

Credit Opinion: Carlsberg Breweries A/S

Carlsberg Breweries A/S

Copenhagen, Denmark

Ratings

Category	Moody's Rating
Outlook	Stable
Issuer Rating	Baa3

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Key Indicators

[1]

Carlsberg Breweries A/S

	2008	2007
EBITA Margin	13.7%	11.1%
FFO/ Net Debt	13.2%	26.2%
RCF/ Net Debt	11.3%	23.2%
FCF/Debt	1.4%	-1.1%
Debt/ EBITDA	4.8	3.1
EBIT/ Interest Expense	2.4	3.7

[1] All ratios are adjusted as per Moody's Rating Methodology: Moody's Approach to Global Standard Adjustments in the Analysis of Financial Statements for Non-Financial Corporations - Part II, February 2006

Note: For definitions of Moody's most common ratio terms please see the accompanying [User's Guide](#).

Opinion

Corporate Profile

Based in Denmark, Carlsberg Breweries A/S ("CB") is 100%-owned by Carlsberg A/S. CB is one of the world's largest brewers in terms of volumes, producing and distributing a wide range of beer brands including the leading Carlsberg and Tuborg beers, as well as regional brands (e.g. Baltika, Cardinal, Holsten), soft drinks and bottled water. In 2008, CB produced 126.8 million hectolitres of beer and posted total revenues of DKK59.9 billion (approximately US\$11.8 billion). The company has an international presence with a focus on Northern and Western Europe (62% of total revenue in 2008), Eastern Europe (32%) and Asia (6%).

Rating Rationale

CB's Baa3 long-term issuer rating is underpinned by the group's scale as one of the world's largest brewers, with leading positions in some of its key European markets including France, its overall well diversified revenue base and prospects of enhanced profitability over time following the purchase of certain assets of S&N in 2008 which gave the company full ownership of Baltika, the number one brewer in Russia with a track record of very strong growth and high margins. At the same time, the rating takes into account the company's increased exposure to emerging markets, Russia specifically, which represents over 50% of total EBIT, and significantly weaker credit metrics as a result of the additional leverage taken to finance the transaction.

The key rating factors of Moody's Global Rating Methodology for the Alcoholic Beverage Industry position CB's rating at Ba1, based on figures at FYE 2008, or one notch below the actual rating of Baa3 reflecting the low credit metrics following the acquisition of certain assets of S&N completed on 28 April 2008.

Rating Drivers

Factor 1 - Scale and Diversification

CB has over the past few years increased its market position ranking number four in the global beer industry, behind Heineken (not rated). Growth has been achieved through the expansion into fast growing markets in Asia and Eastern Europe as well as acquisitions. After the purchase of certain assets of S&N, CB's beer production volumes and net sales, including the full contribution from BBH from the acquisition date on 28 April 2008, reaching nearly 127 million beer hectolitres and DKK60 billion or approximately US\$11.8 billion in 2008. The group scores "Aa" on the sub factor "scale" according to our methodology.

CB's core business is the production and distribution of beer and its portfolio comprises more than 20 major brands led by the Baltika, Kronenbourg, Carlsberg and Tuborg brands. The Carlsberg and Baltika brands rank among the top 20 brands worldwide and have proved instrumental in reinforcing the company's brand equity internationally. The company also has licence agreements to produce soft drinks. In that respect, Moody's notes that CB reached an agreement with The Coca-Cola Company ("TCCC") whereby TCCC

acquired some of Carlsberg's water brands, and also entered into a license agreement regarding a soft drink and a water brands in Denmark and Finland. In 2008, soft drinks represented about 15% of the group's total sales volumes.

CB has expanded its activities outside of the mature Northern and Western European markets, where growth of beer volumes has been subdued, into developing countries in Asia (mainly China, India, Vietnam and Malaysia) and Eastern Europe which generally display high potential for growth. Moody's considers that the purchase, in 2008, of the 50% stake in BBH that CB did not own through its acquisition of S&N together with Heineken, has brought valuable organic growth prospects. We nevertheless note the uncertainties related to the investment climate in Russia and the additional volatility generated by increased dependence on this market, which will represent approximately 50% of CB's EBIT. Moody's notes in particular the sensitivity of the group performance to the evolution of the Russian rouble which has depreciated in recent months and notes that the group bases its current expectations on a EUR/RUB exchange rate of 47, above the average and current rate. Overall, Moody's therefore considers that CB's business risk have moderately increased after this transaction, scoring "A" on the sub factor product/brand diversification and "Ba" on geographic diversity.

Factor 2 - Franchise Strength and Growth Potential

CB is the fourth largest brewer worldwide behind Anheuser-Busch InBev (rated Baa2, stable outlook), SABMiller (Baa1, stable outlook) and Heineken (not rated). The company holds a dominant position in the Nordic markets, France (through Brasseries Kronenbourg), Russia and Ukraine and has a solid presence in some of Europe's largest markets, namely Germany, the UK (number 4), Portugal (number 1) and Switzerland (number 1). In Russia, CB estimated its market share to 39.9% in the first quarter of 2009, well ahead of the number two, Anheuser-Busch InBev (16.8%). Moody's views CB's quality of brand portfolio and market position as being in line with an "A".

Moody's considers CB's distribution infrastructure to be efficient, which positions it in the "Baa" category. Steps have been taken to implement best practices in the logistical processes and enhance the supply chain to increase efficiency from the delivery of raw materials to the sale to end-customers. In Russia, CB has in the recent past reorganised its distribution infrastructure and merged its individual breweries Baltika, Pikra, Vena and Yarpivo. Looking ahead, Moody's expects further benefits, as the company delivers the acquisition synergies estimated at DKK1.3 billion by the third full year after the transaction, of which DKK250 million were achieved to 31 March.

Overall, CB's revenue growth has been around that of its peers, positioning it in the "Baa" category. Whilst Moody's believes that BBH will lift the group's organic revenue growth, the ongoing recession has put a strain on beer consumption. Even in developing countries which had so far been very dynamic, volume growth has decelerated since 2008, as consumers reduce spending on alcoholic beverages and shift to less expensive product categories and channels.

Factor 3 - Profitability and Efficiency

The EBITA margin, as adjusted by Moody's, stood at 13.7% in 2008 compared to 11.1% the prior year. CB's level of profitability remains below that of its rated peers, but the acquisition of certain of S&N assets should contribute to improve profits over time as BBH boasts a considerably higher profitability level than the rest of the group: Eastern Europe reported an operating margin (before special items) of 21.5% in 2008. In other regions, profitability is negatively impacted by the declining beer volume trends, tough competition in some key Western European markets such as the UK, as well as CB's high exposure to the off-trade (e.g. off licences, supermarkets), where margins are lower than in the on-trade (e.g. public houses, hotels, clubs). According to our methodology, CB's profitability is in line with the "Baa" category.

Moody's therefore expects that 2009 will be challenging for CB with reduced room for price increases, which will put pressure on top line expansion. Performance over the first quarter of 2009, traditionally a small quarter for the company, showed a decline in organic net sales growth of 1% although we positively note that operating profit increased by 23% on the back of cost control and higher efficiencies.

Factor 4 - Financial Policy and Credit Metrics

The acquisition of certain S&N assets, which the group purchased for a total enterprise value of DKK57 billion (after transaction costs) on a debt-free and cash-free basis, has resulted in much weaker credit metrics (adjusted by Moody's) which score, on average, in the "B" rating category. They include the full contribution to earnings from BBH since the acquisition date on 28 April 2008. Moody's takes some comfort from management commitment to apply the free cash flow generated by the operations to reduce debt in 2009, Net Debt to EBITDA is expected at 3.0x (as calculated by the company), and restore a financial structure commensurate with an investment-grade rating. Moody's expects CB's credit metrics to improve back to levels in line with our targets, RCF to Net Debt above 18% and Debt to EBITDA below 3.5x, by the end of 2009.

Moody's also notes that the group owns land in Copenhagen, which it is in the process of selling. If and when monetised, this would bring a degree of financial flexibility to Carlsberg A/S, although Moody's does not currently factor any benefit into the rating.

Overall, CB's financial policy is in line with the "Baa" category as per our methodology.

Liquidity Profile

Moody's views CB's liquidity as satisfactory, underpinned by cash balances of DKK3.0 billion at the end of March 2009 (at Carlsberg A/S level) and recurring operating cash flows generated from the brewing activity. Moody's also anticipates that free cash flow generation will benefit in 2009 from the announced reduction in investments to below DKK3.75 billion. The liquidity profile is further supported by CB's access to bank credit facilities of which a five-year EUR 1.225 billion multicurrency revolving credit facility maturing in 2012, which contains a MAC clause deemed to be repeated but no financial covenants.

Furthermore, Carlsberg has arranged in 2008 bank financing for the acquisition totalling approximately DKK25 billion with maturities of up to five years. The latter include an adjusted Net Debt to EBITDA financial covenant required to be below 4.25x at 30 June 09 and 4.0x by the end of December 2009.

In Moody's opinion, the company has sufficient resources to fully cover the existing debt maturing within the next 12 months principally a DKK2.5 billion 4.88% bond coming due on 4 June 2009.

Rating Outlook

The stable outlook reflects the company's relatively stable operating profile and cash flow generation and Moody's expectation that it will maintain a conservative financial policy. In that respect, we take note of the management commitment to maintain an investment-grade rating.

In order to maintain its current Baa3 long-term issuer rating with a stable outlook, we would expect CB to meet the following credit metrics by the end of 2009 and to maintain them: RCF to Net Debt above 18% and Debt to EBITDA below 3.5x.

What Could Change the Rating - Up

A rating upgrade is unlikely at this stage given the weakening in credit metrics subsequent to the acquisition. To consider a positive rating action, Moody's would expect profitability to continue to improve and CB (and Carlsberg A/S) to rebuild and sustain credit metrics with FFO/Net Debt around 30%, RCF/Net Debt above 20% and Debt/EBITDA below 3.0x.

What Could Change the Rating - Down

Negative pressures on the rating and/or the outlook would appear if CB and/or Carlsberg A/S fail to meet the expected credit metrics (as indicated in the Rating Outlook section), as a result of a weakening in the operational performance or corporate activity.

Rating Factors

Carlsberg Breweries A/S

Alcoholic Beverage Industry	Aaa	Aa	A	Baa	Ba	B	Caa
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Factor 1: Scale & Diversification (22.5%)						
a) Global Net Sales		US\$11.8				
b) Diversification by Market					X	
c) Product/Brand Diversification			X			
Factor 2: Franchise Strength & Growth Potential (22.5%)						
a) Efficiency of Distribution Infrastructure				X		
b) Quality of Brand Portfolio and Market Position			X			
c) Innovation and Organic Revenue Growth				X		
Factor 3: Profitability & Efficiency (19%)						
a) Efficiency/Potential for Cost Reduction			X			
b) Profitability (EBITA Margin)				13.7%		
c) Return on Avg Assets (EBITA / Avg. Assets)						8.7%
Factor 4: Financial Policy & Credit Metrics (36%)						
a) Financial Policy				X		
b) FFO / Net Debt						13.2%
c) Debt / EBITDA						4.8x
d) RCF / Net Debt						11.3%
e) EBIT / Interest Expense						2.4x
f) Free Cash-Flow / Debt						1.4%
Rating:						
a) Indicated Rating from Methodology					Ba1	
b) Actual Rating Assigned				Baa3		

Note: Numbers as at FYE 2008

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