Carlsberg A/S
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Q3 2018 Trading Statement Conference Call
Speakers:
Cees 't Hart, CEO
Heine Dalsgaard, CFO

MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, welcome to the Carlsberg Q3 2018 Trading Statement Call. Today, I'm pleased to present CEO, Cees 't Hart. For the first part of this call, all participants will in listen-only mode and afterwards there will be a question-and-answer session. Just to remind you, this conference call is being recorded and a transcript of the call will be made available online. Cees, please begin.

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

Good morning, everybody, and welcome to Carlsberg's Q3 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.

I will go through the current state of the business and highlights of the quarter and Heine will talk you through the regions and outlook. Before I go through the Q3 numbers, let me evaluate on the progress of our business. Internally, we apply three lenses and look at the financial, strategic and organisational health of our company.

Financially, the group continues the positive trajectory and we are confident that 2018, there will be a year that delivers good top line growth, margin improvement, and a very healthy cash flow. At the same time, we have been and are investing significant funds in the business to strengthen the growth profile of the company. From the outset of the year, our ambition was to shift gears to growth, and after the first nine months, we are very satisfied with the execution of our plans for the year, albeit we have been helped by the very warm summer in Western Europe.

A proof point of this year's financial health is last week's upgrade of the full-year earnings expectations which Heine will get back to. Strategically, we are making good progress on our growth priorities in Asia and for craft, specialities, and alcohol-free brews, and we continue to invest in further strengthening our capabilities within areas such as digital and data, sales and marketing as well as the rollout of DraughtMaster.

Looking at the organisational health of the business, we are also moving in the right direction. Although it is an ongoing journey, our winning culture has become much better embedded across the Group. Our pool of managers and people in areas such as commercial, digital, data, finance and supply chain has strengthened and is characterised by a winning spirit.

In addition, we see very good traction behind bringing to light our purpose of brewing for a better today and tomorrow including our ambitious sustainability program Together Towards Zero. With that inflow, let us now focus on the Q3 performance. Please turn to slide 2.

Organic net revenue grew by 9% in Q3. This was driven by 1% price/mix and a strong 7.6% organic volume growth, not least driven by impressive results in Western Europe. For the nine months, organic net revenue growth was 6.4%.

Reported volume growth was 100 basis points higher than the organic volume growth due to the increased ownership of Cambrew which was consolidated from the 1st of August. Reported. Before net revenue grew by 7.4%, positively impacted by Cambrew and negatively by currency movements. The negative currency impact was broadly based, though with the largest impact coming from Eastern Europe.

Please turn to slide 3, and a few comments on our international premium brands for which we saw good growth. 1664 Blanc continued its strong performance and grew by 49%. We saw particularly strong growth in markets such as China, Russia, Ukraine and France. Grimbergen continued its double-digit growth, and grew by 15%. The growth mainly came from Western Europe, which particularly strong results achieved in France. Our largest brand, Tuborg, grew by 11%, supported by strong growth in China and India. The brands also grew in several markets in Western Europe such as Denmark, Serbia, Croatia, Bulgaria and Germany. In Turkey, Tuborg continued its strong performance driven by our very dedicated partner. In Q3, Carlsberg volumes were up by 9% driven by strong results across many markets including Denmark, Sweden, UK, Poland, China, Malaysia, India and Russia.

Please turn to slide 4 and a brief update on some of our strategic priorities. The craft & speciality portfolio grew by 29% with positive contribution from many markets across the group. In particular, we saw a very strong growth in markets such as France, Denmark, Sweden, Poland, UK, Russia and China. Alcohol-free brews grew by 58% in Western Europe and by 50% in Russia. In Western Europe the growth was supported by the warm summer and we saw very strong growth in markets such as Poland, France, Lithuania and Denmark.

In September, we unveiled a new design for the Carlsberg brand along with a series of sustainable packaging innovations. The new design will be applied to all packaging and glassware and will be available in the first markets in Q1 of next year. One high-profile innovation is the pioneering Snap Pack solution, which is set to reduce plastic waste by more than 1,200 tonnes per year. The reason for this reduction is that Snap Pack glues together weld effects instead of using plastic wrap. In addition to the Snap Pack, we've made a number of other betterments for the brand, for example, caps which remove the oxygen so that the beer tastes fresher for longer and changed the green colour ink to cradle-to-cradle certified ink to improve recyclability. We were pleased with the very positive feedback from our customers and the amount of positive publicity that we received globally.

I will now hand over to Heine who will take us through the regions and outlook.

Heine Dalsgaard, Chief Financial Officer, Carlsberg A/S

Thank you, Cees. Please turn to slide 5 in Western Europe. Net revenue grew organically by 8.5% as a result of total volume growth of 10.7% and price/mix of minus 2%. Reported net revenue grew by 7.7% due to a negative currency impact primarily related to Norwegian, the Swedish, and the Swiss currencies.

We saw solid price/mix in most countries in the region but two reasons drove a price/mix into negative territory. Firstly, the warm weather in the Nordics resulted in high growth of non-beer products which have a lower net revenue per hectoliter than beer. Secondly, country mix in our export & license business reduced price/mix. As we've reported throughout the year, we saw lower volumes to high-priced export markets in the Middle East but growth in the license markets such as Turkey.

Adjusting for export and license, the price/mix was around 0.5% positive for the region. The strong volume growth was supported by very warm weather in several of our markets especially in the northern part of the region, largely the same market that experienced a very bad summer last year. We estimate that our market shares were slightly growing for the quarter.

Looking at a few selected markets, our total volumes in the Nordics grew strongly by 11%, supported by the weather and cycling a particular bad month of July last year. As mentioned, the strong growth of non-beer products led to a negative price/mix. In Denmark, we saw a good traction of all beer categories, including craft & speciality, alcohol-free and core beer volumes. Despite a price increase on the Tuborg brand earlier in the year, brand volumes grew by 4%. In Sweden, we saw very good growth of our craft & speciality portfolio and alcohol-free brews. In Norway, volume growth and price increases led to a very healthy top line growth. In Finland, price/mix improved slightly, despite a negative channel mix with strong results achieved in the off-trade.

In France, our craft & speciality portfolio continued to develop particularly well. The French beer market grew slightly and our business had a very strong Q3 with high-teen volume growth, although this was also driven by different timing of certain large campaigns compared to last year. In Poland, we saw a solid volume growth during the summer after a weak beginning of the year due to our price increase in Q1. This positively impacted price/mix along with our successful premiumisation efforts. In the remaining markets in the region we saw growth in the Baltics, the Balkan markets and the UK, while volumes declined in Greece and in Italy.

Please turn to slide 6 and Asia. Our Asian region had another strong quarter, although growth, as expected, moderated somewhat compared to the very strong first half performance. Net revenue grew organically by 11%, driven by 5.8% volume growth and a solid price/mix of 5%. Reported net revenue grew by 12.6%, due to the acquisition of Cambrew which more than offset the negative currency impact.

In China, volume growth slowed down as expected compared to the first half. Nevertheless, volumes grew by 6% and price/mix remained solid due to the continued excellent growth numbers of our international portfolio which grew by 11%. Our big city expansion in China is well on track, achieving volume and numbers ahead of our expectations.

Our Indian volumes grew by 15%, supported by strong growth of the Carlsberg brand. Price/mix was positive in the mid-single digits. As always in India, market conditions varied significantly from state to state. Overall, we've seen a rebound of volumes this year, following the very disruptive year of 2017. The first nine months market growth is estimated at 12%, with our volumes growing ahead of the market.

In other markets in the region, Laos was hit by flooding and higher than normal rainfalls. This dampened beer volumes although growth remained solid at mid-single-digit percentages. In Malaysia, we saw a good momentum in the quarter. The new sales tax and services tax was implemented on the 1st of September. We have fully passed on the tax leading to price increases of 5% to 6%. Consequently, our customers [indiscernible] 00:11:09 in August while destocking in September and October. Nepal growth was mainly strong in the strong-beer segment and the economy segment.

On August 1, we gained control of Cambrew in Cambodia, and we are now in the process of upgrading our systems, our processes, and our capabilities. The foundation for turning Cambrew back into a strong business is certainly there. The brewery is new and efficient, and the Angkor brand is well known by Cambodian consumers. We are very positive about the future for Cambrew, but it will require a few years of additional hard work before we believe we should be there.

Slide 7 and Eastern Europe, please. Net revenue in Eastern Europe grew by 8.2%, due to 4.2% volume growth and 4% price/mix. Reported net revenue increased by 0.6% due to the weak currencies across all markets with largest impact coming from the Russian ruble.

The Russian market grew by an estimated 4% for the quarter and 2%-3% year-to-date. The quarter was positively impacted by the World Cup. Our volumes grew by 6% for the quarter, and our markets share was flat sequentially. Price/mix was impacted by the continued high level of promotion activities in the PET segment and was plus 1%.

Result in Ukraine have been very strong in recent years. In Q3, our volumes were down slightly, impacted by less promotional activity and some destocking. Price/mix was double-digit, due to price increases and growth of our craft & speciality portfolio. Year-to-date, volumes in Ukraine grew by

6% and revenue by 25%. In the remaining Eastern European markets, we continued to see solid volume and price/mix development.

Please turn to slide 8 and the outlook for the year. As you saw last week and also as Cees briefly touched upon at the beginning of the call, we increased our 2018 earnings expectations last week from high-single-digit percentage organic growth in operating profit to an organic growth of 10%-11%. The upgrade was the second one this year and due to the strong third quarter results, which were driven by good process of our strategic priorities, continued strong execution of Funding the Journey, and a warm summer in Western Europe.

We've received some questions as to why we issued the release last week in advance of our Q3 trading statement today. The reason is the EU Market Abuse Regulation – or MAR – that came into effect at the beginning of 2017, which is very much a focus area for the Danish FSA and of course also for us.

In spite of the strong Q3 and last week's earnings upgrade, we still expect second-half profit growth to be lower than first half. Let me briefly reiterate the reasons for this. Firstly, in first half, Asia was impacted by the sell-in to the festive seasons and Eastern Europe witnessed an extraordinary strong month in June due to weather. Secondly, we've been accelerating SAIL'22 investments in second half, which especially will have an impact on central costs. And thirdly, there is a different phasing of certain costs, mainly depreciations, between first half and second half compared with last year.

Based on the spot rates on the end of October, we still assume a negative FX translation impact on operating profit of around minus DKK 500 million. Remember when you do your modeling that there will be a five-month acquisition impact in second half coming from Cambrew. This corresponds to close to 1 million hectoliter in volume at around DKK 300 million to 350 million in net revenue and operating profit loss in the magnitude of around DKK 50 million. The loss is due to the fact that we are increasing cost this year in order to bring the business back into good shape as fast as possible.

Other assumptions for the year were also stated last week and are as follows. CapEx is expected to be between DKK 4 and 4.5 billion. Last week, we adjusted that down from previous expectations of around DKK 4.5 billion due to currencies and slightly lower CapEx in Asia.

Net finance cost excluding FX and fair value adjustments are still expected to be around DKK 800 million and the effective tax rate is still expected to be below 29%. Back to you, Cees.

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

Thanks, Heine. Before we open up for questions, a few final remarks from my side. The Group delivered a strong Q3 with organic net revenue growth of 9% and organic volume growth of 7.6%. We see good growth in our key strategic priorities such as craft & speciality and alcohol-free brews. We will be able to deliver good top and bottom line growth for 2018. And at the same time, we've invested significant resources back into the business.

Finally, the strong Q3 led us to increase our earnings outlook last week. And with this, we are now ready to take your questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] The first question comes from the line of Michael Rasmussen from ABG. Please go ahead. Your line is open.

<Q – Michael Vitfell-Rasmussen>: Thank you very much and well done, guys, on delivering a good set of results. So, three questions from my side. First of all, can you talk a bit about the momentum of DraughtMaster including how many of these have you installed now? What are the plans for the next 12 months? And also, maybe if you could share how large of a share of your on-trade revenues actually goes through the DraughtMaster system at the moment?

My second question is on France. Heine, I think you mentioned that volumes grew by double-digits although I don't image the market grew by that much. So, is this something which we should remember when we do our Q4 numbers and how large in perhaps volume or revenue terms is this timing impact? And my final question goes to you, Cees, on the marketing spending going forward. What are you thinking here, for example, as a percentage of revenues or any general comments that you can make on marketing spending? Thank you.

<A – Cees 't Hart – Carlsberg A/S>: Thank you, Michael. Good morning. With regard to DraughtMaster, we are rolling out DraughtMaster as we speak in Denmark. We are moving to Norway, to Sweden. We have some installations, almost close to 1,800, in the UK, so we're rolling that out. That means that in some of the markets, like Denmark, we will totally convert in the course of the coming two years.

So, that means that in these markets indeed from the percentage of sales, from on-trade, it will be slowly, slowly – or rapidly – moving to 100% in 2020. We're going to roll these DraughtMaster systems as well out in our big cities in China in the course of next year. So, we feel very confident about the momentum and the impact of DraughtMaster. Heine, on France?

<A – Heine Dalsgaard – Carlsberg A/S>: Yeah. So, good morning, Michael. So, markets share in France is flat year-to-date. We lose on Kronenbourg, so mainstream lager is declining while we are gaining on Grimbergen, Tourtel and Blanc. It is important to remember that the strong Q3 is also due to different timing of campaigns versus last year.

<Q – Michael Rasmussen>: Yeah. But, Heine, that was exactly what I was asking into. So, how big was this timing impact and I understand that that will obviously be a negative in Q4.

<A – Heine Dalsgaard – Carlsberg A/S>: Yeah. We don't split it. As we said in Q2, France was not that strong in Q2. Now, France is very strong in Q3, so it is difficult to take out one quarter. So, the key message here is that there is a different timing of campaigns. Q4 is not the biggest quarter, as you know.

<Q – Michael Rasmussen>: Thank you, Heine.

<A – Cees 't Hart – Carlsberg A/S>: And Michael, with regard to the marketing spending as a percentage, this year will be slightly up. In the second half of the year, we will as well continue to invest in SAIL'22 in order to keep the good momentum. We allocate the money very much to DraughtMaster, to craft & speciality and to alcohol-free beer.

<Q – Michael Rasmussen>: Thank you very much.

<A – Cees 't Hart – Carlsberg A/S>: Thank you.

Operator: The next question comes from the line of Sanjeet Aujla from Credit Suisse. Please go ahead.

<Q – Sanjeet Aujla>: Hi, Cees and Heine. Can you just give us some early indications on how you're thinking about the input cost environment into 2019, and what plans you might be taking on pricing or incremental cost to try to mitigate that? And secondly, just on the UK business in particular, with the Carlsberg relaunch there, how long will that business will take to turnaround?

<A – Cees 't Hart – Carlsberg A/S>: Good morning, Sanjeet. Thank you, Heine...

<A – Heine Dalsgaard – Carlsberg A/S>: Yeah. Good morning, Sanjeet. So on 2019, for good reasons, we cannot give detailed comments on 2019 for now. We will come back to this in February 2019. But it is clear that with a very positive 2018, we will have a tough base for next year. We don't comment specifically on 2019. It's clear on the positive side that we have good momentum from our strategic priorities. Our tight cost control, our performance management is very strong. We will enter 2019 with a strong underlying momentum. We've been able to and we'll continue to be able to invest into our brand activities and also capabilities.

And then, as you're seeing on the negative side, there are two main factors. One is the higher input costs which will require price increases as we will pass on the higher input costs to our sales price and then the tough comps, in particular, in Western Europe and Eastern Europe. But the conclusion is from outside that the business has a very strong momentum. We believe that we are very well-prepared for 2019, and we should be able to continue to grow both top- and bottom-line.

<A – Cees 't Hart – Carlsberg A/S>: And then, Sanjeet, with regards to the UK, indeed, we just started this and frankly, I think it will take an investment of two to three years, at least. As we said earlier, we are declining with our brand in a declining mainstream segment. Obviously, we cannot halt the declining of the mainstream segment, but we should be able to halt the decline of our market share.

We have upgraded the visual identity of the brand. We have updated the logo. We have a new bottle. We have several sustainability innovations on packaging. So we're pretty confident that we will be successful with this relaunch, not only in the UK but across the globe. However, please remember that the UK business for us is not that significant. It is only 1.5% to 2% of Group EBIT. But, obviously, we do want to change the course of the Carlsberg brand there.

<Q – Sanjeet Aujla>: Got it. Thanks.

Operator: And the next question comes from the line of Jonas Guldborg from Danske Bank. Please go ahead.

<Q – Jonas Guldborg>: Yeah. Good morning. Thank you for taking my questions. I have two. First of all, if you could put some more words on the upgrade last week and where is it coming from, is it is primarily Western Europe and the good weather or what is driving it? And then, the other question would be on Russia and if you're seeing any change in the competitive dynamics in that market after the merger between ABI and Efes? Thank you.

<A – Heine Dalsgaard – Carlsberg A/S>: Good morning, Jonas. So, on the question of the upgrade last week, there are three elements. We don't split specifically sort of on three, but there are three main elements here. One is the fact that our SAIL'22 investments are coming through, so that means top line investments into craft & speciality, alcohol-free, DraughtMaster, China, India, it's coming through. Second is the continued success and good traction of our Funding the Journey initiatives. We continue to be focused on Funding the Journey. We continue to be focused on tight cost control.

And then, the third element is very clear. It's the unusual weather on top of an unusual bad weather last year, in particular in the northern part of Western Europe. So, these are the three main reasons.

<Q – Jonas Hansen>: Okay.

<A – Cees 't Hart – Carlsberg A/S>: And then, regard to Russia, we can say that obviously here that the merger is moving on between ABI and Efes. We've seen a very strong program in July in relation to the World Cup. And in that month, our share declined a bit. But in August and September, we were back on a positive trend. So, the merger so far has not impacted us in our share. And obviously, we were prepared for the battle in 2019.

<Q – Jonas Hansen>: Thank you very much.

<A – Cees 't Hart – Carlsberg A/S>: Thank you.

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

<Q – Hans Gregersen>: Good morning. You mentioned that China, you're growing ahead of expectations. Could you provide a little bit further insight to your commercial development? Also, if you could sort of indicate to us how many new cities you're going to add on to 2019? That's the first question. In Asia, also in India, can you give a little bit more insight into the growth profile and your market share? And then, finally, on Western Europe, if I got it right, you stated that excluding the license and export, you had a positive price/mix of 0.5 percentage point. I do imagine that soft drinks and water has negative price/mix impact. So if we adjust for the extraordinary weather impact, what would the price/mix have been? And then, finally, you mentioned on Cambrew DKK 50 million in extra costs. Should we read the EBIT guidance that we have the 10% to 11% organic growth minus FX. Should we also deduct DKK 50 million for Cambrew? Thank you.

<A – Cees 't Hart – Carlsberg A/S>: Thank you, Hans, and good morning. With regard to China, yes, we have a good momentum in China. We are rolling out our big city strategy there, and by the end of 2018, we will be in 21 cities. We spent at it during the year. And for 2019, we expect to have an additional 10 cities, meaning that by the end of 2019, we should be in 31 cities.

We are quite successful in the premium brand segment. Our total international premium brand portfolio is 11% [growth in Q3] and Carlsberg grew by 9% and Tuborg by 10% and 1664 Blanc even by 38%. Our share is up by 70 basis points in that segment, and we are, as we said earlier, pretty indeed positive about development in China.

We're as well positive about the development in India. The market went up, but we outgrew the market. We estimate our market share is slightly above 18%. In Q3, we look at a 15% volume increase and more than 25% value increase. We are now number one or two in six states and number three in three states, and we serve 37,000 outlets versus the universe of 64,000. So, that's an update on India, Hans.

Heine, over to you.

<A – Heine Dalsgaard – Carlsberg A/S>: Yes. Good morning, Hans. So, we don't split the sort of price/mix impact further. What we said is that if you take out export & license, it is 0.5%. We don't split it further on soft drinks and on beer. But in total, it's in line with our expectations. On the DKK 50 million, it is an acquisition impact. So that means you take the 10% to 11% and then you take the FX out to DKK 500 million and then you take the acquisition impact, the DKK 50 million from Cambrew, out.

<Q – Hans Gregersen>: But Heine, to just go back to your comments on price/mix, it is right to conclude that there's been a negative mix impact from more sales of water and soft drinks due to this warm summer weather?

<A – Heine Dalsgaard – Carlsberg A/S>: Yes, absolutely right.

<Q – Hans Gregersen>: So, the underlying performance is quite good also in Western Europe.

<A – Heine Dalsgaard – Carlsberg A/S>: Yes.

<Q – Hans Gregersen>: Thank you.

Operator: And the next question comes from the line of Richard Withagen from Kepler Cheuvreux. Please go ahead.

<Q – Richard Withagen>: Yes. Good morning. I've got two questions. First of all, coming back on the UK on the new Carlsberg launch that – or the relaunch that you did there, can you talk a bit about how that has been taken up by your trade partners and also perhaps by consumer because obviously it's a new liquid as you've stated before? And the second question is, yeah, to come back on India, what do you see in terms of market growth? I know that Tuborg is by far your biggest brand, but is the mainstream market growing as well? And what does the growth differential between premium and mainstream in India? And how is the competition with the Indian whiskies?

<A – Cees 't Hart – Carlsberg A/S>: Good morning. Thank you very much. With regard to the U.K., we have just announced it. We had a trade visit of some very important customers here to Copenhagen and to inform them about the changes and to show them what we call the betterments, and they were very enthusiastic. And we have gotten already the first big promotional slot for the Snap Pack in Tesco. So, that's a good pick up.

With regard to the consumers, it's far too early to say that. First of all, it still needs to, more or less hit the market and then you need to see as well the repeat sales. So, I think by June, July next year, we can give you a bit more information about how the consumers appreciated the new betterments. Of course, we have tested this and we see very, very encouraging, very good results out of that. So we are really optimistic and self-confident on that one.

With regard to India, well, that's a big question because the price indexes are not that different in the market. Carlsberg is between 120 and 150 index, and Tuborg indexes on 100. So, basically what we see in that market is the further development in terms of penetration. As you know, we go from state to state, we want to be the number one or number two in the state. And at the moment that we are there successful, we only then move to next state. As I said that earlier, we're totally now in nine states.

The Carlsberg brand as such has a 30% of premium in India. We see the market still growing and obviously that is in some areas on the expense of the hard liquor. It's how we call it in a conversion market, and in that respect, we feel that the market growth will continue in the coming years.

We said earlier it will not be a guide or straight line to continuous growth. There will be some hiccups. It's three steps forward and sometimes two steps back. But 2018 so far has been three steps forward, with in Q1 30% growth, and Q2 7% growth.

<Q – Richard Withagen>: And then in terms of your brands, Carlsberg and Tuborg, I mean not specifically for Q3, but maybe for the nine-month period. Which one grew faster in India?

<A – Cees 't Hart – Carlsberg A/S>: I don't have that information because basically both of them moving in the same kind of direction, so I can't give you that detail.

<Q – Richard Withagen>: All right. Thank you.

<A – Cees 't Hart – Carlsberg A/S>: There's not a big difference. Thank you, Richard.

Operator: And the next question comes from the line of Søren Samsøe from SEB. Please go ahead.

<Q – Søren Samsøe>: Yes, good morning. Basically, if you could tell us whether this strong weather we've experienced has led you to take some costs that you would probably not have taken if it for normal weather in all the season, so you sort of have taken this opportunity to take more cost through?

And then, secondly, if you could just comment, I mean, you've seen some of your colleagues in the industry cut dividends, maybe you could elaborate a little bit on the journey you are on and what your thoughts are here. Thank you.

<A – Cees 't Hart – Carlsberg A/S>: Heine, over to you.

<A – Heine Dalsgaard – Carlsberg A/S>: Yeah. Sure. Good morning, Søren. The weather impact, has it sort of – and whether we've taken additional cost as a consequence of that, I would say no, we haven't. We've continued – as we've said, all through the year, we've continued to invest into future growth. We've continued to stay focused on making sure that we get the benefits from Funding the Journey coming through and then being relatively bold as to how much it is that we invest into future growth initiatives. Just this year, we will, when we close the year, have invested more than DKK 500 million into future growth. It's clear that had Q3 been a catastrophe from a sales point of view, we would probably have done the opposite, which is then to cut cost because we also are protecting our bottom line.

But the weather has not sort of led us to sort of step up anything because these are investments that are carefully thought through and are part of a bigger plan. In terms of the dividends, we can say that we have no plans of cutting our dividends. As you know, we set out on a journey a few years ago with a few very clear priorities in terms of capital allocation.

The first one is to continue to invest into organic growth. We've done that this year with more than DKK 500 million into real organic growth initiatives within craft & specialty, alcohol-free, DraughtMaster, China and so on. Second priority was that we said we're going to reduce our leverage to below 2x. We've done that. AS you saw in the half year numbers, we're below 2x, well below 2x.

And then, with that, we will increase our payout ratio. So, **increase** our payout ratio, not the opposite. We've done that from a historical level of 25% now to 50%, and that is the level for ordinary dividends that we will maintain.

Then the fourth priority, where we've said that we will come back in February is what we call additional shareholder returns in order to keep the leverage sort of comfortably around 1.5 to 2 times, and that's something we will come back to in February. And it's something we have discussed with the major shareholders, we have discussed with our supervisory board, and it is a topic that we will come back to in February. So, we're doing the opposite.

<Q – Søren Samsøe>: Okay. Good to hear. Thank you.

Operator: Our next question comes from the line of Trevor Stirling from Bernstein. Please go ahead.

<Q – Trevor Stirling>: Hi, Cees and Heine. Just one question from my side. Clearly, spectacular results in Western Europe. I guess the best ever in Denmark, reflecting the best-ever volume growth in Western Europe. But if you strip out the good weather and easy comp, do you have a sense of the underlying volume growth in your mix of markets, is it still broadly flat or are we starting to creep into a little bit of growth?

<A – Heine Dalsgaard – Carlsberg A/S>: Yes – no. If we take out the weather impact and there is definitely is a weather impact. But if we take that one out, there is still an underlying growth in particular within craft & speciality and alcohol-free, but also now we see positive trends within some of our core beer portfolios.

<Q – Trevor Stirling>: Great. Thanks very much, Heine.

<A – Heine Dalsgaard – Carlsberg A/S>: Thank you.

<A – Cees 't Hart – Carlsberg A/S>: Thanks, Trevor.

Operator: And the next question comes from the line of Ed Mundy from Jefferies. Please go ahead.

<Q – Edward Mundy>: Hi. Good morning, Cees. Good morning, Heine. Good morning, everyone. Two questions, please. The step-up in alcohol-free within the third quarter, is that just whether or are there new markets and new brands that are driving that? And then just coming back to the guidance again of 10% to 11% EBIT growth for the year. I think that implies broadly flattish margins in the second half. I know you said that the second half wouldn't be as strong as the first half, but why shouldn't we expect some operating leverage in the second half?

<A – Cees 't Hart – Carlsberg A/S>: Thanks, Ed. Good morning. With regard to the alcohol-free and if it is just weather, it grew by 58% in Europe and by 50% in Russia only. So what we see is the increasing momentum of both the category and now people themselves to really put now focus on that. We started this two years ago in articulating this as well as the priorities. Obviously, it always takes some time to really get the momentum, and we feel that we really now hit the momentum of the market with the right brews, the right intentions, and the right investments. So it's more than the weather in our view, but that's what we need to prove to you and to ourselves in 2019.

<A – Heine Dalsgaard – Carlsberg A/S>: Yeah. Good morning, Ed. On the question on the guidance in second half. First of all, 10% to 11% growth in organic operating profit is, from our point of view, a strong outlook and it does require also growth in the second half. But it is right that the second half growth in organic EBIT is lower than first half and there are three reasons for that. One is the fact that in first half, Asia was impacted very positively at the beginning of the year by the sell-in to the festive season. Secondly, as you know, we have accelerated rather aggressively our SAIL'22 investments in the second half, for instance, to DraughtMaster, to Birell which is, as Cees mentioned, our alcohol-free brand, and also into expansion in China and into digital. So, that's the second. And then, thirdly, there is a different phasing of certain cost elements, including depreciation, versus last year in first half versus second half.

<Q – Edward Mundy>: Okay. Thank you. And then, Cees, just to follow up again on the alcohol-free. Are you seeing change in consumption habits, more people drinking, let's say, at lunch as opposed to just maybe substituting for normal beer in the evening?

<A – Cees 't Hart – Carlsberg A/S>: Yes, it's early days, but when you see at least the segment growing pretty quickly. And we are taking share in the segment. We are really coming in with a broader portfolio, so not only as line extensions of our local power brands, but as well from some of our international brands like Carlsberg, and on top of that, Birell, as Heine said.

So, it's a cumulative effort on that that really grows that segment. We see the consumers being interested in it and we see them using alcohol-free beer at more and more moments, which is of course very good for the potential growth of that segment. And it's margin enhancing for us. So, in that respect, we are really keen to continue this speed of growth.

<Q – Edward Mundy>: Okay. Thank you.

Operator: And the next question comes from the line of Olivier Nicolai from Morgan Stanley. Please go ahead.

<Q – Olivier Nicolai>: Hi. Good morning, everyone. Just two questions, please. Firstly on Russia, how big is the premium beer segment today as a percent of the market? And essentially, where do you see this in, let's say, five years' time? I'm just trying to have an idea of the growth potential of the craft & speciality and brands like Grimbergen in Russia. And second question it's about the tax rates. You maintain your tax rate guidance, I think you've mentioned in the past there were some efficiencies potentially to get in China between some of the subsidiaries which were loss-making and some were making profit. How far are you in this journey and could be material to the group tax rate going forward? Thank you.

<A – Cees 't Hart – Carlsberg A/S>: Thanks, Olivier, and good morning. Well, what we see at the moment in Russia is that the premium segment is slightly higher at 30-31%, and the super premium is 6.5%. And actually, we see some growth in these segments. We are overrepresented with our brands in premium. We are underrepresented in the super premium but for 2019 we have a program for that. So we're positive about the development of these two segments which, of course, is good news for our business in Russia. Heine?

<A – Heine Dalsgaard – Carlsberg A/S>: Yeah. Good morning, Olivier. So, on the tax rate, you're right. We are maintaining our guidance of an effective tax rate below 29%. We are running, as you know, several initiatives within tax. The big one is actually to increase the focus and the attention and the discipline around tax, both when it comes to the effective tax rate, but also when it comes to tax compliance. The different initiatives that we are running including the one in China and they're all sort of progressing well, and we feel confident that we will also after 2018 continue the journey of strong focus on compliance and focus on ensuring a continued reduction in our effective tax rate.

<Q – Olivier Nicolai>: Thank you.

<A – Cees 't Hart – Carlsberg A/S>: Can we have the last question, please?

Operator: The last question comes from the line of Andrea Pistacchi from Deutsche Bank. Please go ahead.

<Q – Andrea Pistacchi>: Yes. Good morning. I have three brief questions, please. First one on Switzerland, if you could just say a few words on your performance in Switzerland, an important market for you in Europe. Second on Poland, please, on the competitive environment there, if that – how that has evolved through the year, if it's improved. And finally, just a technical thing in Asia about shipments, the Chinese New Year, the sort of Asian festivities will be a bit earlier this year whether this will impact your shipment. Should we expect – last year Q1 benefited – that will there be a shift this year to Q4 of shipments, please?

<A – Cees 't Hart – Carlsberg A/S>: Okay. Thank you very much, Andrea. With regard to Switzerland, there we saw a kind of modest growth but still in a stable market a very good result in our view. The organic growth was around 1% in Q3 and organic net revenue 1.4% with more or less stable market share. So, in that respect, we are still really satisfied with the performance in Switzerland.

Poland showed very different figures, 6.8% in Q3 volume, 15.5% in value. We had a tough start to the year due to our price increases. The market is 4% up year-to-date in August, 7% in value. And year-to-date, we are losing a bit of market share, but we had a very strong Q3 in terms of market share. We have a strong price/mix due to the price increase at the beginning of the year and we have very good performance of our upper mainstream and that is basically impacting our value market share. Upper mainstream brands and premium brands in Q3 like Okocim, Grimbergen, Blanc and Brooklyn. So, good performance and progress in Poland.

With regard to Asia, we indeed have the sell-in from Chinese New Year in Q1. And Chinese New Year in 2019 is a bit earlier, so we will have part of the impact in Q4 and part of the impact in Q1 2019. So, it's difficult now to see which countries will have an early sell-in and which one perhaps slightly later. So, it's difficult, Andrea, to assess and difficult to find the impact of that.

<Q – Andrea Pistacchi>: Great. Thank you for all that color.

<A – Cees 't Hart – Carlsberg A/S>: Thank you very much. Then before I close, I owe Richard a detailed answer. In India, Tuborg grew by 12% year-to-date and Carlsberg by even 37% year-to-date.

That was the final answer for today. Thank you for listening in and thank you for your questions. We're looking forward to meeting some of you during the coming days and weeks. Have a nice day. Bye-bye.

Operator: This now concludes our conference call. Thank you all for attending. You may now disconnect your lines.