Carlsberg A/S
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H1 2018 Interim Financial Statement Conference Call
Speakers:
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Heine Dalsgaard, CFO

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, welcome to the Carlsberg H1 2018 Interim Financial Statement hosted by CEO, Cees 't Hart; and CFO, Heine Dalsgaard. Today, I am pleased to present CEO, Cees 't Hart; and CFO, Heine Dalsgaard. For the first part of this call, all participants will be in listen-only mode, and afterwards, there'll be a question-and-answer session. As a reminder, this call is being recorded.

Speakers, please begin your meeting.

Cees 't Hart

Chief Executive Officer, Carlsberg A/S

Good morning, everybody, and welcome to Carlsberg's H1 2018 conference call. My name is Cees 't Hart, and I have with me CFO, Heine Dalsgaard; and Vice President of Investor Relations, Peter Kondrup.

Let me first briefly summarize the key headlines for the first half year. We see good growth coming from our SAIL'22 priorities. We now expect that Funding the Journey will deliver benefits in excess of DKK 2.3 billion. We delivered strong financial performance, and we adjust full-year earnings outlook upwards. I will go through the highlights of the first six months and the regions, and Heine will talk you through the financials and outlook.

Please turn to slide 2. We delivered a strong set of numbers in the first half of 2018, and we are pleased that we are also delivering against our key SAIL'22 KPIs. We grew both top and bottom line. Net revenue grew organically by 5.1%, but declined 0.7% in reported terms due to adverse currency movements. Organic operating profit grew strongly by 14.2%, and adjusted EPS grew by 9.3%. Return on invested capital improved by 110 basis points to 7.6%.

The Group's cash generation remained strong at DKK 5.8 billion. And as a result, we continued to reduce net debt and leverage, debt now stands at 1.29 times. As we stated at the beginning of the year, 2018 is the year when we will show that the Group can accelerate top line growth. Heine later will talk you through the upgrade of the expected benefits of Funding the Journey by which we have been able to invest significant resources back in the business to drive growth while at the same time strengthen margins and cash flow.

We expect to reinvest around DKK 500 million back this year, bringing the total investment during the three-year period to more than DKK 1 billion. A few areas where we have decided to allocate further investments in the second half of this year are the rollout of DraughtMaster, the launch of Birell – an alcohol-free beer – further expansion in China, and further development of our digital capabilities.

Slide 3 and a few words on our Golden Triangle which serves as a key KPI in our performance management. It helps us to continuously aim at balancing gross margin and profits, while at the same time delivering a strong free cash flow. We are very pleased with the well-balanced Golden Triangle for H1 as we delivered top line growth, margin improvements and operating profit growth while maintaining a strong free cash flow. The organic volume growth of 3.4% was driven very much by continued growth in Asia and the recovery in Eastern Europe. GPaL margin strengthened by 170 basis points due to a solid 2% price/mix, volume leverage and efficiency improvements.

The 14.2% of organic operating profit growth was the result of improved GPaL and cost efficiencies, which were positively impacted by Funding the Journey. Free cash flow remained strong at last year's high level.

Please turn to slide 4 and a few comments on our international premium brands which all saw good growth. 1664 Blanc continued its strong performance and grew by 55% even after having achieved 46% growth in 2017. The brand grew in most markets, with particularly strong growth in China, Russia, France, the Ukraine, and some export markets.

Grimbergen also continued its double-digit growth and grew by 11%. The growth came from Western and Eastern Europe, with particularly strong results achieved in markets such as France, Russia, and Denmark. Tuborg, our largest brand, grew by 8%, supported by strong growth in India and China. The brand also grew in several markets in Western Europe, such as Denmark, Norway, Serbia, and Bulgaria. In Denmark, the growth was achieved in spite of a price increase as consumers traded up into more premium Tuborg line extensions. In Turkey, our partner has been very successful in making Tuborg one of the largest beer brands in the country.

Volumes of the Carlsberg brand grew by 4%. We saw good growth in Asia from China, India, and Malaysia, and in Eastern Europe from Russia. In Western Europe, volumes grew in markets such as Poland, Denmark, Norway and the Baltics, but declined in the UK.

Please turn to slide 5 and a brief update on some of our strategic priorities which are receiving significant support from our SAIL'22 investments. The strong growth trajectory of the craft & speciality category continues, and we grew our portfolio by 26%. Russia, France, China, and Poland were important drivers of the growth. During the half year, we established a microbrewery in Lithuania as we launched Brooklyn in Poland.

The rollout of the DraughtMaster system continued, supporting the availability of our craft & speciality portfolio in the on-trade. The system is now available in all Western European countries, and we are in the process of converting all steel keg installations in the four Nordic markets to the DraughtMaster system.

Alcohol-free brews grew by 26% in Western Europe. We launched a new alcohol-free beer, Birell, in Poland and Bulgaria and a new Feldschlösschen alcohol-free beer in Switzerland. In Russia, Baltika 0 strengthened its market-leading position within the alcohol-free beer segment. The brand grew by double-digit percentages, which was supported by last year's launch of Baltika 0 Wheat.

Asia is a key growth driver for Carlsberg, and the region had a fantastic start to the year with 14% organic revenue growth. One of the key investments in the region is the expansion of our international premium portfolio in China where momentum remains strong, and we delivered 15% volume growth.

With that, I will hand over to Heine who will take us through the financials and outlook.

Heine Dalsgaard

Chief Financial Officer, Carlsberg A/S

Thank you, Cees 't, and good morning, everyone. Please turn to slide 6 and a few comments on the P&L. First, net revenue grew organically by 5.1%. This was driven by volume growth and the price/mix of 2%. In reported terms, net revenue was impacted by the adverse currency development and declined by 0.7%. There was a slight negative impact from net acquisitions, which was due to last year's disposal of Nordic Getränke in Germany.

Cost of goods sold per hectoliter was flat. The positive impact from volume leverage and efficiency improvements was offset by the overall cost inflation and by mix. The positive volume growth, price/mix, and efficiencies led to a solid gross margin improvement of 90 basis points to 50.6%.

Operating expenses increased organically by 4%. This was driven by higher marketing expenses in support of our SAIL'22 growth priorities. Marketing expenses grew organically by more than 10%, reaching 8.8% of net revenue compared with 8.1% last year. Excluding marketing expenses, reported operating expenses declined by 3% as a result of Funding the Journey initiatives, compounded by the effect of currencies.

Depreciation was down versus last year mainly due to an extraordinary depreciation charge in first half last year. In the second half, depreciation will be slightly lower organically than second half last year. In total, we delivered 14.2% organic growth in operating profit, with high-teen organic growth in Eastern Europe and in Asia, and with around 8% organic growth in Western Europe. In reported terms, operating profit grew by 6% due to a significant impact from currencies of minus 8.5%. The most significant contributors to the currency headwind were the Russian ruble, the Chinese renminbi, and the Swiss franc.

Slide 7, please. Further down the P&L, net special items amounted to minus DKK 37 million primarily due to restructuring measures in Western Europe. Net financials were minus DKK 330 million compared to minus DKK 351 million last year. Excluding currency gains and fair value adjustments, financial expenses amounted to DKK 380 million versus DKK 518 million in 2017. The improvement of DKK 138 million compared to last year was mainly due to a reduction in our gross debt and the repayment of the €1 billion bond in October 2017.

The effective tax rate in the first half was 28%, which was exactly in line with our expectations. Non-controlling interests amounted to DKK 413 million which was on par with last year. Non-controlling interests primarily relates to our businesses in Malaysia, Chongqing, and Laos. The Carlsberg Group's share of consolidated profit increased by 7.2% to DKK 2.5 billion, adjusted earnings per share were up 9.3% to DKK 16.4.

And now, some comments on the cash flow on slide 8, please. Free cash flow was DKK 5.8 billion, positively impacted by the change in trade working capital of plus DKK 2 billion. On a rolling 12-month basis, trade working capital to net revenue was minus 15.2% which was a very strong number and driven by strong focus and an impressive effort, particularly in our Asian region. As said before, we believe that we are doing well on trade working capital, and we do not see any easy wins for further improvements. The change in other working capital was also positive, amounting to DKK 471 million, primarily due to a reclassification of certain trade loans. Net interests paid were DKK 311 million. Last year's number on net interest was impacted by a one-off income related to the settlement of financial instruments. Tax paid amounted to DKK 1.3 billion, which was DKK 371 million more than last year, and due to certain one-off tax payments and phasing within the year.

Total operational investments amounted to DKK 1.9 billion, slightly below depreciations of DKK 2.1 billion. The cash contribution from financial investments and other activities were plus DKK 358 million and related almost solely to dividends received.

Free cash flow showed a slight decline of DKK 97 million compared to first half 2017. The decline was due to the disposal of entities and certain one-off financial income included in last year's numbers and higher tax paid this year. The combined effect of these factors more than offset the significant working capital improvement.

Slide 9, please, and a few words on leverage which continued to decline and by end June, the net debt-to- EBITDA ratio was 1.29 times. Net interest-bearing debt was reduced by DKK 2.4 billion versus year-end 2017 as a result of the strong cash flow that more than offset the significantly higher dividend payout in March this year. In 2018, we have so far increased our ownership in two businesses. The most significant one this year was the deal announced on Monday this week, namely the further increase in ownership of our Cambodian businesses to now 75%, giving us management control. That means that we will consolidate Cambrew fully as of August this year. The acquisition is in line with our SAIL'22 priority of growing our businesses in Asia. We see interesting opportunities in Cambodia, both in terms of future market growth and in terms of further strengthening the business through an enhanced portfolio and improved route to market. In addition, as you know, we increased our ownership in Olympic Brewery in Greece to 100%.

Please turn to slide 10 and the outlook for the year. As a result of the continued good execution of Funding the Journey, we now expect the benefits of the program to exceed DKK 2.3 billion compared to the previous expectations of around DKK 2.3 billion and well ahead of the original expectation of DKK 1.5 billion to DKK 2 billion when the program was first launched. The reason why we're able to upgrade the expected benefits is the positive momentum of several [work] streams within the program, including value management, supply chain and operating cost management. The good traction of the many initiatives across the Group makes us confident that even after the completion of Funding the Journey, the strict financial discipline will remain a key pillar in our continuous efforts to improve profitability, while at the same time also growing top line.

Based on the strong first half-year performance, the upgrade of the expected benefit from Funding the Journey and a good start to Q3, we are able to adjust our earnings expectations for the full year upwards to high-single digit percentage growth in operating profit.

Despite the favorable start to Q3, especially in Western Europe, we still expect H2 profit growth to be lower than H1 for three main reasons. Firstly, in H1, Asia was impacted by the sell-in to the festive season and Eastern Europe witnessed an extraordinarily strong month of June due to weather. Secondly, we will accelerate SAIL investments in second half. And thirdly, there will be different phasing of certain costs, including depreciations versus last year.

Based on the spot rates on August 15, we now assume a negative translation impact on operating profit of around minus DKK 425 million, an improvement of DKK 125 million compared to the previous expectations. All other assumptions remain unchanged.

Back to you Cees.

Cees ‘t Hart

Chief Executive Officer, Carlsberg A/S

Thank you, Heine. Please turn to slide 11 and Western Europe. Our Western Europe business recovered in Q2, delivering organic net revenue growth of 2.3%. For the half-year, net revenue was flatorganically. Price/mix was +1%. Reported net revenue declined by 2.7% due to the disposal of the German wholesaler, Nordic Getränke, in April 2017 and the negative currency impact. Price/mix was positive in most Western European markets due to our successful premiumization efforts and some price increases, although negatively impacted by the higher growth of non-beer products.

On a regional level, the positive price/mix was partly offset by country mix and the volume loss in high-revenue Middle East export markets due to higher duties and VAT. Organic operating profit growth was 7.8%, and operating margin improved by 120 basis points. The earnings progress was driven by value management, premiumization, Funding the Journey benefits, and lower depreciation.

Beer volumes declined organically by 1.2% with improving dynamics in Q2. In Q2, our markets in the northern part of the region benefited from warm weather while the southern part of the region witnessed less favorable weather conditions. Non-beer volumes grew by 1.9% due to good performance in the Nordics. We estimate that our regional market share was largely flat compared to the same period last year. Reported volumes declined by 1.7% due to this divestment of Nordic Getränke.

Slide 12 please, and a few country-specific comments. In the Nordic markets, our total volumes grew by 4% with a slightly positive price/mix. The Scandinavian businesses all benefited from the very warm weather in Q2, positively impacting volumes, net revenue, and earnings. In a flat Danish beer market, we delivered significant value share gains as a result of strong sales execution, good results for Carlsberg 1883, and price increases for the Tuborg brand. In Norway, we saw solid beer volume growth driven by premium products, while our non-beer business was impacted by a large sugar tax increase at the beginning of the year. In Sweden, total volumes grew, driven by strong growth of the non-beer products. Beer volumes declined slightly due to the loss of distribution rights for third-party brands.

In Finland, volume growth was strong, driven by the relisting in Q1 for the winter campaign at a major retailer.

The French market was flat, negatively impacted by weather. Our craft and speciality and alcohol-free brands delivered double-digit growth. Total volumes declined slightly due to the continued challenges for the mainstream Kronenbourg brand and supply chain challenges arising from the railway strike in Q2. Price/mix improved due to the growth of premium products and lower promotional pressure, although the overall pricing environment remains difficult.

Our Swiss business continued its positive development, driven by a strong performance of our beer portfolio, which delivered volume, value, and price/mix improvement. Our key beer brand, Feldschlösschen, our regional brands and our alcohol-free brews all delivered good growth.

Our Polish business recovered strongly in Q2 after a challenging start to the year, following our price increase. Our volumes declined by 4% for H1, but we achieved strong price/mix of high-single digit percentages due to the price increases and good performance of upper-mainstream brands.

In UK, we saw a very good performance of our premium brands growing by double-digit percentages. The mainstream Carlsberg brand lost market share, resulting in total volume decline of 5%. We completed our exit from the porterage activities, which reduced net revenue. In the rest of the Western European region, craft & speciality and alcohol-free brews achieved very strong growth rates supporting a positive price/mix development. Our businesses in the Balkan markets delivered particularly good results.

Slide 13 and Asia. The Asia region delivered a strong set of results for the first six months. Net revenue grew organically by 14.3% driven by 10.4% organic volume growth and 4% price/mix. Reported net revenue grew by 7% due to a negative currency impact in most countries in the region. The price/mix improvement was a combination of strong growth of our international premium brands – Tuborg, Carlsberg and 1664 Blanc – as well as price increases. Organic operating profit grew by 17.4%, mainly driven by the strong revenue growth.

Operating margins improved by 10 basis points to 20.3%. The strong gross margin improvement was largely offset by a significant increase in marketing investments as a sizeable proportion of our SAIL'22 investments is allocated to further strengthening our Asia business.

The 10.4% organic volume growth was broadly based and all major markets delivered solid growth in H1. As expected, Q2 was less strong than Q1, as Q1 was positively impacted by the sell-in to the festive season in several Asia markets and easy comparables in India.

Slide 14, please, and a few country-specific comments.

We are very satisfied with the continued growth of our Chinese business, which led to China becoming our largest market in terms of volume and revenue for the first half year. Our net revenue grew organically by 17% in a market that grew by an estimated 1%. Our revenue growth was driven by 10% organic volume growth and 7% price/mix as a result of continued stellar performance of our international portfolio – Tuborg, Carlsberg and 1664 Blanc – that grew volumes by 15%. In addition, we saw growth for all our key local power brands.

Our Indian business delivered 16% volume growth, showing good recovery after the very volatile 2017. Price/mix was very strong, supported by the growth of the Carlsberg brand and improved pricing. Profitability improved significantly.

In Laos, our volumes grew by low-double-digit percentages, mainly driven by strong growth of water and soft drinks. As a result of this, price/mix was negative. In the beer category, we achieved particularly strong growth in the premium category with Carlsberg and Somersby.

Our Malaysian business delivered solid results, driven by share gains and a reduction in contraband. The share gain was supported by strong execution of the Chinese New Year activations at the beginning of the year and a successful football campaign. The country's Goods and Services Tax is currently being replaced by a Sales and Services Tax. It's too early to estimate the consequences of this change for the beer market.

As Heine has already mentioned, we increased our ownership in Cambrew in Cambodia to 75%, whereby we now have management control. In Nepal, our business delivered strong progress, supported by a new route-to-market approach. At the end of Q2, the Nepalese government implemented a 30% excise tax increase which has led to increases in the retail prices of beer of approximately 15%. In Vietnam, our volumes grew slightly in line with the market, whereby we maintained our market share. In Myanmar, we continued the expansion of our operations and almost doubled volumes albeit from a low base.

Slide 15 and Eastern Europe. Our Eastern European business benefited from warm weather across the region in Q2 and delivered strong progress for the first six months. Net revenue grew organically by 9.1% as a result of 3.4% volume growth and 6% price/mix. Due to weakening currencies across all markets, reported net revenue declined by 4.2%. All markets but Russia improved price/mix, mainly driven by price increases. Organic operating profit grew by 17%, driven by volume growth and the positive price/mix. Operating margin strengthened by 130 basis points to 20.3%. Volumes grew in all markets.

And now, please turn to slide 16. The Russian beer market grew by estimated 1% to 2% in H1 after strong growth of around 6% in Q2, which was driven by good weather and the World Cup tournament. Our Russia volumes increased by 1%, as 10% growth in Q2 offset the decline of 11% in Q1. The growth in Q2 was due to the overall market growth and easy comparables due to the undesirable pricing dynamics in the market following the large-size PET ban last year.

Our market share in Q2 improved sequentially by 70 basis points to 31.4% and was flat year-on-year. This was driven by positive performance of brands in the economy segment such as Zhigulevskoe, as well as new product launches in the economy segment. The Carlsberg brand also delivered strong growth. Price/mix was flat as our price increases were offset by a high level of promotions on PET bottles in the economy segment. These promotions were successful, and we gained market share in the segment. Profitability remained strong with operating profit margin in excess of 20%.

In the Ukraine, the market grew slightly supported by warm weather. Our Ukraine business continued its strong performance, delivering 10% volume growth and strong price/mix. The team in Ukraine has done a fantastic job in recent years, expanding and strengthening distribution, launching innovations and premiumizing the portfolio. Our business in Belarus, Kazakhstan and Azerbaijan all delivered solid revenue and earnings growth.

That was all for today. But before opening up for Q&A, a few concluding remarks on slide 17. 2018 is the year when we will show that the Group can accelerate top line growth. Internally, we talk about shifting gears to growth, while at the same time continuing to improve margins and profitability. In today's environment, that is a bold ambition, but we feel that we are well on our way to achieve this ambition. While we admittedly were helped by favorable weather in markets in Eastern Europe and Scandinavia, the first half year results provided solid indications that we will deliver on our 2018 priorities as well as our SAIL'22 financial priorities.

So, to summarize the first half, we see good growth from our SAIL'22 priorities. We now expect Funding the Journey to deliver more than DKK 2.3 billion. We achieved strong financial results with 5.1% revenue growth, 14.2% operating profit growth, and a strong cash flow, and we adjust full-year earnings outlook upwards.

And with this, we are now ready to take your questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And the first question comes from the line of Jonas Guldborg from Danske Bank. Please go ahead. Your line is open.

Jonas Guldborg Hansen
Analyst, Danske Bank A/S

Q

Yeah. Good morning. I have a couple of questions. Firstly, on your new guidance which calls for high-single-digit organic growth and operating profit with 14.2% in H1, it looks – also, comparable numbers are getting easier, I guess, so could you just repeat the reasons why we should see a much lower organic growth in earnings in H2? And then maybe you could also put a couple of comments on the net debt to EBITDA level of 1.3 which is significantly below your target. I know maybe you could say how much you will spend on the increased stake in Cambrew and then also give an update on Habeco.

Cees 't Hart
Chief Executive Officer, Carlsberg A/S

A

Thank you, Jonas. Heine, over to you.

Heine Dalsgaard
Chief Financial Officer, Carlsberg A/S

A

Yes. Good morning, Jonas. So, a few comments from our side. Let's start with the guidance. You're absolutely right, and we are very satisfied with the 14% organic EBIT growth in first half, but we do expect the growth in the second half to be below, and there are three main reasons for that.

The first is that we had a strong H1 this year as Asia was impacted by the sell-in to the festive season and Eastern Europe witnessed an extraordinarily strong month in June due to extraordinary weather conditions. So, that was the first part of the reason. Second has to do with the fact that we will accelerate SAIL investments even further in second half within, for instance, DraughtMaster, Birell – our alcohol-free beer – expansion in China and also further investment into digital. That was sort of the second reason. Third reason is that there will be a different phasing of certain costs, including depreciation versus last year. So, in total, we expect organic EBIT growth in the second half to be lower than first half and therefore, we expect the full year organic EBIT growth to be high-single digit.

Just to comment on the net debt to EBITDA of 1.29 and then your question relating to cash from Cambrew. First of all, we don't comment and we don't disclose the purchase price of the acquisition here, in this case actually also as per agreement with the seller. But what we can say is that in total for the two acquisitions we've done this year, so that is Cambrew and Olympic in Greece the cash payment is a few hundred million euros. And then on Habeco?

Cees 't Hart
Chief Executive Officer, Carlsberg A/S

A

Habeco, we are still in good contact with the government and there are no further developments at this moment of time.

Jonas Guldborg Hansen
Analyst, Danske Bank A/S

Q

Okay. Then just one follow up on the full year guidance because what kind of weather for Q3 have you incorporated, because we had very bad weather last year, as I remember, in both Eastern Europe and Northern Europe?

Heine Dalsgaard
Chief Financial Officer, Carlsberg A/S

A

We are forecasting normal weather conditions.

Jonas Guldborg Hansen
Analyst, Danske Bank A/S

Q

Thank you very much.

Operator: And next question is from the line of Søren Samsøe from SEB. Please go ahead. Your line is now open.

Søren Samsøe
Analyst, SEB Enskilda (Denmark)

Q

Yes. First question regarding the risks you're seeing. I mean, if you look at the malting price, it is up I think more than 20% the last couple of months. If you could sort of say how much you expect COGS to be up in 2019, for example. Secondly, your free cash flow looks strong underlying, but the reported is down since last year, I guess, it's the big tax payment, but what should we expect for second half in terms of free cash flow development? And then finally, if you could just give us some or elaborate on how much you paid for Cambodia because I don't think you have given any indication of the price for the increases stake in Cambodia. Thank you.

Cees ‘t Hart
Chief Executive Officer, Carlsberg A/S

A

Thank you, Søren. Heine, would you?

Heine Dalsgaard
Chief Financial Officer, Carlsberg A/S

A

Sure. Good morning, Søren. So, let's start with Cambodia, as just said, we don't disclose the purchase price of the acquisition. In particular not in this case, because we have agreed not to with the seller. But in total, for Cambrew and for Olympic, the cash payment is a few hundred million euros.

Then referring to your question on free cash flow, we did have a very strong cash performance in first half. And based on that, you can expect for the full year positive inflow from working capital this year, of course, depending on country mix. It is the fact that we are very depending on country mix. And particular first half is positively impacted by the strong growth we saw in China. So, overall, I will say that we are very satisfied with the minus 15% trade working capital. There are no more sort of low hanging fruits and now we focus on maintaining the current strong performance.

With respect to your question, Søren, on raw materials. First of all, we don't comment on anything relating to 2019 before we give our guidance in February. This is our usual practice. We are following, in particular, of course, the harvest season very closely. It's too early to make any firm conclusions. However, it is clear that sort of current indications are not positive. And we will most likely see some pressure from higher grain prices in 2019 and perhaps already in Q4 this year. We have hedged a significant portion of our barley needs for 2019 and of course we will work hard to pass the higher grain prices on to sales prices.

Søren Samsøe
Analyst, SEB Enskilda (Denmark)

Q

Okay. Thank you.

Operator: And next question is from the line of Trevor Stirling from Bernstein. Please go ahead. Your line is open.

Trevor Stirling
Analyst, Sanford C. Bernstein Ltd.

Q

Morning, Heine and Cees. A few questions from my side. So the first one, I mean clearly very strong quarter, but partly, as you say, the weather and the easy comps contributed. It may be impossible to say, but if you had to estimate the underlying growth rates, it seems that we're still in Europe probably at the high end of your long-term guidance case of 2% to 4%? The second thing is in Russia, has there been any change in behavior of your leading competitors since we saw that merger between ABI and Efes in Russia? That's it. Thank you.

Cees ‘t Hart
Chief Executive Officer, Carlsberg A/S

A

Thank you, Trevor, and good morning. I think you're right, and that gives us confidence for this year, but as well for next year in terms of our growth numbers. Yes, we have been helped by a very good summer, but we see as well that Asia is doing particularly well, not only because of the fact that the comps were easy, but when we look at our performance in, for example, China, when we look at our category performance of craft & speciality and our alcohol-free drinks, we really feel that we are at a slightly higher end of the kind of outlook we gave between 2% and 4% longer term. However, as said, we should, I think, remain to be modest. We have been helped by the weather as well.

Then with regard to Russia, we have seen, of course, some changes in the competitive landscape. The two parties now are really together. It's pretty forceful especially with regard to their promotions during the World Championship. However, we can report an improvement of our shares. So, in that aspect, yes, we will see how that will unfold. But so far, despite the huge investment, we are satisfied with our Q2 market share and as well the improvement of our so-called Balancing the Golden Triangle.

Trevor Stirling
Analyst, Sanford C. Bernstein Ltd.

Q

Thank you. Thank you, Cees.

Cees 't Hart
Chief Executive Officer, Carlsberg A/S

A

Thank you, Trevor.

Operator: And next question is from the line of Hans Gregersen from Nordea. Please go ahead. Your line is open.

Hans Gregersen
Analyst, Nordea Bank

Q

Good morning. The strong cash flow, Heine, you have in the past signaled that you can no longer or you did not expect to continue doing net working capital improvements. Still, you did a significant improvement this half year. CapEx is also very low in the first half versus the full year guidance. Can you elaborate a little bit further into details what we should be looking to for the net working capital going forward? Secondly, unallocated costs were quite high in H1 versus the full year guidance, any comments on that? And then if we look on SAIL'22 investments, what are the total accumulated investments and what is the distributed sort of on a regional basis for 2018? Thank you.

Cees 't Hart
Chief Executive Officer, Carlsberg A/S

A

Heine, over to you. Thanks, Hans. Good morning.

Heine Dalsgaard
Chief Financial Officer, Carlsberg A/S

A

Good morning, Hans. So on cash and the trade working capital performance, it is important to say that there are two main drivers behind the strong first half performance, and that is strong focus within the company, and then it is mainly driven, that's the second part, by Asia, and here in particular by China. And with a negative sort of trade working capital to revenue ratio in China and high revenue growth in first half, we did see a very strong trade working capital for first half from Asia. We do not see the same revenue growth in second half. And hence, we do not expect the same positive for year-end. But it is also very clear, as we've said before and discussed before, the trade working capital will remain a key priority for us in Carlsberg. So we will target to keep the current level that we have and for the full year expect a small positive number. The second part of your second question...

Hans Gregersen
Analyst, Nordea Bank

Q

Sorry. Heine, does that imply a negative net working capital in H2?

Heine Dalsgaard
Chief Financial Officer, Carlsberg A/S

A

Yes. For the reasons just mentioned. That's negative versus the year before, of course.

On unallocated cost in first half, it is absolutely right that our unallocated cost or central cost is up with around 6% or something like that from DKK 700 million to DKK 750 million. That is entirely as planned. And it relates to sort of SAIL'22 investments, in particular within marketing. As you saw, marketing investments are going up and that includes actually also quite big investment into some central marketing activities and also increased digital investments in the first half. So, that is sort of half the explanation and the other half of the explanation has to do with simply phasing between first and second half. If you look at full year on unallocated or central cost, you can expect something broadly in line with last year. So, DKK 1.3 billion to DKK 1.4 billion depending of course, on the specific split of SAIL investments in the second half.

With respect to your last question, Hans, on SAIL investments, so in total, you can expect – or we are expecting more than – now more than DKK 1 billion versus our initial expectations of around DKK 750 million. So, we have accelerated SAIL investments throughout the period because of the strong performance of our Funding the Journey program. And I will say it's across the regions that we are investing, but it is clear with Asia being one of the key priorities within SAIL'22, there is a relatively high portion of the investments within SAIL that have gone to strengthen our position in China, in particular, our big cities initiative in China. The rest of it has been focused, in particular, on Western Europe within alcohol-free, within DraughtMaster rollout, so a significant step-up and acceleration of DraughtMaster, and then the last part has to do with craft & speciality focus. And as you can see from the numbers, it seems to pay off.

Hans Gregersen
Analyst, Nordea Bank

Q

Thank you.

Operator: And next question is from Tristan van Strien from Redburn Partners. Please go ahead. Your line is now open.

Tristan van Strien
Analyst, Redburn (Europe) Ltd.

Q

Hi. Good morning, Cees 't and Heine. Just a few technical questions. First just to follow-up on the previous question, so the working capital benefit that we saw in Asia, it sounds like it's primarily been driven by the better growth of China. So I want to see if that was fair. Then the second question is your sugar tax, is that carried in your net revenue or is that sitting in your gross revenue? And the third bit, just a clarity, obviously, your Tuborg Turkey has grown quite well. Is that just captured in your revenue, so there are no costs involved, and what was your European performance have been ex-Turkey?

Cees 't Hart
Chief Executive Officer, Carlsberg A/S

A

Thank you, Tristan. Good morning. Heine?

Heine Dalsgaard
Chief Financial Officer, Carlsberg A/S

A

Good morning, Tristan. So, trade working capital, there's two factors driving it. First, it is a strong focus across the entire Group, and then the other one is Asia which is very high this year. And it's not only China, but it is clear, if you look at the splits, also the relative size of China in Asia, China is a main driver. It's not the only one we see strong trade working capital basically across the region. Then your question, sugar tax, that's included in COGS. Turkey, what was the question on Turkey?

Tristan van Strien
Analyst, Redburn (Europe) Ltd.

Q

Turkey, so your royalty revenue that you get, you're only getting royalty revenue in your numbers. And I guess I'm just confirming that. And what it would be in Europe? What would your growth have been in Europe ex-Turkey if you want to give that?

Heine Dalsgaard
Chief Financial Officer, Carlsberg A/S

A

You're absolutely right that in Turkey we have some volume – and, of course, there's no FX impact on volume. But if you look at our financials, what happens in Turkey right now is definitely limited to royalty. So, it is primarily royalty income we get from Turkey. We don't disclose any growth figures for Western Europe, excluding ELUD [Export & Licence business] or excluding Turkey.

Tristan van Strien
Analyst, Redburn (Europe) Ltd.

Q

Okay. Maybe just one – just to follow-up on the working capital again, you said basically you're going to balance it out a bit in H2 like you normally do it. Is that mostly the payable balance? Because when I look at your previous years, your payables in H2 are always a little bit less – lower days than it is in H1. Would that be a fair way of looking at it?

Heine Dalsgaard
Chief Financial Officer, Carlsberg A/S

A

Yeah.

Tristan van Strien
Analyst, Redburn (Europe) Ltd.

Q

Okay. Thank you very much, guys.

Cees ‘t Hart
Chief Executive Officer, Carlsberg A/S

A

Thank you.

Heine Dalsgaard
Chief Financial Officer, Carlsberg A/S

A

Thank you.

Operator: And next question is from the line of Mitch Collett from Goldman Sachs. Please go ahead, your line is now open.

Mitch Collett
Analyst, Goldman Sachs International

Q

Morning, three questions, please. So, the majority of your EBIT growth in the first half came from lower D&A, which I think you explained is because of a step-up in D&A in the first half of last year. I guess I'm interested in why, therefore, EBITDA growth lagged organic sales growth? That was the first question. The second was price/mix in Eastern Europe, I think it was plus 6% or thereabouts and price/mix for Russia you said was flat. So, can you explain what's driving the strong price/mix within Eastern Europe, if it isn't Russia?

And then, finally, if we think about the favorable weather you had and maybe a modest benefit from the World Cup, to come back to the 2% to 4% guidance range medium term for growth, I think you've argued that you were probably towards the top end of that extra weather benefit. So, is the right way to think about next year to think about that range and then take off the benefit you have this year? Is that the right way to think about how we should factor in the comparator when we think about F 2019? Thank you.

Cees 't Hart
Chief Executive Officer, Carlsberg A/S

A

Thank you very much, Mitch, and good morning. The EBIT question, over to you.

Heine Dalsgaard
Chief Financial Officer, Carlsberg A/S

A

Yeah. Good morning, Mitch. On depreciation, you're right that they are lower versus last year. It is important to note that approximately 25% of the lower depreciation come from FX. So, if you take that out, we are around DKK 300 million lower than last year. And that has to do with one-offs last year in first half. For the full year, it's not as high an impact because we did not have the same extraordinary charges in the second half last year.

Actually, our EBITDA growth, in reported terms, it is down with 2%, if we look at organically, actually it's up with 4%-5%. Why it's not up more? That has to do with our investments into, in particular, marketing spend, the acceleration that we've seen in marketing up organically with 10%, from 8.1% to 8.8% [of net revenue]. So, the reason why it is as it is has to do with accelerated investments into future growth.

Mitch Collett
Analyst, Goldman Sachs International

Q

Okay. Sorry to interrupt, but EBITDA, I think you said organically grew 4.3% sales and net revenue grew 5.1% and operating expenses including marketing grew 4%. So, I guess there must be something else that's causing EBITDA growth to lag revenue growth that I've missed.

Heine Dalsgaard
Chief Financial Officer, Carlsberg A/S

A

No, it has to do with increased investments into marketing primarily and in other SAIL-related growth initiatives.

Mitch Collett
Analyst, Goldman Sachs International

Q

Sorry. I thought that the 4% of operating expenses included that marketing growth.

Heine Dalsgaard
Chief Financial Officer, Carlsberg A/S

A

No.

Mitch Collett
Analyst, Goldman Sachs International

Q

Okay.

Cees 't Hart
Chief Executive Officer, Carlsberg A/S

A

Then with your second question with regard to price/mix in Eastern Europe, indeed, the price/mix in Russia was more or less flat and the other countries like Ukraine, Belarus, Kazakhstan, and Azerbaijan have a very strong price/mix, in particular, Ukraine that had an organic volume growth of 10.4% and a value growth of 28.5%. So, basically, particularly Ukraine has influenced that figure.

Then with regard to your question on the growth for next year, well, first of all, we're not going to guide year-by-year our top line. We said at our Capital Markets Day that we will change gears to growth and in the coming years you should expect from us between 2% and 4% net revenue growth. And we can only now say that we had a very strong start of that. It makes us more confident about the outlook for our top line, but we should indeed as well consider that this year was, particularly in quarter two, pretty strong because of the weather.

Mitch Collett
Analyst, Goldman Sachs International

Q

Okay. Understood. Thank you.

Heine Dalsgaard
Chief Financial Officer, Carlsberg A/S

A

Yeah.

Operator: And next question is from the line of Sanjeet Aujla from Credit Suisse. Please go ahead, your line is now open.

Sanjeet Aujla
Analyst, Credit Suisse Securities (Europe) Ltd.

Q

Two questions, please, from me. Firstly, on the balance sheet, outside Habeco, do you see further opportunities for deals, particularly in Asia? And then my second question is just going back to Russia and the competitive environment there, can you just talk a little bit about how your price gap on the PET has developed versus competition now?

Cees 't Hart
Chief Executive Officer, Carlsberg A/S

A

Thank you, Sanjeet, and good morning. Well, we are looking, of course, at the market for potential attractive investments. Habeco, is one of them, Cambrew was the other, and we might have some others on our list, but we are not going to talk about that at this moment of time.

With regard to our Russian price gap, as we said earlier, we needed to change in 2018 the balance in our Golden Triangle. Last year, we had incurred some volume loss. We have repaired that this year because, if you like, the marching order to the Russian team was repair the Golden Triangle, and I think they did very well on that one. Our pricing on shelf is now in line with the average of the market which is in the PET segment RUB 95.

Sanjeet Aujla
Analyst, Credit Suisse Securities (Europe) Ltd.

Q

Got it. And just a follow-up on the increased investment, I think a few months ago, you actually spoke about the investment opportunities perhaps not being compelling enough and, therefore, you actually lowered the amount you were going to invest relative to your initial expectations I think as a percentage of the gross savings. So, you seem to be stepping that back up again, so I'm just trying to understand why that's changed over the last sort of six to nine months.

Heine Dalsgaard
Chief Financial Officer, Carlsberg A/S

A

Do you mean with respect to SAIL investments?

Sanjeet Aujla
Analyst, Credit Suisse Securities (Europe) Ltd.

Q

Yes, exactly.

Heine Dalsgaard
Chief Financial Officer, Carlsberg A/S

A

Yes. Good morning. So what we said originally was that, since we worked hard I think to start with Funding the Journey benefits of DKK 1.5 billion to DKK 2 billion, what we said was that, in order to be prudent, we started our planning for investments of around DKK 750 million, so 50% of that. Then as we stepped up towards the DKK 2 billion, we also said that we're going to step up in our investments. But as you go above the DKK 2 billion, we really don't see a lot of additional investments. We will invest more, but the target was set to be approximately 50% of the total benefits.

Now that we are significantly above the DKK 2 billion, we don't see that all of it can be invested into future growth. So, the 50% will be lower, as expected, once we are significantly above DKK 2 billion. That means that the part that goes to the bottom line will be higher. But it is right that as we saw and became more positive sort of towards the outlook to increase afterwards the DKK 2 billion and also a little bit higher, then we also increased our investments. And it's not that we don't see compelling sort of business cases. There's a lot of energy within the organization and a lot of good ideas. So, we do see a lot of good opportunities to continue to invest into future growth.

Sanjeet Aujla
Analyst, Credit Suisse Securities (Europe) Ltd.

Q

Okay. Many thanks.

Operator: And next question is from the line of Nico von Stackelberg from Liberum. Please go ahead, your line is now open.

Nico von Stackelberg
Analyst, Liberum Capital Ltd.

Q

Hi. Good morning. Could you please provide me with your top markets, the top countries by profit? Could you maybe rank the top maybe three or five, please, because there's some shifting going around here? I just want to make sure I got my numbers right. The next one is on progress with excise legislation in Russia. I understood there was a bill in Duma that could hold the excise flat for the next two years. Is that still in the Duma, and what's the progress there? And lastly, I see that trade loans – well, I guess they were reclassified out of other receivables and now they have their own line here in the cash flow from investing activities. Why did you do that and why is there a DKK 270 million outflow? Thanks.

Cees 't Hart
Chief Executive Officer, Carlsberg A/S

A

Nico, thank you. Well, we don't give a league table, but as you heard this morning, in the first half year, China was the largest that overtook Russia. So, it's logic that China and Russia are our largest market in both revenues and profit. So, that just gives you a bit of a feel.

With regard to the excise, yes, there is something happening in the regulations in Russia. A few members of the Duma have proposed to reduce the maximum size of the PET even further. That's what we see now. It's not backed by the government at this stage and the proposal doesn't seem to get further traction at this moment of time.

The taxes, as we read here now, and probably we have the same information as you have, they're unchanged for 2017 to 2019 at RUB 21 and for 2022 then, RUB 22, and then further RUB 23 in 2021. And the latest conversation I had with the Minister of Finance, but that person has changed, he said that he intended to follow excise increases in line with inflation. So, that's so far the information we have.

There is, however, a different proposal, introducing special steps, and that's something that could unfold in the coming 18 months. And we are in conversations with government officials about how to do that. We, as an industry, strongly oppose to it. And as said, we are having, as we speak, more or less, conversations with the new government on that.

Heine Dalsgaard
Chief Financial Officer, Carlsberg A/S

A

Good morning. The question on trade loans, important to note is that it is a classification within the free operating cash flow. And it's simply correcting a mistake in one of our markets that correctly – that by mistake had corrected a set of classified trade loans wrongly. So, it's simply correcting that mistake and moving that from other working capital now down to the specific line that we have for this, which is, as you can also see, included in free operating cash flow and it's called the change in on-trade loans. It's around DKK 238 million. So, it's a classification within free operating cash flow, and it's simply correcting a mistake.

Nico von Stackelberg
Analyst, Liberum Capital Ltd.

Q

And it's a pretty big number, to be frank, compared to the previous year. So, can you give more color as to why it's a bigger number there, bigger outflow? Thanks.

Heine Dalsgaard
Chief Financial Officer, Carlsberg A/S

A

Yeah. It's because we didn't have the mistake last year.

Nico von Stackelberg
Analyst, Liberum Capital Ltd.

Q

Okay.

Heine Dalsgaard
Chief Financial Officer, Carlsberg A/S

A

So, it's simply correcting a mistake in one of our markets that had classified trade loans as other working capital, which is not the case.

Nico von Stackelberg
Analyst, Liberum Capital Ltd.

Q

Okay. Okay. Thanks.

Cees 't Hart
Chief Executive Officer, Carlsberg A/S

A

Thank you, Nico.

Operator: And next question is from the line of Catherine Fong from HSBC. Please go ahead, your line is now open.

Catherine Fong
Desk Head, Credit Advisory, HSBC Private Banking

Q

Thank you very much for taking my questions. I have two questions regarding to the China market as your China business is getting better and better. The first question is that we noticed that AB InBev has been gaining market share mainly through one local brand, Harbin, and the international brand. And we see Carlsberg's international brands performed very well. Does

Carlsberg consider to develop one of your local brands into a national brand in China?

And the second question is that Carlsberg promised to solve the horizontal competition between different business units in China between 2017 to 2020. So, can you elaborate to us about that process and the different ways that may help solve the problem? Thank you very much.

Cees 't Hart
Chief Executive Officer, Carlsberg A/S

A

With regard to the first one, moving from brand into international brands, well, we're not going to unfold our commercial agenda here. The fact of the matter is that we are very much focused on Western China. And in that respect, we have a good position there. Eastern China, as you know, we have less coverage. We retreated from there three years ago. And in Eastern China, we're very much focused on the big cities and we will then invest in our international brands. So, as you've seen in the figures, that serves us well. We grew our international portfolio by 15% with Carlsberg 12%, Tuborg 15%, 1664 Blanc 64%, coincidently, and so, in that respect, we continue on that. And last, with regard to market share, we basically are gaining market share in the premium and sub-premium segment and our total market share has grown now to even 6.5%. Heine?

Heine Dalsgaard
Chief Financial Officer, Carlsberg A/S

A

Yeah, and good morning. And then just reflecting on the other parts of your question, you're absolutely right that as part of the partial takeover of CBC where we increased our ownership to 60%, we made a commitment so within the next four to seven years to sort potential competition between our other local China's businesses ex-CBC and the tender offer of CBC was completed in 2015. So, we are getting closer. There's a lot of elements that we are looking into and that we need to address, and we are carefully evaluating all of these different elements. As CBC is a listed company, we can't, for good reasons, not make any further comments on this, but just to be clear, and I'm sure that you're fully aware, a non-compete undertakings are quite common in China. So, this is something we will come back to within the next one to two years.

Catherine Fong
Desk Head, Credit Advisory, HSBC Private Banking

Q

Well, thank you very much.

Cees 't Hart
Chief Executive Officer, Carlsberg A/S

A

Thank you, Catherine.

Operator: And next question is from the line of Andrea Pistacchi from Deutsche Bank. Please go ahead, your line is now open.

Andrea Pistacchi
Analyst, Deutsche Bank AG

Q

Yeah. Good morning. Two questions, please. First one on Poland, you had a better Q2 compared to Q1, has the competitive environment been improving there? I think one of your main competitors haven't really moved on price at the beginning of the year when you had this change.

Second question on Russia, which has obviously also improved in this year, in H1. Leaving aside World Cup and weather benefits, how would you characterize the underlying market performance in Russia? Is that getting better? And what would you expect for the market from here? Thanks.

Cees 't Hart
Chief Executive Officer, Carlsberg A/S

A

Good morning, Andrea. Thank you for your questions. With regard to Poland, yes, indeed, in Q2, we improved. We have not, let's say, yet improved our market share there, but that's because of the fact that we indeed took pricing in Q1 together with Heineken. Asahi didn't follow there. So, the average price increase was 3.1% and basically some others are far below that. So, in that respect, on pricing, we don't get yet the same development from others, and by that, we have a slightly higher price premium. On the other hand, our premium part of the portfolio is doing very well. So, we have a very positive price/mix in Poland, and we are very satisfied with that.

We're satisfied as well with our underlying performance in Russia. Both the markets is behaving a bit better, as you see – or is better – and as well, our market shares are coming back, and we expect that the underlying market development for this year will be positive in Russia, for a change, and that that'll in our view be between 1% or 2%.

Andrea Pistacchi
Analyst, Deutsche Bank AG

Q

Thank you.

Cees 't Hart
Chief Executive Officer, Carlsberg A/S

A

Thank you, Andrea. Can we have the last question, please?

Operator: Of course. And the final question is from the line of Andrew Holland from Société Générale. Please go ahead, your line is now open.

Andrew Holland
Analyst, Société Générale SA (UK)

Q

Yeah. Thank you. Just a couple. Firstly, I'm just interested in your use of words where you – in relation to Funding the Journey where you referred to moving from about DKK 2.3 billion to above DKK 2.3 billion. I just wonder what you think that means in numbers.

And the second one is just coming back to Russian beer regulation, my memory is that the Russian government proposed a ban on advertising which was then reversed because of the impending World Cup. The World Cup is now out of the way, and I'm just wondering whether you are either anticipating or knowing that the government is going to reimpose an advertising ban. And could you also enlarge a bit on the special stamps that you were talking about? Can you tell us what that scheme might involve and what the impact might be? Thank you.

Cees 't Hart
Chief Executive Officer, Carlsberg A/S

A

Okay. Thank you, Andrew. Good morning. First question will be answered by Heine.

Heine Dalsgaard
Chief Financial Officer, Carlsberg A/S

A

Good morning, Andrew. So, on the Funding the Journey benefit above or more than DKK 2.3 billion, we don't want to be more precise at this point in time. Of course, you will know more when we come up with the full-year results in February. But just to confirm that we are very pleased with the development of Funding the Journey. So, it's from originally DKK 1.5 billion to DKK 2 billion, then around DKK 2.3 billion and now above DKK 2.3 billion, which makes us confident, first of all, that we will deliver above DKK 2.3 billion, and secondly also that it is sustainable in Carlsberg that the sort of continued focus on costs, the financial discipline is now a way of living.

Cees 't Hart

Chief Executive Officer, Carlsberg A/S

A

Then on the ban, as we said in the conversation we had with investors and with you as well is that we thought that for 2018 there will be less focus on some of the regulations because of the big championship in 2018. There's a new government and as you said, the tournament is over. So, yes, we expect that maybe some of these rules which were more strict in the past than in 2018 might come back again, but we don't have any new news on that one.

With regard to special stamps that will be introduced in Russia, that's still too early to say. There are different proposals to introduce these kind of regulations. Some of them basically will have a bigger impact than others. So, at this moment of time, nothing is certain. First of all, it is uncertain that it will happen. And the second thing is not certain which kind of regime they will put onto us and that means that it's too early to make any calculation on that.

With that, thanks, Andrew, and we will close the call. This was the final question for today.

Cees 't Hart

Chief Executive Officer, Carlsberg A/S

Thank you for listening in and thanks for your questions. We are looking forward to meeting some of you during the coming days and weeks. Have a nice day.

Operator: And this now concludes the conference call. Thank you all for attending. You may now disconnect your lines.