

RATING ACTION COMMENTARY

Fitch Affirms Carlsberg Breweries at 'BBB+'; Outlook Stable

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Fitch Ratings - Milan - 26 May 2023: This is an update of a release originally published 25 May 2023.

Fitch Ratings has affirmed Carlsberg Breweries A/S's Long-Term Issuer Default Rating (IDR) and senior unsecured rating at 'BBB+'. The Outlook on the IDR is Stable.

The rating reflects Carlsberg's stable and resilient trading performance as the third-largest international beer company with a strong market presence in Europe and Asia complemented by further scope for revenue and profit growth. It also reflects the company's consistently conservative financial policy.

We expect the company will continue to operate with comfortable headroom within its leverage target of net debt/EBITDA below 2.0x, despite an assumed progressive dividend payment policy and continuation of share buybacks. We expect the already agreed M&A transaction for the buy-out of minorities at the company's Indian subsidiary will lead to a mild increase from 2019-2022's conservative 1.3x-1.5x net leverage levels.

KEY RATING DRIVERS

Rating Headroom Absorbs Headwinds: Carlsberg has ample leverage headroom under the rating, even excluding Russia, which has been deconsolidated since 2022 and is being divested. Carlsberg's credit profile benefits from one of the lowest leverage ratios

among Fitch-rated alcoholic beverages producers. Our forecast assumes that EBITDA net leverage will stabilise around 1.7x-1.8x in 2023-2026, well below our negative sensitivity of 2.5x. The projected level is slightly higher than the average 1.3x-1.5x ratio in 2019-2022, but takes into account that capex and shareholder remuneration will moderately grow from the sizeable levels of 2020-2022.

Challenges to Pass on Inflation: Inflationary pressure on operating costs have intensified since 2H21, affecting both production and logistics. In 2022, this affected profit margins but the company managed to defend its overall EBITDA, thanks to price increases and the continued recovery of demand in the more profitable on-trade channel.

For 2023, we expect inflationary pressures will continue to affect the company's cost base and that further price increases will be necessary to defend profits. However, these actions will be more difficult to implement in a weaker consumer environment, and we estimate mild volume contraction this year. At the same time, the company's cost rationalisation plans should support stable profits in 2023.

Growth Strategy Continues: The company's growth relies on increasing premiumisation, given the still stronger focus on mainstream products and this will require more emphasis on alcohol-free beers, for instance, which remain a niche. It will also require a stronger presence in the more expensive craft segment, where the company has made good in-roads. Carlsberg also continues to increase its presence in more developed Asian cities.

Following successful completion of the SAIL22 strategy in 2022, which led to an improved EBITDA margin of around 22% and better revenue growth capability, the company confirmed these objectives in its strategy update to 2027.

Robust Free Cash Flow: Carlsberg has historically generated robust annual free cash flow (FCF) of around DKK4 billion to DKK5 billion (4% to 6% of sales). However, as we assume capex will increase from 2023 to DKK5 billion and dividends will also continue to grow, we project more conservative FCF of approximately DKK3.0 billion to DKK3.5 billion (4% to 5%) per year.

Working capital benefits from long average payment terms, which when calculated in terms of the ratio between trade payables and cost of goods sold, imply a length of 206 days. Reported trade payables are inflated by the inclusion of capex-related payments and deferred discounts to customers, therefore actual payables to suppliers have shorter payment terms. However, we still assess the length of total payments at above industry average and caution that if these reduce, it could have a substantial adverse

impact on working capital. Reported trade payables equaled DKK22 billion at end-2022, which is equivalent to 1.5x of 2022 EBITDA.

Conservative Financial Policy: Carlsberg's ratings benefit from the company's commitment to a conservative capital structure. Its maximum net debt/EBITDA of 2x (management-calculated) is below Fitch's negative sensitivity of 2.5x on EBITDA net leverage basis. Adherence to its financial policy enhances Carlsberg's financial flexibility to reduce shareholder remuneration if there is a risk of internal leverage target being exceeded.

This flexibility was proven in 2020 when Carlsberg cancelled the second tranche under its DKK5 billion share buyback programme and again suspended buybacks in 2023, ahead of the expectation of higher than average M&A spending in the year. We believe that Carlsberg's shift to quarterly share buyback programmes in 2021 enables it to adjust or cancel these disbursements if the operating environment worsens or larger-than-expected M&A opportunities arise.

Moderate Scope for M&A: Carlsberg's rating still allows for bolt-on M&A funded with a combination of FCF and debt. We believe most of this would take place in Asia, where Carlsberg aims to exploit opportunities. M&A opportunities are limited by the consolidated profile of the global beer industry, as illustrated by the acquisition of Canadian craft brewer Waterloo Brewing in 2022, which diverged from the company's focus on Asia and Europe.

Our rating case assumes Carlsberg acquires a 33% remaining stake in Indian and Nepalese brewer CAPL in 2023 for DKK5.7 billion. The transaction would strengthen Carlsberg's ability to control its operations in this promising market. We also assume bolt-on M&A spending will continue, aimed at new markets and buying out minority stakes in subsidiaries.

Third-Largest International Brewer: Carlsberg's ratings reflect its market position and scale as the third-largest international brewing company globally, with operations in Europe and Asia. Efforts to reduce its reliance on the Russian market and improve geographical diversification allow it to withstand a permanent exit from Russia and temporary part closure of the Ukrainian market without a material impact on its credit profile.

DERIVATION SUMMARY

Carlsberg is the third largest international beer company, with operations in Europe and Asia. It is smaller and less geographically diversified than Anheuser Busch InBev NV/SA (ABI, WD, previously BBB/Positive) and Heineken NV (NR). Its scale, including EBITDA

and profitability, is comparable with Molson Coors Brewing Company (NR). Nevertheless, prior to the withdrawal of ABI's rating, Carlsberg was rated higher than ABI due to its more conservative financial policies and capital structure, resulting in much lower leverage.

Carlsberg is rated on par with spirits companies Bece S.A.B. de C.V. and Pernod Ricard SA. Compared with Pernod, this reflects that Carlsberg's more limited geographic and product diversification, as well as lower EBITDA margin of approximately 20% versus Pernod's 30%, are counterbalanced by significantly lower leverage. This is approximately 1.5x to 2.0x lower at Carlsberg than Pernod's 3.5x. The two companies generate comparable annual FCF of approximately EUR500-700 million.

Among spirits peers, we view the business profile of Bece, the world's largest tequila producer, complemented by a smaller portfolio of spirits in the whiskey, rum, vodka and mixers category, as weaker than Pernod's due to more limited geographic and product diversification. Its profitability, with an EBITDA margin of 21% is comparable to Carlsberg's but leverage metrics are slightly stronger, with net debt/EBITDA projected to remain below 1.5x. No Country Ceiling, parent-subsidiary linkage or operating environment aspects were applied to these ratings.

KEY ASSUMPTIONS

- Approximately 5% revenue growth in 2023, followed by 2-3% growth onwards resulting from reduced volumes offset by higher average price per hectolitre
- Flat EBITDA margin in 2023 mainly due to persistent inflationary pressures on costs, offset by price pass through. We expect EBITDA improvement over the rating horizon driven by premiumisation of product portfolio beer consumption and cost controls
- Capex at DKK5 billion a year over 2023-2026
- Dividend pay-out remaining at 50% of net income and annual dividend disbursements growing over the rating horizon to DKK4.5 billion from around DKK3.5 billion
- Annual share buyback disbursements of DKK3 billion
- Acquisition of remaining stake of CSAPL for DKK6 billion in 2023, followed by bolt-on M&A of DKK1.5 billion a year over 2024-2026
- Deconsolidation of Russian operations in 2022 but no proceeds assumed from the planned divestment

RATING SENSITIVITIES

We do not envisage any positive rating action unless Carlsberg further materially strengthens its business profile. However:

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- Maintenance of leading positions in core markets and mid-single digit organic revenue growth
- EBITDA margin above 25% and FCF margin sustained above 5%
- Financial policy pursuing EBITDA net leverage below 1.5x on a sustained basis

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- Weakening market position in key markets or much stronger remuneration of shareholders, coupled with an increased M&A appetite, causing EBITDA net leverage to increase above 2.5x on a sustained basis
- Erosion of the FCF margin to below 3% on a sustained basis
- Shift in financial policy towards higher net debt/EBITDA from the current target of below 2x

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>.

LIQUIDITY AND DEBT STRUCTURE

Strong Liquidity: Liquidity was strong at end-2022 as DKK3.7 billion of short-term debt (essentially represented by a EUR500 million bond due in September 2023) was well

covered by undrawn committed long-term credit lines of DKK14.9 billion (mainly represented by a EUR2 billion revolving credit facility maturing in 2026) and cash and cash equivalents of DKK8.3 billion. Although close to 60% of debt matures in 2024-2027, maturities are well spread within the period, and we do not forecast any difficulties for Carlsberg refinancing debt at maturity or repaying it from existing cash flows.

In terms of working capital seasonality, the year-end position is historically better than 1H, and would need an adjustment or to restrict cash. However, for 2022, we do not apply any adjustment due to our understanding that the year-end working capital position reported a historically high level.

ISSUER PROFILE

Carlsberg is the third-largest international beer company globally with operations in Europe and Asia.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

RATING ACTIONS

ENTITY / DEBT ⚡	RATING ⚡		
Carlsberg Breweries A/S	LT IDR	BBB+ Rating Outlook Stable	Affirmed
	ST IDR	F1	Affirmed

senior unsecured

LT BBB+ Affirmed

[VIEW ADDITIONAL RATING DETAILS](#)

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APPLICABLE CRITERIA

[Corporates Recovery Ratings and Instrument Ratings Criteria \(pub. 09 Apr 2021\)](#)
(including rating assumption sensitivity)

[Corporate Rating Criteria \(pub. 28 Oct 2022\)](#) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1)

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Carlsberg Breweries A/S

EU Issued, UK Endorsed

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