Event: Carlsberg Q2 2014 Results Call

Date: Wednesday, 20 August 2014

Speakers: Jørgen Buhl Rasmussen, CEO, and Jørn P Jensen, CFO

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OPERATOR: Welcome to the Carlsberg Q2 report 2014. At this time, all participants are in a listen-only mode and later we will conduct a question-and-answer session. Please note that this conference is being recorded.

I'll now turn the call over to CEO, Jørgen Buhl Rasmussen. Jørgen, you may now begin.

JØRGEN BUHL RASMUSSEN: Thanks a lot and good morning, everybody. Welcome to our six months results conference call. My name is Jørgen Buhl Rasmussen and I have with me our CFO, Jørn P Jensen, and also Vice President of Investor Relations, Peter Kondrup.

Please turn to slide 3 and the headlines for the first six months. We saw mixed beer market development across our three regions. We had a flat market share in Western Europe, we had market share decline in Eastern Europe and market share improvement in Asia. Driven by our increasingly stronger commercial execution, we continued to improve price/mix and delivered a very healthy 5 per cent price/mix improvement. We keep pushing our commercial agenda and maintain a high level of investment in our international brand portfolio and we launched several innovations and maintained an overall high level of commercial activities. Our cost agenda remains unchanged and we focus on executing on our many efficiency programmes including the rollout of BSP1. The integration of Chongqing is progressing according to schedule. We sustained a solid operating profit growth, delivering 8 per cent organic growth for the first six months. Adjusted net profit was flat for the six months but with 7 per cent growth in Q2.

Now slide 4, please. Our Eastern European business delivered a very good performance for the first six months in spite of the challenging market conditions. Our teams in Russia and Ukraine are doing an excellent job mitigating the impact of the challenges. However, due to the recent macro events, the general consumer sentiment and the outlook for some of the economies in Eastern Europe are becoming increasingly challenging and uncertain. In light of this, we believe that consumer spending in Eastern Europe will be impacted more negatively than previously anticipated and, as a consequence of this, the beer category will deteriorate further in the second half of the year.

This will impact us in two ways. Firstly, we expect the Russian and Ukrainian beer markets to decline more than previously expected with Russia declining by high single-digit percentages for the full year. Secondly, we expect our partners in Russia to build less inventories at year-end than previously due to their potentially restricted financing opportunities, as well as a possible freeze of excise duties for 2015. Please note that the lower stocking is more a phasing issue as these volumes will then be sold in Q1 2015 instead.

We have taken tough decisions to adapt our business to the current challenges. Our actions include the implementation of several structural changes in different parts of the organisation such as logistics, sales and production. In addition, we are considering brewery closures as well. We will not comment further on such closures but will come back to you when final decisions are made.

Notwithstanding a tough approach to the current challenges, we will continue to do what is right for our business long-term. This includes investing in our brands and keeping commercial activities at high level. We don't want to optimise short-term profits for the long-term health of our Eastern European business. We want to ensure that we maintain a very strong and very profitable Eastern European business now and in the future. In conclusion, this unfortunately means that we have had to adjust our 2014 outlook downwards and Jørn will go through the details later.

Now to slide 5, please. Beer volumes in the first half declined organically by 3 per cent. Organic volumes grew in Western Europe and they were flat in Asia and declined in Eastern Europe. Reported volumes grew by 3 per cent due to the acquisition impact of the Chongqing Brewery acquisition in December 2013.

Slide 6. Organic net revenue growth was 4 per cent, supported by the continued good price/mix development of 5 per cent. Operating profit grew organically by 8 per cent with 14 per cent growth in Q2. All three regions delivered organic operating profit growth with a particularly strong performance in Western and Eastern Europe. Profits in Asia were impacted by growth investments such as higher sales and marketing investments and expansion into new markets. The acquisition impact was related to the purchase of Chongqing Brewery and the substantial negative currency impact was due to weaker currencies in several markets. All in all, the group delivered a 1 per cent reported operating profit growth, despite the volume decline in Eastern Europe and the substantial negative currency headwind.

Slide 7 and an update on some of our commercial activities. Overall, we continued to push our commercial agenda and saw strong performance of our international premium brands. The Carlsberg brand grew 3 per cent in its premium markets. The brand gained market share in the majority of its markets and did particularly well in Asia, driven by the good performance of Chill and Lite in China and Carlsberg Elephant in India. The Tuborg brand grew by 26 per cent. An important driver was Asia, where volumes more than doubled as a result of good performances in China and in India. 1664 grew by 15 per cent, mainly driven by good performance in France, which was partly due to easy comps due to destocking in Q1 last year and partly due to market growth and share gains in France. Our super premium beer Grimbergen grew almost 40 per cent in the first six months due to the expansion to new markets and market share gains in France. Somersby grew 48 per cent as a result of rollouts in new markets, line extensions in existing markets and continued strong Polish performance.

Now slide 8, please. Our innovation agenda is very important and as a very positive result of our centralised and very structured innovation process, we are able to bring more innovation to our markets faster than was the case previously. On this slide, we highlight just a few interesting products that are either completely new innovations or existing products that are being launched in new markets. Some of these products are targeting the increasing demand in some markets for specific products such as lower-alcoholic beverages and flavoured beers. Other products are targeting the specialty or craft beer category that is also growing fast and, perhaps more importantly, also creating a renewed interest for the beer category. All of these products are premium products which help drive price/mix and margins. Finally, we are also working on further improving the beer experience for consumers by developing products and systems which enable customers to serve and sell beer of the highest quality. Our DraughtMaster technology is a good example of a break-through technology which delivers towards these demands.

Now slide 10, please, and a few comments on our regions. The Western European beer markets grew by estimated 2 - 3 per cent for the first six months and an estimated 3 - 4 per cent in Q2. Q2 this year was positively impacted by the Football World Cup and Easter. We continued to deliver robust market share performance. Our overall Western European market share was flat with growth in markets such as France, Poland, Italy, Portugal and Greece. Our beer volumes grew organically by 5 per cent, mainly as a result of the overall market growth and destocking in France last year. Price/mix in this region was flat. The positive impact from our value management efforts across the region was offset by the strong growth in other beverages which impacted price/mix negatively. Our non-beer volumes grew organically by 6 per cent, primarily due to strong performance in the Nordics and Switzerland. In Poland, we grew 6 per cent in a market growing by an estimated 1 - 2 per cent. The strong performance of our local premium brands Somersby and Radler explains the strong growth. Price/mix was flat. Our French volumes grew 25 per cent in a market growing by 7 per cent. Our volumes were positively impacted by last year's destocking in Q1. Our market share was slightly up, driven by a strong performance of our premium brands such 1664, Grimbergen and Tuborg Skøll. The UK market grew 4 per cent with a strong uplift in Q2. Our market share declined slightly. BSP1 was launched in the UK in March, which gave some initial challenges in our wholesale business. Our Nordic business performed strongly, driven by good weather compared to last year, the growth of soft drinks and strong commercial execution, including innovations and value management efforts. All markets grew, with the exception of Finland. The operating profit grew strongly by 11 per cent and the operating profit margin expanded by 50 basis points to 12.4 per cent. The earnings growth was driven by the volume growth, further savings in the supply chain driven by our centralised supply chain organisation and the overall efficiency improvements in all areas throughout the region.

Slide 11 and Eastern Europe. The Eastern European beer markets were challenging for the first six months due to the overall uncertain macroenvironment in Russia and Ukraine. The Russian beer market declined by 6 - 7 per cent in the first six months, while in Ukraine it was down by approximately 10 per cent. Our beer volumes declined by 11 per cent, mainly driven by our Russian business. Organic net revenue declined by 2 per cent and by 18 per cent in DKK due to the significant negative currency impact from the Russian and Ukrainian currencies. Approximately 70 per cent of the FX impact in the region was from Russia and 25 per cent from Ukraine. Price/mix was strong at 8 per cent. The price/mix was mainly driven by price increases and changed pack sizes in Russia, which I will address shortly. Organic operating profit grew by 7 per cent despite the substantially negative volume development. Operating profit margin improved by 170 basis points to 20.2 per cent and then an even higher improvement of 460 basis points in Q2. The earnings growth and margin improvement was mainly driven by positive price/mix, different phasing of marketing investments versus last year and accelerated cost savings and efficiency improvements. Profits in Russia, Kazakhstan, Belarus and Azerbaijan increased while profits in Ukraine declined.

Slide 12 and Russia. The Russian market declined by an estimated 6 - 7 per cent for the first six months. The market was impacted by slower economic growth in Russia, which impacted overall consumer spending negatively. The Russian market has become increasingly challenging and, with the current geopolitical tensions, we do not expect market conditions to ease in the remainder of the year. Our volume market share declined by 120 basis points for the first six months. Our strategy is to always balance volume and value and our value share declined considerably less, as our share loss was most pronounced in the economy segment, while we gained share in, for instance, local premium thanks to good performance of Baltika 7. The overall market share decline can mainly be explained by three factors. Firstly, our price leadership during parts of the half-year impacted share development negatively. Secondly, we have replaced some SKUs with SKUs containing slightly less liquid, which is done to minimise price increases and improve affordability. This did not impact the number of bottles sold but, as we have solid less liquid, it impacted share performance negatively but price/mix positively. Finally, we had to list these new SKUs at the same time as Baltika changed its legal structure. That created disruption in deliveries due to more required administrative work than expected for us and our customers; and it took longer to execute than expected. Our shipments declined by 11 per cent due to the market decline and market share development. Price/mix for beer was plus 9 per cent, driven by price increases in March and May, mix improvements and value engineering, ie the launch of the aforementioned smaller pack sizes.

Now slide 13 and Asia, please. In Asia, we continued to strengthen our market share in most markets across the region. We kept a high level of commercial activities, including the rollout of our international premium portfolio, further strengthening of sales capabilities and revitalising of local brands. As mentioned previously, our international premium brands delivered outstanding performance with Tuborg more than doubling its volume and Carlsberg up 12 per cent in premium markets.

Volumes declined organically by 2 per cent with a slight trend improvement in Q2, where volumes were flat. Including the Chongqing acquisition, beer volumes grew by 21 per cent. We saw particularly strong growth in India, Nepal, Cambodia and Laos and for the international premium portfolio in China and India. The beer market in the western Chinese provinces performed worse than overall China for the first six months due to unrest and bad weather in Xinjiang, as well as a very wet summer in Chongqing. In addition, we have delisted unprofitable SKUs in one province and, consequently, our overall Chinese volumes declined organically.

In spite of the 2 per cent organic volume decline in the region, our revenue grew organically by 9 per cent due to a very strong price/mix of 7 per cent. Organic revenue growth and price/mix accelerated from Q1 to Q2. The strong price/mix improvement was driven by our international premium brands, price increases and value management efforts across the region and delisting of low-priced and unprofitable SKUs in China.

Organic operating profit grew by 5 per cent. Profits were impacted by investments in growth such as the start-up in Myanmar and higher sales and marketing investments. However, this negative impact was more than offset by the positive price/mix and income from a terminated license agreement. The operating margin decline of 300 basis points was due to the consolidation of Chongqing Brewery that comes in with a margin somewhat below the regional average.

With this, I would like to hand over to Jørn, who will walk us through the financials.

JØRN P JENSEN: Thank you, Jørgen, and now please turn to slide 15. Our business delivered solid organic growth rates in first six months of the year. As already mentioned, volumes were suppressed due to the market conditions in Eastern Europe and adverse events in Asia, particularly China, but a very strong price/mix was able to offset this.

Adjusted net profit was flat as the positive impact from organic growth and acquisitions were neutralised by quite negative FX. Free cash flow was up DKK 600 million versus last year. The rollout plan for BSP1 is on track and the next markets to go live will be Poland, Finland and Switzerland in the fall. In May, we successfully placed ten-year euro notes at a principal amount of €1 billion with a coupon of 2.5 per cent.

Before I dig further into the numbers, I would like to reaffirm our strong focus on earnings and cash flow in all business units. The challenging conditions in our largest market only further emphasise the importance of our group-wide efficiency agenda. However, as we have also stated before, we will not compromise the continued investments in our brands and the future growth of our business.

Now slide 16. Organic net revenue increased by 4 per cent or DKK 1.1 billion as a result of a strong price/mix of 5 per cent. The negative currency impact was due to several currencies, but most pronounced were the Russian, Ukrainian, Norwegian and Chinese currencies. Organic COGS per hectolitre were up 3 per cent and in reported terms down 4 per cent. Reported gross profit margin improved by 80 basis points. Total opex increased primarily as a result of BSP1 implementation costs, which in the first half amounted to approximately DKK 250 million, higher logistic costs, particularly in Eastern Europe, and phasing of sales and marketing investments.

All in all, organic operating profit amounted to DKK 4.4 billion, up 8 per cent versus last year. Organic operating profit growth was strong in Western Europe and Eastern Europe. However, in Eastern Europe the significant negative currency impact of 18 per cent versus the first half of 2013 resulted in a lower operating profit in that region in reported terms. Consequently, reported group operating profit was up 1 per cent to DKK 4.1 billion.

Now to slide 17, where you also will notice the Carlsberg Nordic collection, which has been launched in several markets this year. Special items were minus DKK 124 million, in line with last year. Generally, special items relate to restructuring initiatives. Net financials were down DKK 44 million compared to last year. DKK 102 million were lower interest charges as a result of lower average funding costs. We've seen our average funding costs coming down continuously over the past few years. Other financial items were up DKK 58 million, mainly due to currency movement, fair value adjustments and fees. The tax rate was 25 per cent. All in all, reported net profit was DKK 2.1 billion. Adjusting for special items after tax, net profit was DKK 2.2 billion. The flat development versus last year was due to adverse currencies.

Now to cash flow on slide 18. The sum of the first three lines - EBITDA including other non-cash items - adds up to DKK 5.9 billion, a small increase of DKK 61 million. The change in trade working capital was minus DKK 673 million. As usual, trade working capital was impacted by normal seasonality, but this year this was further impacted by higher sales in Western Europe at the end of Q2. Other working capital was impacted by lower VAT payables at the end of the quarter compared to last year.

I would like to remind you that our working capital focus is on reducing the average trade working capital, ie during the year, and not the number period-end. Our track record in reducing the average trade working capital during the year has proven quite solid and at the end of Q2, the 12-month average trade working capital to net revenue was minus 3.8 per cent compared to minus 3.1 per cent last year. Paid net interest was DKK 768 million, down DKK 0.5 billion due to lower funding costs as well as the settlement of financial instruments last year. All in all, cash flow from operations was DKK 2.9 billion, on par with last year.

Slide 19. Capex was DKK 2.2 billion. In the first half, capex primarily included investments in sales equipment to generate top-line growth, capacity expansion in Asia and different projects in Western Europe to improve structure and efficiency. Net acquisitions amounted to minus DKK 30 million. All in all, free cash flow followed the normal seasonality of our business and amounted to DKK 641 million. The positive difference of DKK 624 million versus last year was mainly due to the prepayments last year related to the Chongqing Brewery acquisition.

Now to slide 21 and our outlook for the year. As Jørgen stated earlier in the presentation, we have had to change our outlook due to the recent Eastern European macro-events. Our 2014 results are being impacted in two ways. Firstly, the weak macroeconomy in Russia and Ukraine means that we are now assuming that the Russian beer market will decline by high single-digit percentages compared to previously mid-single-digit. We also see the Ukrainian beer market being under increasing pressure with a decline of 10 per cent in the first half-year. Secondly, we don't anticipate the usual high level of stocking at distributors as we've seen in recent years due to the potentially restricted financing opportunities in Russia and also the possible freeze of excise duties for 2015. Although the stocking issue is merely a question of the phasing of shipments from Q4 this year into Q1 next year, it will impact numbers negatively in Q4. Other assumptions are largely unchanged. Based on these assumptions, we now expect a low to mid-single-digit percentage growth in organic operating profit this year compared to our previous expectation of a high single-digit increase. Including the acquisition impact from Chongqing and the assumed significant currency headwind, reported operating profit is expected to decline by low to mid-single-digit percentages. Adjusted net profit or clean EPS is expected to decline by mid to high single-digit percentages compared to previously mid-single-digit increase.

JØRGEN BUHL RASMUSSEN: Thank you, Jørn, and that was all for today. To summarise, with 8 per cent organic operating profit growth, we delivered satisfactory performance for the first six months. We also delivered solid market share performance in most of our markets except Russia, and especially our international premium brands are performing strongly. The outlook for the second half for Eastern Europe has become increasingly challenging lately, which will impact the beer market and our 2014 profitability negatively. Finally, we are taking some tough decisions and are implementing several structural changes to mitigate the impact from the lower Eastern European volumes. With this, we are happy now to take your questions.

OPERATOR: Thank you. We will now begin the question-and-answer session. If you have a question for the speakers, please press star and then one on your touchtone phone. If you wish to be removed from the queue, please press the hash key or the pound sign. Once again, I will remind you: if you have a question, please press star and then one on your touchtone phone.

We have our first question. It's coming from Mr Trevor Stirling from Sanford C. Bernstein. Please go ahead, sir.

TREVOR STIRLING: Good morning, gentlemen. Two questions from my side. The first one: in terms of the downgrade to expectations of roughly 8 - 9 per cent of the net profit level, can you just quantify how much of that is due to your expectations for a weaker underlying beer market and the change in phasing of shipments in Russia?

JØRN P JENSEN: If you want it as a percentage, sorry. If you want it as a percentage, it is a little more than 70 per cent, which is market/consumer/macro-related and the rest being less stocking being expected.

TREVOR STIRLING: Less stocking. So then, as I think forward to 2015, you'll regain that 30 per cent that was due to the destocking in Q1 and you also have an easy comp in Q4. Is that the right way to think about it?

JØRN P JENSEN: Yes.

TREVOR STIRLING: Great. The second question may be one for Jørgen, which is: the 250 basis points market share decline year-on-year and you went through the various factors of that, but I also look at the others and the others have yet another big increase in market share, you know, up to 22.8 per cent in the quarter. Is there something that starts to worry you now about that continued increase in the others share, even though the macro-environment is looking bit better? Perhaps just talk a little bit more about that others share.

JØRGEN BUHL RASMUSSEN: I am not sure we see the macro-environment looking a little better, maybe in fact going in the opposite direction again. What we see with others is also the average value is coming slightly down, so it is a little more price also in this other group if you look at market share development and volume and value. I think what we've seen in the first half would be that the gain has been driven a lot by let's say a bit of price from some others and also one of the key players and then the other factors I also referred to in our presentation being the downsizing, so to speak, of some SKUs and also this listing of new SKUs and the change of legal entity structure.

TREVOR STIRLING: Yes. Do you think that growth in the others has the potential to destabilise the pricing structure in the market in the second half?

JØRGEN BUHL RASMUSSEN: No, because it is not that significant. It's just if we calculate the average we see a slight decline on average price for others.

TREVOR STIRLING: Okay. Thanks very much.

OPERATOR: Our next question is coming from Mr Ian Shackleton from Nomura. Please go ahead, sir.

IAN SHACKLETON: Yes, hello, good morning, gentlemen. A few questions around Russia. The first question is: have the sanctions had any impact at all on the way you are running the business in Russia? Secondly, how confident are you that duties won't increase in 2015? The third question, really: in the Baltika release I see that's out today there is talk about a change in the management team and the supply change structure. Perhaps you could just talk about what's happened there.

JØRGEN BUHL RASMUSSEN: Yes. In terms of the sanctions and the impact sanctions have had in the way we run the business, I would say not directly because we operate within Russia. At the same time, because of the worsening macro-economy, we do see the consumer being less willing to spend. Yes, we are looking at every measure we can take to compensate for what we expect to be lower sales in Russia. So, in that sense, you could say it impacts how we run the business.

On duties increases, I don't want to say how confident we are or not confident. At the moment, there is proposal for a decision by the government not to increase duties and it has to be approved by the Duma. Time will tell.

JØRN P JENSEN: On the third question, Ian, there is no correlation, so to speak, between that announcement and what we are talking about in our release this morning. That's more a normal management change within the supply chain in Russia.

IAN SHACKLETON: I know you weren't going to talk too much about further brewery closures, but could you outline a little bit what's happened within the business already in Russia in terms of the changes you've mentioned?

JØRN P JENSEN: Of course, the overall logic here is that when the market is declining more than what we expect, it of course at some point in time becomes apparent that we have - and will have for very long time - more capacity in the market than we need. That of course leads to considerations around how the brewery landscape should be also some years out in Russia.

JØRGEN BUHL RASMUSSEN: But if you want some examples on this, when we refer to how we are changing structure and we are making organisational changes, we are also in Eastern Europe moving towards a one supply chain organisation across markets. If you take sales, we have less sub-regions in sales today than what we used to have. Again, we are restructuring how we are being set up in sales. If you take the whole G&A area, in every brewery where we also have admin organisation and in the headquarters in St Petersburg, we are also in a lot of places changing the structure of how we operate to take out costs and be as efficient as possible in this very challenging market right now.

IAN SHACKLETON: Very good. Thank you.

OPERATOR: The next question is coming from Mr Michael Vitfell-Rasmussen from ABG Sundal Collier. Please go ahead, sir.

MICHAEL VITFELL-RASMUSSEN: Thank you. I have three questions, if I may. If you could start by talking a little bit about the proposed PET ban, are we likely to see this being pushed into 2015? How would you think the effects on average retail prices would be in the three steps that the proposal looks like right now?

Then second question being on Asia, can you give us little bit more insight into how large volumes are you phasing out that are unprofitable in China? Also in terms of volumes again, how big of an area of China has been affected by the poor weather and political unrest, just so we can kind of understand how Asia is doing excluding these kinds of one-off things?

Then my final question being on Ukraine, as I understand it Q2 looked a little bit worse than the 10 per cent decline in the first half. What is happening in Q2 in terms of the market in Ukraine and where do you see Ukraine going in terms of your new guidance? Are we looking at 20 per cent declines in the second half or what have you assumed in your guidance? Thank you.

JØRGEN BUHL RASMUSSEN: I hope you got all you questions, Michael. If not, you have to repeat maybe, in particular last one. But if we start with the PET proposal, you know we put forward a proposal and that was broadly accepted, we believe, in the government, so we still believe the proposal being put forward by the Russian government back in the early part of this year is likely to be implemented. That was a kind of state implementation. I don't think I need on this call to go through all the different stages, but at the end we would get to not being able to sell beer in PET in more than one-and-a-half-litre PET sizes at the end, being 2017. We think this is still a likely route forward for PET. Also in the proposal, it was not supposed to have any impact until 2015 with the first step. As we have commented on before, we think if it comes in line with that proposal, we will have time for the transition. We can then manage and also convert some of that volume into multi-pack and other types of packaging. Not having big sizes of PET will of course be positive for the average selling price to the consumer over time.

MICHAEL VITFELL-RASMUSSEN: Do you think that this could mean that we could see the group of others lose a bit of market share again?

JØRGEN BUHL RASMUSSEN: Yes. As I've said always, I think the others group really got momentum back in 2009/2010 when we were hit by the crisis and everyone supported more local community and local producers. That's how they started getting that momentum. Because the market environment in Russia's since has not really been an easy environment – it hasn't improved a lot since - they have been able to build on this momentum including by introducing some kind of retro Soviet-style type brands in some places and also local draught beer where you go and buy draught beer in some outlets including off-trade. We do not believe this growing trend will continue. We still believe it's close to having peaked. The uncertainty right now about the macro-economy does not help, but again overall as a trend we don't see them getting a much higher share of that market. I think I hear Efes saying the same last time when they were out with results.

JØRN P JENSEN: Michael, on Asian volumes, as you know, we don't normally do this market-by-market but China was really impacted a lot in western China by weather, by the unrest in Xinjiang, northwest China, which is a big contributor both volume and earnings wise in our Chinese business, and the delisting of unprofitable SKUs in another province. It was in the majority of our Chinese business that we were having these so-called one-off effects. If we exclude China as such from the Asian volume numbers, then we had a very solid underlying, actually a little more than mid-single-digit, growth in the first half.

JØRGEN BUHL RASMUSSEN: Ukraine, Michael, was it about if Q2 was worse than Q1? Was that the question in terms of market development?

MICHAEL VITFELL-RASMUSSEN: Yes, and then what are you assuming for the second half in Ukraine?

JØRGEN BUHL RASMUSSEN: You are right. Q2 was definitely worse than first half and that's how we got close to the minus 10 per cent, so you are right. The development is getting worse. We still see very big variances between east and west. In the west it's basically flat volume year-on-year if you go to a region like Lviv. But then if you go east it could be pretty bad depending on what's going on at the moment. So, if anything, we would expect what we see in Q2 to probably continue for the remainder of the year, but that will imply some double-digit decline in the market. Would it be a lot more than 10 per cent? Probably not, but again it's very difficult to predict. What will happen in Ukraine in the second half? Only time will tell.

MICHAEL VITFELL-RASMUSSEN: Great. Thank you very much.

OPERATOR: Our next question is coming from Mr Casper Blom from Handelsbanken. Please go ahead, sir.

CASPER BLOM: Thanks a lot. A couple of questions from my side also. Firstly, on the Russian market share, I know that you don't like to talk too much about the quarterly development but still there is a large decline here in the second quarter. Now that the legal structure of Baltika is in place, have you seen any sort of normalising of the market share going into the third quarter? Also relating to the change in SKU pack size, have you seen any of your competitors following that?

Then secondly, on Western Europe, could you give an overall update on the weather situation now that you have gone through the summer period? Has it been worse or better than last year when you look at Western Europe overall?

Then finally on Eastern Europe, I know you commented on the phasing of sales and marketing spending, could you give an indication of the level of this and how the underlying profitability development looks in Eastern Europe? Thank you.

JØRGEN BUHL RASMUSSEN: Thanks, Casper. On market share, you are right. We don't want to comment too much on quarter-by-quarter development. It's really important to look at trends and, as I say always, some quarters can be better than others. But it's certainly fair to say that we have been extremely focused on making sure we balance volume and value in times like this, so we don't go just for volume. We get the value as well and that's why our value share is performing a lot better than our volume share also in quarter two.

The issue we referred to about the legal entity and the change of SKUs, that's behind us and will not have any impact going forward. This change to legal entity is all about a lot of administration when you change legal entity number and you have to go to all your customers and change paperwork. That's so much administration and that was a lot more difficult than what we expected. That's what we're referring to when we talk about the change to legal structure. But that's behind us and will not have an impact going forward. What will has an impact on market share going forward would be the introduction of smaller SKUs where we are taking out a little liquid but still selling at the same price to avoid further price increases. You can say on an annualised impact, because we have so far touched about 50 per cent of our volume in terms of reducing 50 per cent of our volume into slighter small SKUs, the negative impact from that on volume market share on an annualised basis is 0.8 per cent market share loss, so that we should get by definition by having downsized some SKUs but with no negative impact on value share. We do expect our market share to be up in the second half versus the first half. But we do not expect market share now for the full year to be up.

On competitors, what we have seen or we have certainly heard some of our competitors making reference to that they would like to look at the same, so possibly they will follow. We have seen some new products from some competitors being also launched in slightly smaller pack sizes, so it looks like certainly some are following already.

Your third question was about the weather situation in Western Europe. It has a positive impact in particular in Q2. It's mainly in a couple of markets. From memory, I think it was France and Switzerland where it is more significant than other markets if you look at Q2 and weather impact.

JØRN P JENSEN: And then on Eastern Europe. You can say that the very solid earnings progression in Eastern Europe, as we said before, it is several things. Price/mix is of course is very important. All the cost and efficiency programmes that we are running are really delivering. Then there is also, as I said, a smaller element of phasing of sales and marketing. But we are not separating into all these different cost lines. So a bit of sales and marketing but more importantly a very positive price/mix and a good result on all the efficiency programmes.

CASPER BLOM: Great. Thanks a lot, guys.

OPERATOR: Our next question is coming from Sanjeet Aujla from Credit Suisse. Please go ahead.

SANJEET AUJLA: A few questions, please. Firstly, just a clarification on the guidance. The downgrade to adjusted net profit seems to be larger than the downgrade to organic EBIT. I just wanted to understand the moving parts there. Is it FX? Is it higher minorities because the tax rate doesn't seem to be changing? So, if you can clarify that, that will be great.

And then secondly, just on the price/mix development in Western Europe, one of your competitors this morning was talking about inflationary pressures. Are you guys seeing the same? Can you please talk a bit more around that? Thank you.

JØRN P JENSEN: On the first question, as you are saying, there is nothing else really changing below EBIT, so it's more the simple fact that of course the EBIT change after tax in percentage terms becomes bigger on the bottom line than it does on the EBIT line.

JØRGEN BUHL RASMUSSEN: To the price/mix in Europe, we don't see a big change compared to the past, so in general you can get just a very, very little on price increases. We do see a negative impact in general across Europe for channel mix and that's what's kind of reflected in the flat price/mix for Western Europe.

SANJEET AUJLA: Okay, great. Thanks.

OPERATOR: Our next question is coming from Mr Søren Samsøe from SEB. Please go ahead, sir.

SØREN SAMSØE: Yes, hello, gentlemen. First, a question on Russia regarding the major food inflation after the food ban price was up 10 - 30 per cent on different categories. How is this going to impact your sales? If you could maybe elaborate on how the food price increase has impacted your sales in the past in Russia?

The second question is regarding the BSP1 programme. I understand that you are spending a little bit less this year than planned. Maybe go into detail why and in what countries?

The third question is regarding the production structure in Russia. You're flagging a little bit that you want to maybe do changes there, but how is this possible given that you already have a pretty optimal structure in Russia and could that lead to one-off costs going forward?

Then finally, you have a very strong margin development in Eastern Europe, if you could go into detail with that because your volumes are down and I am sure you have also saved costs. Is this the price/mix effect going through or how come there is this very strong development? Thank you.

JØRGEN BUHL RASMUSSEN: Søren, could you just repeat questions four.

SØREN SAMSØE: Yes. Sorry about the many questions. Just the market increase of 460 bps in Q2 in Eastern Europe is very strong and just if you could elaborate on how you can do that with the volumes down so much and the market share losses. Is it the price/mix effect or cost savings or what is it? Thank you.

JØRGEN BUHL RASMUSSEN: I can take the first one on food inflation. In Russia, you are right. It is going up and in July I think we are looking at the food inflation being around 10 per cent, so higher than what we saw for the first six months in Russia. It will of course impact disposable income and that's really why we are saying the second half will be tougher in Russia and in Eastern Europe than what we had anticipated before due to sanctions, what will happen to inflation, et cetera, so that's really reflected in the outlook.

JØRN P JENSEN: Then, Søren, to take other three questions, on BSP1, it is broadly based, so to speak, and of course as we are getting close and closer and more and more into each and every market, the estimates of what will be required in each and every market also becomes more precise. There's nothing kind of structural in this in this change.

SØREN SAMSØE: But is it because it's going better than you had planned or ...

JØRN P JENSEN: No, it's in line with the plan. In general, the BSP1 rollout, which is a big exercise and a big change project in general in Western Europe, is on plan.

On the potential brewery closures that we will not, as I said before, talk specifically about, as you know, it is always so that in connection with a brewery closure you would normally see special items or one-off costs come with that in order to deliver even higher savings in the future.

When it comes to the margin in Eastern Europe, the same answer as before: that it is price/mix. It is a very positive price/mix. It is all the cost and efficiency programmes that we are running in the region and then, as I also said, it is also slightly impacted by the phasing of sales and marketing.

SØREN SAMSØE: But just going back to regarding the production structure in Russia, you have earlier stated that it does not really make sense for you because you have such a good structure already. Is it fair to assume that the savings from this would not be that significant compared with, for example, the savings you are making in Western Europe with the brewery closures there?

JØRN P JENSEN: We will get to that if and when we announce a brewery closure in Eastern Europe, but of course it is also so that the market is now lower than what we previously expected it to be. Of course, that also means that we now do not have the same optimal brewery structure in Eastern Europe as we used to have.

SØREN SAMSØE: Okay. Thank you very much.

OPERATOR: Our next question is coming from Mr Nik Oliver from Merrill Lynch. Please go ahead.

NIK OLIVER: Hey, good morning, guys. Just two questions left on my side. One is coming back to the East European margins. Given your comments about the key drivers in the first half and assuming that the price/mix holds up in the high single digits in the second half, should we still expect decent margin expansion in H2 in Eastern Europe, even given the tougher comps, as we annualise the Q3 cost saves from last year?

The second question is on Asia. I think in the past your midterm volume outlook used to be around 5 - 7 per cent. Does that still hold as a decent run-rate or are you being a bit more conservative now given a few quarters of slower growth?

JØRN P JENSEN: Nik, on your first question, we would consider it to be a bit too optimistic to assume margin expansion this year, so more flattish, I would say.

NIK OLIVER: Okay. And the key swing factor there, I guess, is weaker volumes and the phasing of the marketing spend. Would that be right?

JØRN P JENSEN: Yes, and specially the volume development, of course.

NIK OLIVER: Okay. On Asia?

JØRGEN BUHL RASMUSSEN: Yes, on Asia and the volume outlook, I would say 5 - 7 per cent is probably the very high end and it is always an average of the many, many markets we are in. As we can see again and again in China, if you have some changes in a region somewhere it can really change the volume trend, but then we have to compensate in different ways. But it will be better than what you've seen year-to-date and we are certainly closer to a mid-single-digit increase in general when we talk volume for Asia.

NIK OLIVER: Okay. That's very clear. That's great.

OPERATOR: Our next question is from Melissa Earlam from UBS. Please go ahead.

MELISSA EARLAM: Good morning. Just a couple of questions following up on Russia, please. First of all, could you give us an idea how much headcount is down in Baltika on a year-on-year basis and whether you still see significant scope for rationalisation there? The second question: you mentioned how food inflation has been rising and obviously with import restrictions the risk is that it continues to rise, putting further pressure on disposable income. Do you think you've pushed the pricing lever too aggressively and how significant is your SKU initiative to mitigate that? Thanks.

JØRN P JENSEN: Melissa, on the first one, the headcount in Eastern Europe has been reduced quite significantly over the last years in line with volumes coming down. It is also down a bit this year. So, if we will continue to see lower volumes at least for the remainder of this year, of course that will eventually lead to a need for fewer FTEs than we currently have on the payroll. Again, those kinds of things we like to come back to when we actually are making the final decisions.

JØRGEN BUHL RASMUSSEN: On your second question about Russia and pricing and if we are pushing pricing too much in Russia, of course we don't believe so and we think also in tough times, it is really important not to just to get too focused on volume because it can really harm the category development long-term and make it more and more a commodity and not a branded category. I think we have to strike that balance and we believe we are finding the right balance and losing some volume short-term is okay. But of course we'll never accept we keep losing volume. Then we have to respond at some point in time and that I have said before as well. In general, a lot of the players in the market are following what we are doing on pricing, with a few exceptions.

MELISSA EARLAM: Thank you.

OPERATOR: Our next question is from Mr Hans Gregersen from Nordea. Please go ahead, sir.

HANS GREGERSEN: Good morning. Just a clarification first. Was it right that you stated that 50 per cent of the total packs have now been reduced and that has had a negative market share impact of 0.8 per cent?

Over to the questions. If I look at your market guidance, which implies a more than double-digit decline in H2, is that reflecting what has already happened as of now in quarter three or is it more forward-looking expectations? The first question.

The second question is: you mentioned you have some filing issues in terms of your legal structure and the new products. Will that have any impact at all for the second half?

Thirdly, you mentioned that you have this market share decline from lower pack size. Can you give a little bit more flavour on what the competitor reaction has been as of now?

Then finally, gearing-wise, where will you end up this year and what would it take for you to consider returning more capital to shareholders? Thank you.

JØRGEN BUHL RASMUSSEN: Hans, to your first question or clarification, yes, it is correct. It is 50 per cent of our volume that's now being sold in pack sizes being slightly smaller than what it was before. The impact on an annualised basis is 0.8 per cent. Of course it will be a little less for the first half because we introduced those SKUs in the first half. When we talk about market guidance, guidance is always forward-looking.

On the legal structure, I hope I explained it earlier about the SKU change and legal structure change and all the administrative work you have with your key accounts to get that listed and the paperwork involved in that in a place like Russia is enormous. It is all behind us. You won't see any negative impacts in terms of market share and volume development in the second half from that.

HANS GREGERSEN: Could I just clarify your previous answer? Am I right in understanding you to say that the changed market guidance has nothing to do with July or, so far, August?

JØRGEN BUHL RASMUSSEN: We use all the knowledge we have, but it is forward-looking and our expectations on the market in the remainder of the year.

JØRN P JENSEN: Then there was a question on leverage. What we are guiding at now is that leverage, including the negative effect in Q4, basically will be reversed in Q1, anyway, with what we think will be the reported numbers for the year, leverage will be relatively similar to what it was at the end of last year.

HANS GREGERSEN: What would the EBIT impact be from the destocking effect you were mentioning?

JØRGEN BUHL RASMUSSEN: That we are not guiding on specifically, but I guess in one of the first answers in this call we agreed that around 30 per cent of the adjustments for the outlook is probably due to less stocking expected at the end of this year.

HANS GREGERSEN: Thank you.

OPERATOR: Our next question is coming from Mr Andrea Pistacchi from Citi. Please go ahead.

ANDREA PISTACCHI: Yes, good morning. I have two questions, please. The first one is on Western Europe and volumes there. Now, you've obviously had a very strong quarter with a lot of positive moving parts: the weather, World Cup, Easter, et cetera. Do you have a sense roughly of what an underlying growth rate in Western Europe could be or, to put it another way, are you seeing an underlying improvement in the market macro-driven in places like GB and France in particular?

Then secondly, on Russia, you talked about price leadership as one of the reasons for losing share. You partly answered, I think, this with another question but compared to three or six months ago, are you seeing any change in the competitive behaviour from the other players in terms of pricing?

JØRGEN BUHL RASMUSSEN: Yes, thanks. On Western Europe, compared to a slightly declining market, which was probably the trend before, I think we see underlying a very tiny improvement, so maybe now it is more underlying flat or maybe a little bit up and the rest would be weather, the World Cup and other factors, we believe. So a slight improvement, but not a significant change on underlying West European total market development in the markets we are in.

On Russia, remind me again of the question. Yes, on competitive behaviour, we don't see any significant change. I would say it's more of the same. There is one maybe not leading as much on price as the rest and in particular in modern trade, but apart from that we don't see a change.

ANDREA PISTACCHI: Thank you.

OPERATOR: The next question is from Andrew Holland from Société Générale. Please go ahead.

ANDREW HOLLAND: Very quickly because I think we have going to have to come to end here, can you just talk about your isolated Q2 volumes in Russia which I don't think you have given - I can't see them anywhere - and what you think the market did in Q2 to give us an idea of the sort of difference between your stock levels and what was going on in the market?

The second one is just related to the sanctions in Russia. Can you say what if anything you are importing from the EU into Russia to produce your products in Russia?

JØRGEN BUHL RASMUSSEN: On the market development, Andrew, it was worse in Q2 than Q1. It was a little more than 8 per cent down in Q2. We've said the full year will be 6 - 7 per cent, so worse in Q2.

JØRN P JENSEN: On the imports, it is very, very little that we are currently importing. It is very, very few of the raw materials that we are using to produce. As you can imagine, we have also taken action in order to ensure that we will not run out of those raw materials in the near future.

ANDREW HOLLAND: Okay. Just coming back to that first question, so the market was down 8 per cent in Q2. What were you down in shipments?

JØRGEN BUHL RASMUSSEN: We were down by minus 13 per cent, so reflecting also our market share loss in Q2.

ANDREW HOLLAND: Okay. Thank you.

OPERATOR: Our next question is from Mr Frans Høyer from Jyske Bank. Please go ahead, sir.

FRANS HØYER: Thanks very much. A question on Western Europe and the price/mix in Western Europe in Q2 separately. If you could strip out the effect of the growth in soft drink, that would be good.

JØRGEN BUHL RASMUSSEN: If we talk price/mix, we won't split out the number by quarter here but I can tell you there's not a big difference on price/mix quarter one to quarter two.

FRANS HØYER: Okay. Secondly on the market share, coming back to that, in Eastern Europe it was down 190 basis points Q-on-Q in volume terms. What about value terms? You've mentioned that you did better in value terms but could you be more specific?

JØRGEN BUHL RASMUSSEN: Significantly better. We tend not to go into a long debate on market share development in value share as well. But it's significantly better on value share.

FRANS HØYER: But still a decline?

JØRGEN BUHL RASMUSSEN: Still a decline, yes.

FRANS HØYER: Okay. Thanks very much.

JØRGEN BUHL RASMUSSEN: I think we have time for one more question. I know many of you probably want to get onto another call right now as well.

OPERATOR: Okay. We'll take our last question. This will come from Mr Mitch Collett from Goldman Sachs. Please go ahead, sir.

MITCH COLLETT: Hi, there. I just wanted to come to the lack of stock build in Q4. I think we first saw stock build in Q4 in 2011 and that was about a million hectolitres. Can you maybe quantify? Is it going to be similar sort of change? I think I'd understood from an earlier question that you will stock-build, you think, in Q4 next year, so we should basically strip a million out from this year and add it back to next year and then, I suppose, going forward.

Then maybe more broadly my second question is: we haven't really seen meaningful volume growth in Russia since 2008. You are obviously talking about removing brewing infrastructure. What do you think the long-term growth opportunity is for beer volumes in Russia from here?

JØRN P JENSEN: To the first question on stock-building, of course it is very difficult to say because it is not really that much up to us. It depends what the distributors want to stock up with. When we are saying that we don't expect them to do it this year, it is for these two reasons. One is that if excise duty is not increasing, they might not see the need to do it. They might not be having the same access to financing to have high inventories and to keep high inventories end of this year as they have done in previous years. So it's very much based on us not expecting them to stock-build this year as they have done in previous years.

When it comes to what was implied in the previous question, I agree that it seemed to imply that there would be easy comps for Q4 next year in the sense that there would be stock-building next year and no stock-building this year. That we do not know anything about at this point in time, so we need to get to that when we get into next year. It's just too early to say.

MITCH COLLETT: I guess what I am trying to ask is that prior to 2011 I don't think there was a Q4 stock-build. Is it possible we revert to a pattern of business where you don't have a Q4 stock-build from now on?

JØRN P JENSEN: I think a generic answer would be that with the previously announced excise duty increases for the coming years that are significantly lower than what we have seen in past years, the reason to build inventories end-of-year for distributors is definitely not the same as it has been in previous years.

MITCH COLLETT: Okay, understood. And then on the long-term volume growth potential?

JØRGEN BUHL RASMUSSEN: It is one of course I am getting always a little more reluctant to discuss based on what we have seen now for years in terms of market decline. But again, underlying, definitely, all indicators point towards we should see market growth and per capita growth coming back into this market again when the whole macro-economic situation normalises, whenever that will be. It is driven by this very, very low consumption per capita now being below 60. It is also based on, in any market, the more you develop a culture around drinking and alcohol consumption, in the past, you can see markets moving away from strong spirits and into wine and into low-alcohol beverages including beer. That should benefit beer. We would assume that real incomes will go up in Russia on average every year if there's not a major macro-economic crisis like we are maybe having now, so a lot of indicators point towards at some point in time we should get back to growth in this marketplace in volume and in value.

Remember, if you look back now on the last four or five years, in every year except one - and that was 2009 - we have seen value growth in the beer market. So, despite the volume decline, the market has been growing in value every year.

MITCH COLLETT: I guess, if that is true, does it make sense to take brewing infrastructure out?

JØRGEN BUHL RASMUSSEN: Sorry?

MITCH COLLETT: If that is true, does it actually make sense to remove brewing infrastructure that might become useful at some point in the future?

JØRGEN BUHL RASMUSSEN: That is the kind of assessment we'll go through before we make the final decisions.

JØRN P JENSEN: What we did not articulate is of course that the capacity utilisation we will be at at the end of this year is quite low. In spite of us taking out some capacity, we will still have enough capacity also for a market that is slowly starting to grow again.

MITCH COLLETT: Okay. Understood. Thank you.

JØRGEN BUHL RASMUSSEN: I think we have to close the call now, but thanks for attending and I am sure to speak to many of you in the coming days. Thanks a lot.