**2.30**
AmBev	BRL	21.0	332.6	28.5	22.4	19.7	19.4	16.0	3.8%	5.2%	0.0	-0.1	3.6%	3.9%	12%	1.80

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

3.2. DCF-based fair value of DKK350

Our DCF-based fair value of DKK350 for Royal Unibrew is based on a consistent method to generate fair values using a standardised DCF model. Following this, our valuations are compared against a peer group in order to formulate our final investment view.

Our standardised DCF model incorporates the following:

- The WACCs are calculated using a levered beta which allows us to adjust for the companies' different financial structures. We use an unlevered beta of 1.0 and a levered beta of 1.15 (based on a net debt/EBITDA of 2.5x).
- The WACCs are calculated using cost of debt forecasts which account for the differing tax rates and interest charges of the companies under our coverage.
- The long-term growth rates for the companies reflect their geographic spread and potential growth of their markets.
- The cost of equity is based on a BG standardised 1.6% risk free rate and 7% equity risk premium.

Fig. 11: DCF-based fair value of DKK350

DKKm	Dec-16	Dec-17e	Dec-18e	Dec-19e	Dec-20e	Dec-21e	Dec-22e	Dec-23e	Dec-24e	Dec-25e
Sales growth	5%	0%	5.3%	3.7%	2.3%	2.4%	2.4%	2.5%	2.5%	2.5%
EBIT margin	15.8%	16.6%	17.2%	17.5%	17.8%	18.0%	18.2%	18.5%	18.8%	19.1%
Tax rate	-21.4%	-21.4%	-21.4%	-21.4%	-21.4%	-21.4%	-21.4%	-21.4%	-21.4%	-21.4%
Depreciations	4.6%	4.6%	4.6%	4.6%	4.6%	4.6%	4.6%	4.6%	4.6%	
Investments	0.2%	-3.7%	-3.7%	-3.7%	-3.7%	-3.7%	-3.7%	-3.7%	-3.7%	
WACC	8.4%	8.5%	8.4%	8.4%	8.4%	8.3%	8.3%	8.3%	8.3%	8.3%
Working capital	-1.5%	0.0%	0.7%	0.5%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%
Sales	6,340	6,337	6,671	6,918	7,079	7,247	7,422	7,608	7,798	7,993
EBIT	1,001	1054	1149	1214	1257	1303	1350	1406	1465	1525
Taxes	-214	-226	-246	-260	-269	-279	-289	-301	-314	-327
Operating profit after taxes	786	828	903	954	988	1,023	1,060	1,105	1,151	1,198
+ Depreciations	295	295	310	321	329	337	345	354	362	0
-Investments in fixed assets	12	-234	-247	-256	-262	-268	-275	-281	-289	0
Total net investments in fixed assets	307	60	63	66	67	69	70	72	74	0
-Investments in working capital	-93	0	48	35	23	24	25	23	23	24
=Operating cash flow	1,000	887	1,014	1,054	1,078	1,116	1,156	1,200	1,248	1,222
Discount factor		1.00	0.92	0.85	0.79	0.73	0.67	0.62	0.57	0.53
Present value of free cash flow		887	935	897	847	809	774	742	712	644
Cumulative present value of free cash flow		7,248		**Long term assumptions**						
+Present value of terminal value		11,503		Risk free		1.6%				
=Enterprise value		18,750		Equity premium		7.0%				
Adjusted net debt (restated cash)		-991		Unleveraged Beta		1.00				
Other liabilities and commitments		-376		Leveraged Beta		1.15				
(Revalued minority interests)				Company debt spread		1.0%				
Assoc. + revalued investments		728		RRE		9.7%				
=Excess Stock				LT Growth		2.5%				
=Theoretical market cap		18,112		Target Debt/IC		20%				
Theoretical share price fully diluted (DKK)		350		LT WACC		8.2%				

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

3.3. Upside to fair value

Because of the particular interesting position that the company holds in the Nordics, we believe that a bigger international brewer might be interest in Royal Unibrew as a fill-in for its Nordic distribution channel and access to its international non-alcoholic beverages. However, given Royal Unibrews' relatively good profitability, any further efficiency improvements should be limited to international benchmarking and integration in a global supply set-up.

4. Business and Strategy

A leading Northern European beverages group (beer, soft drinks, cider, water, juice)

Royal Unibrew, with its headquarters in Faxe, Denmark, is a leading regional Northern European beverage company (Denmark, Finland and the Baltics) with an additional presence in Italy with premium beer and soft drinks and in the international malt beverage market. The company produces, markets, sells and distributes beer and cider (43% of 2016 sales volumes), soft drinks (44%), malt beverages (4%) and long drinks (7%). Furthermore, Royal Unibrew has a 25% stake in Hansa Borg, the Norwegian number 2 with a 20% share of the market, and it has a 32% stake in Nuuk Imeq in Greenland.

Owned by financial investors

Since, 2009, the company's main shareholder is the Danish Chr. Augustinus Fabrikker (which also holds 51% of Scandinavian Tobacco Group) that holds 10.4% of the company and, since 2013, Hartwall Capital that holds 7.1% (the Hartwall family previously owned Hartwall Brewery before it was sold in 2002 to Scottish & Newcastle). Other shareholders are Danish and international institutional investors. There is only one class of voting shares.

4.1. Portfolio and positioning

4.1.1. A portfolio of assets around the Baltic Sea complemented by a profitable export business

No. 2 in Denmark and Finland

A leading beverages group in the Baltics

Export of non-alcoholic beverages and Faxe beer

Royal Unibrew's main markets are Denmark, Finland, Italy and Germany as well as Latvia, Lithuania and Estonia. In Denmark, it is the second largest provider of beer and soft drinks and distributes additionally international spirits and wine brands. Its German business is mainly supplying retailers on the German/Danish border with beer (Royal, Ceres, Thor, Albani, Slot) and soft drinks (not Pepsi). Faxe beer is exported for the German market. In Finland, the company is not only the second largest brewer and soft drinks provider, but also sells cider and long drinks. In the Baltic countries, the company is among the leading providers of beer and soft drinks, holding considerable market positions (leader in soft drinks in Latvia and second largest brewer in Lithuania). In Italy, Royal Unibrew is among the market leaders in the super premium segment for beer with Ceres Strong Ale. Furthermore, the company is active in the international markets (mainly for premium dark malt beverages exported from Denmark) made up of established markets in the Caribbean and major cities in Europe (London, Amsterdam, Paris) and North America (New York, Miami, Atlanta) as well as emerging markets in Africa.

Fig. 12: Breakdown of Royal Unibrew's volumes 2016 (m hl)

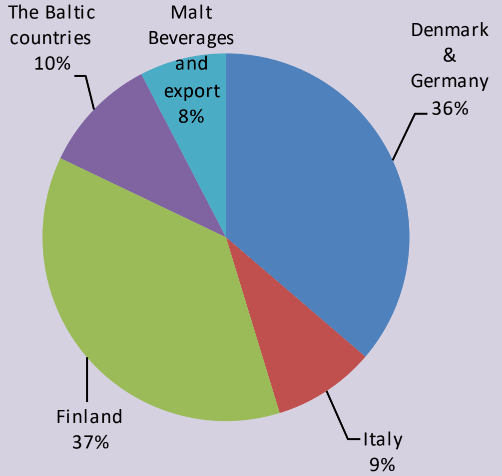
m hl	Beer	Cider	Soft drinks	Malt beverages	Wine & spirits	Group
Denmark	0.7		1.4			2.1
Germany border trade	0.7		0.4			1.1
Germany export	0.2					0.2
Finland	1.1	0.1	1.4		0.7	3.3
Italy	0.4					0.4
Latvia	0.3		0.8			1.1
Lithuania	0.5	0.0	0.2			0.7
Estonia	0.0		0.0			0.0
International markets	0.3			0.4		0.7
Group	4.2	0.1	4.2	0.4	0.7	9.7

Source: Canadean; Bryan, Garnier & Co ests.

Denmark and Finland are each roughly 1/3rd of revenues and profits

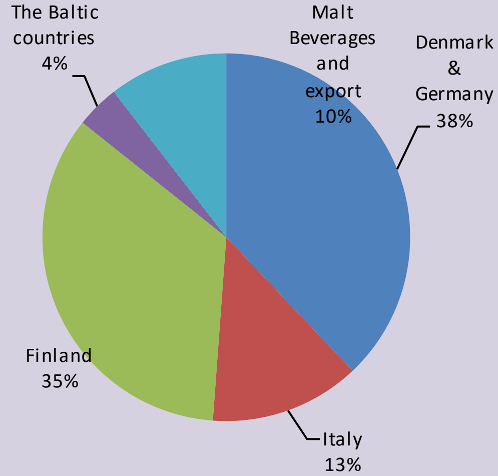
We estimate that the Danish/German business and the Finnish business are roughly the same size, each accounting for just over a third of net revenues and EBIT. However, the most profitable areas in terms of margin seem to be the Italian export business (estimated 26% EBIT margin) and the export business (estimated 24% EBIT margin), compared to an estimated 15% EBIT margin in Finland and 17% in Denmark/Germany. The Baltic countries are the least profitable with an estimated 6% EBIT margin.

Fig. 13: Royal Unibrew - 2016 revenue breakdown



Source: Company Data; Bryan, Garnier & Co ests

Fig. 14: Royal Unibrew - 2016 EBIT breakdown est



Source: Company Data; Bryan, Garnier & Co ests

4.1.2. Local brands supplemented with licensed based international Heineken and Pepsi brands

The biggest brand is Pepsi, followed by Karjala and Faxe

Royal Unibrew has very much a portfolio of local beer and soft drink brands which is complemented through strategic bottling agreements with Heineken and PepsiCo. Pepsi is the company's largest brand accounting for 1.3m hl (13% of group volumes) but the Heineken brand (0.12m hl does not make the top 10 brands). Mainstream Finnish beer brand, Karjala, is the second largest brand in the company followed by Faxe (super premium beer export), Royal (Premium beer in Denmark), Kondi (soft drinks Denmark) and Ceres Strong Ale (super premium beer in Italy).

Fig. 15: Table of the top 10 largest brands by sales volume, 2016

Brand	m hl	Area
Pepsi	1.3	Soft drink mainly in Denmark and Finland
Karjala	0.7	Mainstream beer Finland
Faxe	0.4	Super premium beer export
Royal	0.4	Premium beer Denmark
Kondi	0.4	Soft drink Denmark
Ceres	0.4	Super premium beer Italy
Mangali	0.4	Water Latvia
Cido	0.3	Fruit juice Lithuania & Estonia
Hartwall Novelle	0.3	Water Finland
Hartwall Jaffa	0.3	Soft drink Finland

Source: Canadean; Bryan, Garnier & Co ests

A lot of local brands

In Denmark, Royal Beer and the Heineken brand are the company's national brands, whereas other brands, such as Albani, Ceres and Thor, are sold locally. Within soft drinks, Royal Unibrew offers its own brands including Faxe Kondi (carbonates and energy drinks) and Egekilde (water), as well as licence-based brands of the PepsiCo Group (Pepsi, Pepsi Max, 7UP and Mirinda). As of 2016, the beverage range is supplemented by the PepsiCo Lay's and Bugles snack products, which added about 3% to the Western European division's revenues.

The brand structure in Finland is very similar to the Danish one with Royal Unibrew offering local, national and international brands as well as a number of international wine (e.g. Lanson) and spirits brands (spirits mainly from the Diageo range). The range of brands for the Finnish market include own brands such as the Karjala and Lapin Kulta beer brands, Jaffa (soft drinks), Original (RTD), Upcider (cider), ED (energy drink) and Novelle (mineral water) as well as international brands such as Fosters, Heineken and Pepsi.

Royal Unibrew is also an important beverage provider in the Baltic countries offering a combination of own national brands as well as the international Heineken brands and, as of 2016, also a number of PepsiCo soft drinks brands. Royal Unibrew's brewery business, Kalnapilio-Tauro Grupe, is the second largest in Lithuania with the national beer brands Kalnapilis and Taurus, as well as Faxe and Heineken as international brands. Cido is the number two fruit juice brand. Royal Unibrew's Cido Grupa in Latvia is the leading provider of fruit juices (Cido), nectar drinks (Fruts) and mineral water (Mangali). With the national beer brands Lacplesa Alus and Livu Alus as well as Heineken as an international brand, Cido Grupa holds a number three position within beer. The primary brands in Estonia are Cido in the soft drinks category and Meistriti Gildi, Faxe and Heineken in the beer category, but all those brands are relatively small.

Ceres Strong Ale is exported from Denmark to Italy and is there amongst the market leaders in the super premium beer segment (BG estimates a 10% value share). About 70% of Ceres Strong Ale is consumed away from home, whereas the rest is consumed at home. Following on from a 50-year history of penetrating the market (originally it was a product used to fill the trucks transporting canned ham), Ceres Strong Ale is well distributed in the on-trade channel. However, Faxe is Royal Unibrew's strategic export brand mainly exported to Germany, the Baltics, and Italy but also to the regions where it sells malt beverages.

With a similar type of history of gradually penetrating markets is the malt beverages business, which grew alongside the Danish government's aid to developing countries (and part of this was giving money to buy the very nutritious malt beverages). The Malt Beverages and Exports business is an export and licence business, mainly relating to non-alcoholic malt beverages but also to beer exports under the Faxe brand. Royal Unibrew has several internationally strong dark malt beverage brands which are sold in the premium segment. Vitamalt is probably Royal Unibrew's malt beverage with the broadest global distribution, whereas Supermalt and Powermalt hold strong regional positions. The key market areas for Royal Unibrew's malt beverages are countries in the Americas and Africa, as well as among ethnic groups from those areas living in and around major cities in Europe and the USA. The malt beverages and exports markets are primarily supplied by exports from Royal Unibrew's Danish breweries but, in certain cases, are produced locally by licence holders.

In itself with its many small local beers, Royal Unibrew should be well positioned to benefit from the consumer trend that calls for greater originality and locally-produced products. Unlike most of its bigger competitors, Royal Unibrew is not shying away from developing its own craft beers. In Denmark it has launched Schiøtz and Lottrup, In Finland, it developed the Hartwall 1836 Classic range and, in Lithuania, it launched the Vilkmerges craft beer brand and Liekvardes in Latvia. But all this remains still a very small business, which we estimate to be around 60,000hl.

Craft beers in early development stage

Fig. 16: Craft beers developed by Royal Unibrew

Schiøtz in Denmark

Lottrup in Denmark

Hartwall 1836 Classic in Finland

Vilkmerges in Lithuania

Source: Company; Bryan, Garnier & Co ests.

4.2. Strategy

It is Royal Unibrew's strategy to be a focused, regional beverage provider within beer, malt beverages and soft drinks – and to achieve leading positions in the markets or the segments in which it operates. The main elements of its strategy are:

- Running operations from a local platform and developing leading positions;
- Keeping the brands and company relevant through innovation and development;
- Improving operational efficiency;
- Keeping financial flexibility in order to take advantage of external growth opportunities.

4.2.1. Leading (number 2) positions

A focused strong regional beverages group

The first element from the company's strategy is to be a focused, strong regional beverage company, aiming at holding leading positions in beer, malt and soft drinks, including soda water, mineral water and fruit juices as well as cider and long drinks (RTD).

In Denmark and Finland, the second largest beverages group behind Carlsberg

As such, Royal Unibrew is the second largest beverages company (beer and soft drinks) in Denmark and Finland. In Denmark, it has two production facilities – one in Faxe and one in Odense. Both off-trade and on-trade customers are serviced through direct distribution from its own terminals. In Finland, Hartwall operates two production facilities in Lahti (produces all products but not mineral water) and Karijoki (mineral water), respectively. A distribution network of own terminals supplies off-trade and on-trade customers directly.

Top 3 in the Baltics for beer and soft drinks

In Lithuania, it is the second largest brewer and has a number 3 position in soft drinks. In Latvia, it holds a number three position within beer and is the largest soft drinks company. In Estonia, its presence is still fairly limited but it is allowed to sell the Heineken brand (as in the other Baltic countries, Denmark and Finland). And, since the agreement to distribute PepsiCo soft drinks products in Latvia, Lithuania and Estonia (from 1st January 2016), the company is getting a footprint through which it can better promote its Cido soft drinks and Meistriti Gildi, Faxe and Heineken beers. Royal Unibrew has three production facilities in the Baltic countries – one in Lithuania producing beer, and two in Latvia producing beer and soft drinks, respectively. Sales are made business-to-business, and distribution is made directly to the individual off-trade and on-trade customers from its own terminals.

A 10% value share in Italian super premium

In Italy, the company has built a leading position (10% value share) in the super premium beer segment with Ceres Strong Ale. It distributes the brand mainly through wholesalers which serve the on-trade channel. In October 2017, Royal Unibrew bought the Freedea Lemonsoda business from Gruppo Campari, which adds the category of non-alcoholic drinks to its Italian business, more than doubling its Italian volumes. The Lemonsoda business has also strong overlaps with the route-to-market of Royal Unibrew's existing beer business, promising significant synergies.

Export of malt beverages and Faxe beer

Furthermore, the company has an interesting position in the premium segment for dark malt beverages. The key market areas for Royal Unibrew's malt beverages are the Caribbean and Africa (West Africa) as well as among ethnic groups from those areas living in and around major cities in Europe (mainly London, Amsterdam and Paris) and the USA (incl. New York, Buffalo, Miami). The malt beverages and exports markets are primarily supplied by exports from Royal Unibrew's Danish breweries, but also in certain cases on the basis of licence agreements with local breweries.

Fig. 17: Market positions of Royal Unibrew, 2016

Beer				
	m hl	No 1	No 2	No 3
Denmark	3.5	Carlsberg 53%	Royal Unibrew 21%	Harboes 9%
Finland	4.6	Carlsberg - Sinebrychoff 28%	Olvi 27%	Royal Unibrew - Hartwall 27%
Lithuania	2.7	Svyturys-Utenos Alus 55%	Kalnapilio-Tauro Group 19%	Volfas Engelman 16%
Latvia	1.6	Cesu Alus 31%	Aldaris 22%	Royal Unibrew Latvia 21%
Estonia	1.2	A Le Coq 49%	Saku 37%	Viru Olu 6%
Norway	2.6	Ringnes 58%	Hansa Borg 25%	Aass Bryggeri 6%
Sweden	4.7	Carlsberg 33%	Spendrups 30%	Abro Bryggeri 9%
Italy	17.5	Heineken 31%	Peroni 20%	AB InBev 10%
Germany	84.4	Radeberger 14%	AB InBev 9%	Bitburger 8%
Soft drinks				
	m hl	No 1	No 2	No 3
Denmark	11.4	Carlsberg 36%	Royal Unibrew 12%	Orkla Foods 9%
Finland	6.7	Eckes-Granini 21%	Royal Unibrew - Hartwall 21%	Carlsberg - Sinebrychoff 21%
Lithuania	3.4	CCHBC 16%	Neptuno 9%	Royal Unibrew - Svyturys-Utenos Alus 7%
Latvia	2.7	Royal Unibrew - Cido 30%	CCHBC 18%	Gutta 9%
Estonia	1.7	A Le Coq 26%	CCHBC 21%	Värska Vesi 13%

Source: Canadean, Bryan, Garnier & Co ests.

4.2.2. Innovation & development

Royal Unibrew's portfolio as a regional brewer is built on established local brands. However, the portfolio is continuously developed further. This can take the form of new tastes and varieties of existing brands. Indeed, the company has been developing organic beer, gluten-free beer, non-alcoholic beer, beer with lower alcohol content and new flavours.

For example, in 2015, Royal Unibrew strengthened its position in Denmark with the launch of the organic beer Royal Økologisk (Royal Organic) and craft beers Schiøtz and Lottrup. In 2016, a number of new beers were developed together with Tivoli Gardens. The craft beer idea is further developed and, in the first half of 2017, the first speciality brews of a the Albani Royal Unibrew brand were launched (Denmark) and, by the end of the first half, the new craft brewery in Odense started up. But it is not just in beers but also in soft drinks that the company looks for new products with mineral and vitamin additions and healthier alternatives to sugar and sweeteners. For example, in 2016, in Finland, a series of enriched water was launched under the Novelle Plus brand, which led to significant market share gains in water.

Fig. 18: Albini crafty beer in Denmark

Source: Royal Unibrew

Fig. 19: Novelle Plus enriched water in Finland

Source: Royal Unibrew

Another way of developing the portfolio is to include international brands in the portfolio. As such, Royal Unibrew has long standing cooperation agreements with Heineken and PepsiCo. And, as of 2016, the PepsiCo beverages distribution agreement expanded to the Baltic countries. In Denmark, the company is taking over the sale of PepsiCo's snack products under brands such as Lay's and Bugles in Denmark.

4.2.3. Operational efficiency improvements

New management team arrived in 2008 and started a big clean up

After years of international expansion on the back of cheap credit, Royal Unibrew ran into disappointing results with the financial crisis in 2008. By the end of that year, a new CEO Henrik Brandt had arrived and the "doubling up" strategy was scrapped. Restructurings started already in 2008. It included not only the disposal of non-profitable activities like the Polish business, but also a complete change in the organisations in Denmark, Lithuania and Latvia. In Denmark, the production in Aarhus was moved to Faxe and Odense (the Aarhus site was developed and sold) and distribution was insourced. In the Baltic countries, the operations in Lithuania and Latvia were merged into one structure, except for the sales organisation. Reflecting all the changes was the decline in the number of employees from 2,755 in 2008 to 1,635 in 2012 and the EBIT margin went from 3.2% in 2008 to 14.1% in 2012.

Improving the profitability of Hartwall after its 2013 acquisition

With the acquisition of Hartwall (from Heineken), the margin was diluted as Hartwall was running at an EBIT margin of 8.8%. Royal Unibrew's full management team relocated to Finland for the first couple of years to steer the efficiency drive and indeed significant improvements were achieved (mainly in supply). Over a period of two years, production per employee increased by 14%, extract losses decreased by over 50%, syrup loss declined by 30%, the distribution utilisation rate increased by 9% and electricity consumption per hl went down by 3%. The group's EBIT margin increased from 12.5% in 2013 to 15.0% in 2016. In 2016, the groups' SAP ERP system was implemented in Hartwall which finished the integration process into Royal Unibrew. For the coming years, we no longer expect any significant improvements but rather gradual progress as the efficiency-enhancing opportunities are now limited. Further margin upside should come from volume growth (gaining market share) and mix improvements.

Outside Finland, the integration of the PepsiCo beverages portfolio in the Baltic countries should also improve the efficiency of the organisation (operating leverage), as should the integration of Lemonsoda in Italy since it more than doubles the Italian volumes.

4.2.4. M&A the answer to limited internal growth opportunities

Acquisitions are an important part of the strategy

Overall, Royal Unibrew's markets are not particularly attractive in terms of growth profile or margin upside. However, acquisitions are an important part of the company's strategy. Its acquisition in 2013 of Hartwall (Finland) from Heineken has been particularly value creative. Hartwall was bought for DKK2.8bn (EV of DKK3.3bn, EV/Revenues 2013 1.4x, EV/EBITDA 2013 8.8x, EV/EBIT 2013 15.9x) which was partially financed (DKK 0.56bn) with new shares and the remainder with debt. The leveraging/deleveraging and efficiency improvements at Hartwall, nearly doubled Royal Unibrew's EPS to DKK12.9 in 2015 from DKK6.9 in 2012.

Consolidating the Nordic market

However, in the near term, we don't see anything similar and look more for smaller external growth opportunities which reinforce its existing market positions in smaller markets, e.g. Estonia in soft drinks/water. In the longer term, opportunities still exist including a further consolidation of the Nordic market. Currently, Royal Unibrew still holds 25% in Hansa Borg, Norway's second largest brewer. However, the Swedish no. 2 Spendrup, which had a 15% share in Hansa Borg, sold it, pouring cold water on an imminent further consolidation in the Nordic market. Other potential Nordic partners include Olvi (no. 3 in Finland and Lithuania and the market leader in Latvia and Estonia, or Danish Harboes (no. 3 in Denmark and Estonia), but family owners seem, currently, unlikely sellers and the relatively small weight of these countries makes a merger of operations (e.g. Estonia) unlikely.

Options in Italy are limited in view of the attraction of such assets (purchase multiples, e.g. the Peroni sale) and this seems also to be the case for malt beverages which limits expansion outside its core Nordic market. Indeed, although the company seems to have the ability to manage local small operations, management seems reluctant to venture away from the mainstream and its Nordic region, which might indicate that the ultimate goal is to be taken-out by a bigger international player.

4.3. Financial targets and capital structure

Target EBIT margin of 16% is not very challenging

The company is targeting an EBIT margin of approximately 16% (despite already achieving 15.8% in 2016) which, according to management, reflects the challenging European markets, expected lower growth in the malt business than in previous years, smaller efficiency gains than achieved in recent years, as well as increased investments in market positions and brands. Our take on this is that management does not want to put too much external pressure on itself and we guess that an 18% EBIT margin is probably feasible (which in our model the company reaches by 2022) depending on the macro-economic recovery in the Baltic countries and opportunities to gear up that business. Indeed, in the Danish business the company is already reaching 17%, in the malt and export business it is already 22.3% and in Italy it is 23.8%.

Net debt/EBITDA below 2.5x

In terms of leverage, Royal Unibrew wants to keep net debt/EBITDA below 2.5x and keep an equity ratio of at least 30%. However, at the end of 2016 its net debt/EBITDA was at 0.8x which seems to be a level that the company is trying to keep (hence the share buy-backs) as it would allow it to act on business opportunities and maintain independence in relation to its bankers, and, on the other hand, ensures that Royal Unibrew is not heavily overcapitalised. With the acquisition of Hartwall, Royal Unibrew temporarily increased the debt level beyond the 2.5x ratio while putting its distribution of profits on hold. However, it resumed dividend payments (policy is 40-60% of net profit) and continuously executes buy-backs. The current buy-back programme is DKK560m (2016: DKK450m). Except for in 2014, the total distributed profit is about the level of the net profit.

Part of the target of keeping financial flexibility also focuses on generating enough cash and we estimate the company will continue to generate free cash flow T around 85% of EBIT or about 15% of revenues (which is where it was in the past five years).

Working capital: Since 2008, management has been working on reducing working capital and we calculate that trade working capital as a percentage of revenues fell from 10.4% in 2008 to -2.6% in 2015, releasing nearly DKK800m. One of the areas which contributed was the lowering of inventories in Denmark following the logistics restructuring in 2008 (insourcing distribution and customer service), but also trading terms improved. On the other hand, the company has been paying its supplies later (from 40 to 60 days). However, the company has indicated that working capital is unlikely to improve further and in 2016, the ratio was -1.8%.

Limited capex programme: We estimate that total production capacity at year end 2015 was about 15m hl compared to a production of 9.7m hl, which puts the estimate 12-month capacity utilisation at 65%. Although there is some seasonality of the business, it does imply that there is some opportunity to reduce capex. Indeed, we estimate the brewer's ongoing maintenance capex at 3% of net revenues, i.e. DKK180m. Given the company's capex level has been between 3% and 4% over the past years, we expect the company has been expanding in some areas where there is some constraint or new product developments (i.e. craft brewing, malt products). Nevertheless, given the limited growth in the markets in which it is active, we expect capex to remain in that range.

Non-core assets: In addition to the positive cash flow from the underlying business, the gradual sale of the brewery site in Aarhus also contributed considerably to Royal Unibrew's total cash flow. In 2015, the last part of the site was sold and the cash in from that fell in 2016. Over time other disposals are possible. Indeed, Royal Unibrew still holds a 25% minority interest in Hansa Borg in Norway and a 32% stake in Nuuk Imeq in Greenland. However, both positions do make sense. Nuuk Imeq distributes Royal Unibrew products, and, with the Hansa Borg stake, the company has an attractive starting position in case of further consolidation of the Nordic markets. In the meantime, the Hansa Borg stake generated in 2016 a handsome after tax income of DKK28m.

5. Results and outlook

Despite the maturity of the markets in which it operates, Royal Unibrew has been increasing net profit by on average 19% over the past five years. This growth has come from gaining market share in declining markets and improving the efficiency in both Denmark and Finland. Now that both countries have already strongly improved, there is less upside left. Hence, we are expecting a slowdown in EPS growth to an average 8% EPS growth for the next five years.

Its core Danish and Finnish markets are in structural decline, and we expect Carlsberg to be a tougher competitor than it was in the past.

Indeed, Denmark and Finland, are each about a third of the company's operating profit and both are in structural decline and face price deflation (sometimes of Royal Unibrew's own making). We assume that, given the effort from Carlsberg to bring new products to the market and, in the on-trade, the switch from kegs to the DraughtMaster, gaining share from Carlsberg will become more difficult. Furthermore, in Finland, Olvi has been gaining share with its own brand and its involvement in private labels, putting pressure on both Carlsberg and Royal Unibrew in that market. This could, for the medium term, leave Royal Unibrew with flattish volumes but some revenue growth driven by mix improvements which should also drive marginal margin expansion in these two key markets.

However, in some of the other businesses there is some volume upside. In Italy, its third most important market, Royal Unibrew owns a 10% value share in the super premium category with its Ceres Strong Ale and should be able to benefit once the country's economy picks up again (especially as there is still room for growing beer consumption per head). In the Baltic countries, per capita consumption is already 76 litres in Lithuania and 71 litres in Latvia which is in line with the European average of 70 litres and the 75 litres consumed in Denmark (including border trade). However, there is more upside in the soft drinks business (which includes not just carbonates but also packed water and juice) which stands at 99 litres per capita in Lithuania, 123 litres in Latvia and 130 litres in Finland compared to 210 litres in Denmark. The largest upside comes probably from the non-alcoholic malt beverages which are exported to the Caribbean, Africa and some major cities in Europe and US (mainly those with a large Caribbean population).

Expecting an EBIT margin of 18.1% by 2022 vs 16.6% in 2017

Linked with the slower top-line growth, we believe there is also less opportunity for margin expansion. In 2010, the EBIT margin was 11% and this rose to 15.8% in 2016. For 2017, we expect the margin to come in at 16.6%. This 0.8% increase is to a large extent driven by the change in customer agreements and the lower marketing spend in Denmark. Nevertheless, there is further underlying improvement due to efficiency improvements, share gains in Denmark and mix, which balance out the effect of bad weather in the Nordics. Over the medium term, i.e. in five years' time, we are expecting an EBIT margin of 18.1% even assuming that there is no economic rebound in Finland or the Baltics.

So far in 2017 (9 months), the company has increased underlying revenues by 1% on a volume decline of 2%, as volumes were affected by poorer weather than in 2016 in Northern Europe in the peak season from June to September. EBIT amounted to DKK862m, which is DKK37m above EBIT for 9M 2016 due to a combination of efficiency improvements, cost control and continued optimisation of product and sales channel mix.

We forecast for 2017, flat revenues at DKK6,337m (guidance is for net revenues of DKK6,250m to DKK6,350m) and, for EBIT, we are forecasting growth of 5.3% to DKK1,053m (which is at the high end of the EBIT guidance of DKK1,030m to DKK1,080m).

For 2018, we are expecting a strong contribution from the newly-acquired Freedea Lemonsoda business from Campari. Not only does the acquisition more than double Italian volumes but it also adds muststock products to the business. In 2016, the Freedea Lemonsoda business realised net revenues of DKK245m, an EBITDA of DKK45m and an EBIT of 35m. The DKK0.6bn acquisition price is 13.3x 2016 EBITDA (pre-synergies) and we are estimating synergies at DKK10m. As a result, we are expecting that the acquisition enhances 2018 net profit and EPS by 3% and that the net debt/EBITDA reaches 1.2x including a further DKK520m share buy-back programme.

Fig. 20: Financial forecasts

EUR m	2016	2017e	2018e	CAGR 17/22
Western Europe				
Net revenue (45% of group)	2,870	2,813	3,083	4%
Operating profit (52% of group)	527	550	609	5%
Operating margin (%)	18.4%	19.6%	19.8%	
	Sales increased by 3%, as Danes slightly increased their consumption (easy weather comps for Denmark and Germany, and also the European Football Championship) while RU increased its market share in beer and soft drinks. Furthermore, the company has started selling the PepsiCo Lay's and Bugles snack products which added nearly 3% to the top-line. However, these products do not contribute meaningfully to the operating profit.	Changed customer agreements that give discounts instead of a fixed promotional contribution are impacting revenues by about 4%. Volumes are expected to be up 3% despite less good weather (in Denmark) but driven by market share gains. Volume growth is driving margin and is also supported through the lower marketing spend.	The Danish consumer market is expected to structurally decline in the coming years and increased investments from rival Carlsberg behind its brand, will make it more difficult for RU to gain share. However, the Italian beer market should show a slight structural increase, given the low per capita consumption. The acquisition of Lemonsoda should boost revenues in the division by 14% and EBIT by 10%. Opportunities are in craft and non-alcoholic beers, premium beers (Heineken) and new sub-categories in soft drinks and water (e.g. health trends).	
Baltic Sea				
Net revenue (47% of group)	2,986	3,046	3,076	2%
Operating profit (37% of group)	395	433	462	4%
Operating margin (%)	13.2%	14.2%	15.0%	
	Net revenues showed an increase of 5% as they were affected by an extraordinary campaign activity in Finland (SOK), which started in Q4 2015. Furthermore, we estimate that the new cooperation with PepsiCo on production, sale and distribution soft drinks products in the Baltic countries added 8% revenue in the Baltic countries. Further efficiency improvements in Finland helped operating margin but, on the other hand, lower consumption in the Baltic countries had a negative effect.	Despite improving economic conditions, consumers remain cautious and poor high season weather also in Finland had a negative effect on beer volumes. The company's focus on value also affected its market. In Q4 the company starts sharing the SOK contract with Carlsberg and it looks increasingly as it will not be renewed next year.	With beer consumption in the Baltics at the European level, there is little expectation for further growth in the category especially as excise duty, deposit and collection fees are increasing beer prices further. Also, migration in these countries is impacting volumes negatively, which leaves premiumisation as the only route to deliver organic growth (but then the macro-economic conditions need improving). There seems more upside in the non-alcoholic soft drinks and water segment, where levels of consumptions are not yet at Western European levels, but for growth the macro outlook should improve first.	

Malt beverages				
Net revenue (7% of group)	484	479	513	9%
Operating profit (11% of group)	108	99	107	9%
Operating margin (%)	22.3%	20.6%	20.8%	
	Organic top-line growth remains strong despite more difficult conditions in some emerging markets, but was supported by the Faxe export business. EBIT margin would have been flat adjusted for negative currency impacted	Volumes are expected to be up by (only) 3% as hard currency shortage in some developing markets slows down growth. The currency devaluation of some developing markets is also weighing on the EBIT margin which was down by 1.9 percentage points after 9 months.	There is still plenty of scope for malt beverages to gain traction in the global markets. And as the market for dark malt beverages is still geographically fragmented, it might be an area where Royal Unibrew could leverage its brands.	
Holding costs				
Operating profit	-29	-29	-29	na
Group				
Net revenue	6,340	6,337	6,671	3%
Revenue growth (%)	5.1%	0.0%	5.3%	
Organic revenue growth (%)	3.9%	0.1%	2.8%	
		Guidance is for net revenues of DKK6,250m to DKK6,350		
Adjusted operating profit	1,001	1,054	1,149	5%
Operating profit growth (%)	9.1%	5.3%	9.1%	
Organic operating profit growth (%)	9.3%	5.5%	9.1%	
Operating margin (%)	15.8%	16.6%	17.2%	
		Guidance is for EBIT of DKK1,030m to DKK1,080m		
Financial expenses	(31)	(26)	(43)	
	. Net debt/EBITDA of 0.8x	Despite all the diidends and DKK550m buyback, net debt/EBITDA is to remain at 0.8x.		
Tax	(214)	(220)	(237)	
		Tax rate assumed to remain at 21.4%		
Affiliates - net profit	28	29	29	3%
		Steady increase in profits from Hansa Borg		
Net profit	784	836	899	
Adjusted net profit	784	836	899	5%
Adj. diluted EPS (EUR)	14.63	16.06	17.79	8%
Growth (%)	13.1%	9.8%	10.8%	

Price Chart and Rating History

Royal Unibrew

Ratings

Date	Ratings	Price
24/11/16	NEUTRAL	DKK296.8
13/05/16	BUY	DKK290.8

Target Price

Date	Target price
24/11/16	DKK306
13/05/16	DKK325

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Stock rating

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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.

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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.

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