FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Carlsberg at 'BBB+'; Outlook Stable

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Fitch Ratings - Milan - 09 Apr 2020: Fitch Ratings has affirmed Carlsberg Breweries A/S's Long-Term Issuer Default Rating (IDR) and senior unsecured rating at 'BBB+' and Short-Term IDR at 'F1'. The Outlook on the IDR is Stable.

The rating affirmation and Stable Outlook reflect our expectation that Carlsberg's strong rating headroom and conservative financial policy will allow the company to weather the crisis caused by disruptions from the COVID-19 outbreak, keeping its leverage within our rating sensitivities for 'BBB+'.

We also take into account the liquidity position of Carlsberg, supported by almost undrawn EUR2 billion revolving credit facility (RCF) and flexibility in managing some of its cash outflows, including the DKK2.5 billion second tranche of its share buyback programme planned for the period between August 2020 and February 2021. The rating remains supported by the company's position as the third largest player in the international beer market, its geographic diversification, healthy annual free cash flow (FCF) generation and conservative credit metrics supported by its financial policy .

KEY RATING DRIVERS

On-Trade Channel Disrupted by COVID-19: Alcoholic beverages companies, including Carlsberg, are exposed to the disruption from the pandemic due to their reliance on on-trade sales channel and occasion-driven nature of alcohol consumption, especially in the high-end pricing segment. As a result of the restriction of movements and of socialisation of people imposed by governments to limit the pandemic spread, we expect out-of-home beer consumption to fall sharply in 2020, before normalising in 2021. We also assume a slight decline in Carlsberg's sales in retail stores, which we estimate at around three quarters of revenue.

Organic Growth to Resume in 2021: We project Carlsberg's sales to decline organically in 2020 primarily on the back of a sharp drop in Asia in 1Q20 and 2Q20, followed by Europe in 2Q20 and 3Q20, before recovering gradually in 2021. Once trading conditions normalise, we assume that organic sales growth will return to within the 2%-4% targeted by Carlsberg's SAIL'22 strategy. Organic growth is likely to come primarily from Asia due to more favourable market fundamentals than in mature western Europe and sluggish and highly competitive eastern European markets. In our view Asia should deliver mid-single-digit growth on the 'premiumisation' of demand for beer and growing per-capita beer consumption in certain markets.

EBITDA Shortfall in 2020: Our rating case assumes a drop in the company's EBITDA by around 15% in 2020, similar to our expected reduction in revenue, due to Carlsberg's cost-cutting initiatives aimed at preserving margins in a tough market environment. In addition to lower administrative costs, we assume a reduction in marketing and promotional expenses to the extent it does not impact the long-term health of brands. As sales volumes recover in 2021, we project EBITDA margin to grow gradually, benefitting from a more profitable sales mix.

Large Rating Headroom: Carlsberg has one of the lowest leverage ratios among Fitch-rated alcoholic beverages producers, despite increased shareholder remuneration in 2019. Its funds from operations (FFO) net leverage of 1.6x in 2019 was materially below our negative leverage sensitivity of 3x, ensuring ample headroom under its 'BBB+' rating. We believe this strong rating headroom would allow the company to absorb a projected COVID-19 related increase in leverage to 2.5x on a FFO net leverage basis in 2020, but still remain below our negative sensitivity threshold of 3.0x.

Conservative Financial Policy: Carlsberg's ratings benefit from the company's commitment to a conservative capital structure. The maximum management-calculated net debt/EBITDA of 2x corresponds to Fitch's FFO net leverage of

2.3x-2.5x, which is comfortably below our negative rating sensitivity of 3x. Adherence to its financial policy enhances Carlsberg's financial flexibility to reduce shareholder remuneration if the internal leverage target is endangered. In particular, the company could cancel the second tranche under its DKK5 billion share buyback programme in 2020 in case of liquidity needs.

Scope for M&A: Carlsberg's rating allows for bolt-on M&A from 2021, despite a sharp drop in profits expected in 2020. We project the company to resume its healthy FCF generation to DKK4 billion from 2021, providing sufficient liquidity to fund potential deals without releveraging the balance sheet. We believe most of this will take place in Asia, where Carlsberg aims to exploit opportunities. Our rating case assumes it acquires a controlling stake in Vietnamese brewer Habeco in 2022, which would strengthen Carlsberg's position in this promising market and be a defensive move in light of growing competition from Heineken and from Thai Beverage Public Company Limited (BBB-/Negative), which acquired Sabeco in 2017.

Third-Largest International Brewer: The rating of Carlsberg reflects its market position and scale as the third-largest international brewing company globally, with operations in Europe and Asia. We view as credit-positive the company's ability to diversify geographically over the past five years and decrease dependence on the Russian beer market, which has been challenged by stringent industry regulation and decreasing consumer spending. In 2019, Russia accounted for only 11% of its revenue (2012: 21%) and its contribution was for the first time exceeded by China (14%), which is now the company's single-largest market by sales.

DERIVATION SUMMARY

Fitch rates Carlsberg according to its Ratings Navigator framework for alcoholic beverages companies. Carlsberg is smaller and less geographically diversified than Anheuser Busch InBev NV/SA (ABI, BBB/ Stable), the world's largest beer company with a stronger business profile and superior profitability. However, Carlsberg is rated one notch higher than ABI due to its more conservative financial policy and capital structure, while ABI's leverage is more representative of a 'B' category rated issuer. Furthermore, Carlsberg exhibits a more conservative financial structure than US-based beer producer Molson Coors Brewing Company (BBB−/Stable) and global spirits companies Diageo plc (A−/Stable) and Pernod Ricard S.A. (BBB+/Stable). Diageo is rated one notch higher than Carlsberg, despite higher leverage, as it has a stronger business profile. Diageo is the largest spirits company globally with geographically diversified operations and strong brands across different spirits categories.

No Country Ceiling, parent-subsidiary linkage or operating environment aspects apply to these ratings.

KEY ASSUMPTIONS

- Lockdowns in 2Q20 across almost all markets leading to a sharp fall in on-trade channel sales and low single-digit decline in off-trade channel sales;

- No wide-scale recurrence of lockdowns in 2H20 but weak consumer sentiment maintained until 2021;

- Unfavourable FX impact on sales limited to 2% in 2020;

- EBITDA margin declining only slightly in 2020 due to significant cost reductions;

- Capex at DKK4 billion in 2020 and DKK4.5 billion a year over 2021-2023 with flexibility in cutting or postponing some investments if necessary;

- Dividend payout at 50% of net income over 2021-2023;

- Share buyback of DKK5 billion in 2020 with ability to cancel DKK2.5 billion second tranche in case of worse-than-expected performance;

- Acquisition of a stake in Habeco in 2022; and

- Other M&A of DKK1.5 billion a year over 2021-2023.

RATING SENSITIVITIES

We do not envisage any positive rating action in the foreseeable future unless Carlsberg further materially strengthens its business profile. However,

Developments That May, Individually or Collectively, Lead to Positive Rating Action/Upgrade:

- Maintenance of leading positions in core markets and mid-single-digit organic revenue growth;

- Group EBITDAR margin above 25% (2019: 22.4%) and FCF margin sustained above 5% (2019: 6.3%);

- FFO net leverage sustained below 2.0x (2018: 1.6x).

Developments That May, Individually or Collectively, Lead to Negative Rating Action/Downgrade:

- Deeper economic disruption as part of, or following, the COVID-19 crisis than currently modelled by Fitch, leading to meaningful delay to normalisation of operations;

- Severe decline in operating performance from key markets or much stronger remuneration of shareholders, coupled with an increased M&A appetite, causing FFO net leverage to increase on a sustained basis above 3.0x;

- Erosion of the FCF margin below 3%; and

- Shift in financial policy towards higher levels of net debt/EBITDA from the current target of below 2x.

BEST/WORST CASE RATING SCENARIO

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 https://www.fitchratings.com/site/re/10111579.

LIQUIDITY AND DEBT STRUCTURE

Strong Liquidity: Liquidity was strong at end-2019 as DKK3.7 billion of short-term debt was well covered by undrawn committed revolving credit facility of DKK14.9 billion (EUR2 billion) due in June 2024 and cash and cash equivalents of DKK5.2 billion. In addition, Carlsberg's liquidity was supported by a EUR500 million bond issue in March 2020. The company also has a one-year bank loan of EUR500 million, which can be drawn for near-term liquidity needs.

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

ESG issues are credit neutral or have only a minimal credit impact on the entity(ies), either due to their nature or the way in which they are being managed by the entity(ies). 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+	Affirmed
	ST IDR	F1	Affirmed
• senior unsecured	LT	BBB+	Affirmed

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Corporates Notching and Recovery Ratings Criteria (pub. 14 Oct 2019) (including rating assumption sensitivity)

Short-Term Ratings Criteria (pub. 06 Mar 2020)

Corporate Rating Criteria (pub. 27 Mar 2020) (including rating assumption sensitivity)

Sector Navigators-Addendum to the Corporate Rating Criteria (pub. 27 Mar 2020)

APPLICABLE MODELS

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

Corporate Monitoring & Forecasting Model (COMFORT Model), v7.9.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Carlsberg Breweries A/S	EU Issued

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