Carlsberg A/S
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H1 2020 Financial Statement Conference Call

PARTICIPANTS

Corporate Participants

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Heine Dalsgaard – Chief Financial Officer, Carlsberg A/S

Other Participants

Trevor Stirling – Analyst, Sanford C. Bernstein Ltd.
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Simon Hales – Analyst, Citigroup Global Markets Ltd.
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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, welcome to the Carlsberg First Half 2020 Results Call. Today, I'm pleased to present the CEO, Cees 't Hart. For the first part of this, all participants will be in listen-only mode and afterwards, there will be a question-and-answer session. And just to remind you, this conference call is being recorded.

Speakers, please begin.

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

Good morning, everybody, and welcome to Carlsberg's H1 2020 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 hope you and your families are all safe and well and that you're all getting through these challenging times.

Let me first briefly summarize the key headlines for the first half year. The pandemic is having a significant impact on the business. We've taken many steps to protect our people, support our communities, and protect the commercial and financial health of the Group. We have been able to mitigate a large part of the financial impact, thanks to our resilient business and cost actions. We have made significant cash returns to shareholders, kept a strong balance sheet, and secured liquidity. And despite of the continued high level of uncertainty, we are today issuing a new full-year guidance. I will go through the group and regional highlights after which Heine will take you through the financials and 2020 outlook.

Please turn to slide 3. The health and safety of our people have been and will remain a key priority for us. We have implemented new processes and procedures to minimize the risk of infections and ensure the physical and psychological safety of our employees. I would like to extend my thanks to all our colleagues who have done a tremendous job under very challenging conditions.

We have strengthened our overall communication, set priorities and aligned objectives across markets and functions. Our leaders and employees were given the opportunity to be supported by virtual trainings and tools in order to cope with the new challenges. At the breweries, our initiatives included working in special shifts and expanding the use of protective equipment.

It has been very important for us to contribute to and support our communities. We have been engaged in a variety of initiatives, including the production of hand sanitizers, donations of protective and testing equipment and alcohol-free beverages to healthcare workers and financial donations to local organizations. In addition, our majority shareholder, the Carlsberg Foundation, has made earmarked COVID-19 donations amounting to more than DKK 100 million in support of research and various aid measures.

Slide 4, please, and some overall comments on how we have navigated these uncharted COVID-19 waters. Our results were significantly impacted by the pandemic, as our markets were affected by a range of government interventions, including lockdowns, social distancing and restrictions on people gatherings. Generally, the on-trade channel in all markets has been severely impacted. With around 25% of our volumes being sold in the on-trade channel, which has an above average revenue and profit per hectoliter, the impact on business results is substantial.

Our volumes declined by 7.7% and price/mix was minus 4% due to the negative channel mix and also country mix. During the first half year, we have implemented many changes to protect the financial health of the Group in terms of safeguarding 2020 results while still ensuring that we are able to capture new, long-term growth opportunities.

We have been pleased to see that the resilience of our business which we have built over the past years really proved very solid, and was key in our ability to manage the sudden and very new challenges and make the necessary changes. With resilience, we are referring to financial position, organization, people and portfolio.

Our financial resilience relates to our strong balance sheet and our ability to quickly adjust our cost base, protect cash and secure liquidity. The organizational resilience was evidenced by a high-degree of flexibility and engagement, enabling fast adaption to change. The resilience of our people has been commendable. Everyone has walked the extra mile for the company. There is no doubt that being a purpose-driven company with a high-level of employee engagement and satisfaction supported this.

Lastly, our resilient brand portfolio enjoys strong market positions. In addition, our continued investments in and focus on building the craft & speciality and alcohol-free categories has been an advantage for us and helped us cater for changing consumer preferences. As a consequence of the business resilience, we were able to reduce the impact from the pandemic, and by that deliver an increase in operating margin of 30 basis points while organic operating profit declined by 8.9%.

Slide 5 please and some insights into what we are doing to prepare for a different future that is impacted by the uncertainty as to how the pandemic will evolve, the longer term impact on the global economy and consumer spending, and actions of regulators.

For the beer industry, in particular, there is uncertainty related to the longer term impact on the on-trade and possibly longer lasting changes in consumer preference in terms of channels, brands, and price points.

Taking a prudent approach to these uncertainties, we have updated our priorities, pooling them under two headlines: respond for top-line growth and reset for the future. Before elaborating on respond and reset, let me emphasize that our long-term strategic priorities are unchanged. We will continue to invest in and grow our well-positioned and strong core brands in order to ensure that we capture the long-term value opportunities in the core beer segment. We continue to believe in the long-term growth opportunities for craft and specialities and alcohol-free brews. And we will therefore continue to invest in these categories. When looking at our geographies, we are also confident that Asia will return to growth, and therefore, we will continue to expand our Asian business.

And let me now explain what we mean by our two headlines. By respond, we are referring to an even more focused execution of our commercial programs, leveraging our strong brands and market positions. It also means prioritizing fewer brands and activities, focusing our innovation efforts more and make them more efficient. We will intensify our value management approach to ensure that we hit the right price points that appeal to consumers' possibly lower disposable income. And we will continue to invest in and expand our e-commerce activities.

We will reset our business for the future to ensure that our structures, processes and cost base are well-suited for a post COVID-19 reality. This includes a review of above-market cost structures in our central, regional, and support functions as well as supply chain. Unfortunately, this will impact the number of employees in these functions. In our markets, we are taking actions to assure the right structures, flexibility, and capabilities in response to a possibly smaller on-trade and changes within the off-trade sub-channels. We will continue to leverage our Funding the Journey culture and we are embedding the positive learnings and ways of working from this half year in our future ways of working.

Slide 6, and Western Europe. As expected, Western Europe had a very difficult start to Q2 which was impacted by restrictions and lockdowns of the on-trade channel in almost all markets. When the gradual reopening started towards the end of the quarter, we saw some improvements in performance, albeit still in decline year-on-year. Volumes were also impacted by the changed Danish-German soft drinks border trade. Excluding this lost volume, total volumes declined by approximately 7%.

Price/mix in most markets was impacted by channel mix and for the region as a whole, mix was impacted by country mix as Poland performed much better than some of the high-priced markets in the Nordics and Switzerland. We were able to push through significant cost savings, particularly within supply chain, logistics, marketing, and administration. Nevertheless, operating profit declined organically by 19.2%, as the savings were not sufficient to offset the revenue decline.

Slide 7 and a few country-specific comments, in addition to the general COVID-19 situation in the region. In Norway, we saw a positive impact from the closed borders. As the Norwegians didn't travel abroad and were unable to buy their beers on the Norwegian-Swedish border. Mix was negative due to channel mix, but within the off-trade, we saw favorable mix both on channel and category, the latter due to a higher share of beer vis-à-vis water.

As we already highlighted, volumes in Denmark were also impacted by the changed German-Danish border trade of soft drinks.

The weather in Poland has been very poor, which has impacted the markets negatively. Nevertheless, we achieved mid-single-digit percentage volume growth, helped by our limited exposure to the on-trade. We saw particularly good results for our craft & speciality portfolio, including the international specialty brands Grimbergen and 1664 Blanc and alcohol-free brews. Both categories were up by solid double-digit percentages.

As Switzerland is a large on-trade market, accounting for approximately 50% of our volumes, our business was severely impacted by COVID-19. On a positive note, we saw good growth for our craft & speciality and alcohol-free brew portfolios despite the closure of on-trade.

In France, we were hit twice by the virus, so to speak. Not only was the on-trade closed for a prolonged period of time, we also faced production challenges due to the fact that our brewery was impacted by COVID-19 constraints.

In the UK, we saw good pick up of the Carlsberg brand in the off-trade, and our market share was slightly up. As you have probably read, in May we signed an agreement with Marston's to form a joint venture with our UK business and their brewing business. We expect to get the final approvals for the deal in Q4.

Please turn to slide 8 and Asia, where the market development varied significantly. China turned positive in the second quarter, but unfortunately this could not offset the challenges in the rest of the region. Price/mix was positive in Q1, but reversed in the second quarter due to the very strong recovery in China where pricing is below the regional average. As we started taking out costs very early on in the year, due to the early impact of COVID-19 in China, cost savings in H1 were substantial, resulting in a modest decline in operating profit and a significant operating margin increase of 290 basis points.

Slide 9 and a few market-specific comments. As already mentioned, China saw a strong rebound in Q2 following a tough Q1. The strong 18% volume growth in Q2 compared to the market growth of around 5% was due to a number of factors. These included restocking at distributors and stock building ahead of the peak season, as well as our commercial drivers such as impressive growth in e-commerce of more than 100%, admittedly on a low base, expansion of the Wusu brand, growth in our big cities, and very good results for our international premium portfolio with Tuborg growing by 16% in Q2 and Blanc by 21%. We gained around 1%-point market share for H1. The Chinese price/mix was 6% up due to the growth of the premium products.

In Laos and Vietnam, the beginning of Q2 was tough but towards the end of the quarter, restrictions were gradually lifted and that converted into a more positive momentum for our local businesses. Our local power brands Beerlao in Laos and Huda in Vietnam were important drivers of the volume growth seen in June. Unfortunately, in the beginning of Q3, we have seen new lockdowns in the central part of Vietnam.

Our businesses in India, Nepal, and Malaysia were severely impacted through Q2. During the quarter, all three markets had to completely shut down operations, which, not surprisingly, led to steep volume decline. By the end of Q2, we were able to reopen the breweries but trading conditions remain tough. In addition, the Indian business has been impacted by very complicated and cumbersome processes for renewing licenses and also by excise tax increases in most states.

Slide 10, and Eastern Europe, where our business saw a relatively modest impact from the pandemic due to a small on-trade exposure of approximately 5% of volumes. Beer volumes grew organically by 1.4%, positively impacted by growth in Russia and Kazakhstan. Non-beer volumes grew strongly by 20.4%, following continued solid growth of energy drinks across the region. Consequently, total volumes grew by 2.4%. Price/mix was impacted by the higher level of promotions in Russia as we are working on reversing last year's market share trend, and consequently, revenue declined organically by 1.3%. We delivered a flat operating profit margin of 18.9%, as the significant cost savings across the region offset the higher promotional investments in Russia.

Slide 11, please. The Russian market grew by around 1% in the first half year. We saw no change in the competitive dynamics in the market, which continued to be highly promotional driven. In March, we therefore kicked off our plan B, which entails a much more aggressive promotional approach in order to stop our market share and volume decline. And so far, our activities have delivered the intended outcome.

Volumes were up 3%, and our market share was strengthened significantly vis-à-vis the beginning of the year, giving us in June the highest monthly market share during the last 18 months or slightly more than 28%. Not surprisingly, our high level of promotions impacted price/mix negatively. At this moment in time, we see no change in the level of promotions in the market and thus, we will continue our current strategy.

Our business in Ukraine is more skewed towards the on-trade than the regional average and we therefore saw a negative impact from COVID-19. Price/mix was slightly down due to the channel and packaging mix. Albeit still small volumes, we were satisfied that we were able to strengthen our market share in the craft & speciality and alcohol-free segments.

And with that, I will hand over to Heine who will take you through the financials and outlook. Heine.

Heine Dalsgaard, Chief Financial Officer, Carlsberg A/S

Thank you, Cees, and good morning, everyone. Please turn to slide 12 and the P&L highlights of the first half year. Revenue declined organically by 11.6%, impacted by both the volume decline and a negative price/mix of 4%. As Cees said earlier, the drivers of the price/mix were many, including country, channel, product and packaging mix. The slightly higher reported decline of 12.6% was due to currencies.

COGS per hectoliter declined organically by 2.5%. The decline was mainly a result of country mix and due to the growth of China, Russia and Poland, which have below average COGS. Looking at COGS per hectoliter by market, our supply chain has done a really good job in reducing costs to mitigate the impact from under absorption of fixed costs. And in most markets, we therefore saw only very modest increases or declines. Gross profit declined organically by 13% and 14% in reported term. Gross margin was 48.6%, a decline of 90 basis points.

Our operating cost management tool really proved its worth during first half, when we were faced with a significant headwind from COVID-19. The OCM tool enable us to quickly respond and execute very tight cost control and consequently, operating expenses declined organically by 16%.

Starting already in January, we were able to reduce costs in 14 out of 15 cost groups, with the main contributors to the decline being marketing, supply chain and administration, including people-related costs. The one cost group where costs were not reduced was bad debt due to the hardship felt by most on-trade customers.

Excluding marketing spend, operating costs declined organically by 12%. As a percent of revenue, marketing investments declined 150 basis points organically to 7.1%. The reduction in marketing was done partly as an obvious response in a time of crisis when certain marketing activities were less efficient, and partly as a measure to protect short-term earnings. The decline in marketing spend is not sustainable long term, and we will have higher marketing spend in second half compared to first half.

Reported operating profit amounted to DKK 4.6 billion, which was a decline year-on-year of 10.8%. In organic terms, the decline was lower at 8.9%. The currency impact mainly related to the Norwegian, the Russian and the Chinese currencies. The operating margin improved by 30 basis points to 16%. Net profit benefited from lower financial expenses and also a lower tax rate. The former was positively impacted by lower average funding costs, and the latter was 26% versus 27% last year.

Adjusted net profit was DKK 2.872 billion and it was almost on par with last year, while adjusted earnings per share were up by 2.8%. The improvement was the result of lower financial expenses, the lower tax rate, and also supported by lower number of shares due to the share buyback.

Please go to slide 13 and some comments on cash flow and net interest-bearing debt. Operating cash flow was, of course, impacted by the low earnings or EBITDA, which in reported terms declined by DKK 540 million. Trade working capital was significantly impacted by lower trade payables as a result of less production, less purchasing and lower CapEx, all due to COVID-19. Looking at the rate of the average trade working capital to revenue, this remained strong at minus 17.5%, although this number of course was helped by the lower revenue.

Somewhat counter-intuitive especially as we've talked about reducing CapEx and focus on cash, operational investments went up in the first half. This was, however, due to the acquisition of the Brooklyn brand rights in our markets. Please note that following IFRS, this posting in operational investments is offset by a similar entry in external financing into cash flow from financing activities, as the first cash payment is deferred to second half. CapEx, excluding the acquisition of the Brooklyn brand rights, declined by around DKK 700 million. Note that when comparing net CapEx with last year, last year was positively impacted by the disposal of the brewery sites in Trondheim in Norway.

Free cash flow amounted to DKK 3.1 billion, a decline of around DKK 2 billion of which a big part relates to the Brooklyn brand rights acquisition. The increase in net interest-bearing debt of DKK 3.1 billion versus year-end 2019 was mainly due to the lower free cash flow and a significant cash return to shareholders in the half year. In total, dividends and share buybacks amounted to DKK 5.5 billion. We have been very focused on securing a continued strong liquidity and financial flexibility and hence, we issued two new €500 million bonds at very favorable rates of 0.625% and 0.375%, respectively.

Please turn to slide 14 and a follow up on our capital allocation priorities, which remain unchanged. As you may recall, our first priority is to continue to invest in our business to ensure the long-term value creation of the Group. Despite being severely impacted by COVID-19 and notwithstanding significant costs in operating costs including also marketing, we have been very alert not to compromise the commercial health of the business.

Our second and, of course, very important priority is to maintain a strong balance sheet. As I mentioned on the previous slide, net interest-bearing debt increased, but at 1.51 times, our leverage ratio remains well below our target of below 2. We are satisfied with the financial flexibility that comes with a strong balance sheet. Please remember that the leverage multiple is based on 12 months trailing EBITDA, which means that there is strong pre-COVID-19 numbers included in the EBITDA figure.

Our third priority of an adjusted payout ratio, a dividend payout ratio of around 50% was delivered upon again in March, where we paid a dividend of DKK 3.1 billion equal to 50% of adjusted net profit in 2019.

Our fourth priority is to distribute excess cash to shareholders, currently in the form of share buybacks. In February, we initiated the first tranche of this year's intended share buyback. And last week, we completed the DKK 2.5 billion share buyback and bought 2.9 million shares, or 2% of total volume of shares, at an average price of DKK 863. Combined with the share buyback carried out in January as part of the 2019 buyback program, this calendar year's total share buyback as of today amounted to DKK 2.9 billion. We have, therefore, in total returned DKK 6 billion to our shareholders while at the same time maintaining a strong balance sheet.

Our fifth priority is value enhancing acquisitions. This year, we have entered into an agreement with Marston's in the UK to form a JV with their and our brewing businesses. We expect the deal to be completed in Q4. In addition, we have further strengthened our relationship with Brooklyn and acquired the rights to the brand in our markets, thereby reducing complexity and importantly, also increasing future profitability.

Due to the continued uncertainty related to COVID-19, the pending Marston's transaction, which amounts to approximately DKK 2 billion, the purchase of the Brooklyn brand rights and possible other inorganic opportunities, it has been decided not to initiate the second tranche of the share buyback. The decision not to initiate the second tranche also reflects us prioritizing a solid balance sheet and the ability to pay solid dividend in line with our capital allocation principles.

And now please turn to slide 15 and the outlook for the year. On April 2, we suspended our guidance but today, we're issuing a new guidance. The reason for this is that we now have first half and July numbers and are therefore well into the peak summer season. By providing guidance today, we are hopefully giving you a better understanding of how we, at this point in time, are seeing the impact of the pandemic on our full year financials.

That said, we cannot emphasize enough that the guidance is significantly more uncertain than usual, as the development of the pandemic, currently unknown government actions, consumer reactions, and the macroeconomic development may have significant implications on business performance in the remainder of the year. Important to also keep in mind is that we are still in the beginning of August, which is part of the important summer season, and a month that in recent years has accounted for up to 15% to 16% of the full year's profit. Based on the results, until and including July, the current COVID-19 situation in our markets and the mitigating actions that we are planning, we are now forecasting an organic operating profit decline of 10% to 15%.

The guidance is based on the following assumptions for second half:

In Western Europe, we are assuming a gradual recovery of the on-trade, although it will not in 2020 come back to the pre-crisis levels.

In Asia, the situation is more fluid. China started Q3 well, but due to recent lockdowns in some of our key provinces, H2 will remain volatile. In the rest of Asia, the situation is also volatile, with some markets gradually recovering, while others continue to be heavily impacted.

In Eastern Europe, our business is still expected to be less directly impacted by COVID-19, while macro environment definitely is a risk.

On costs, we will continue our focused and very disciplined cost agenda but our marketing costs are expected to increase compared to first half, as some activities were postponed to second half and as we invest to prepare for 2021, ensuring the long-term health of our brands.

Additional assumptions related to 2020 financials are a currency impact on operating profit of minus DKK 400 million based on spot rates on August 12, and primarily coming from NOK, RUB, renminbi and LAK. Finance costs excluding FX are expected to be around DKK 600 million to DKK 650 million and we expect a reported effective tax rate of around 26%. Our CapEx expectations, excluding the purchase of the Brooklyn brand rights, have been lowered to now around DKK 4 billion in constant currencies, as we have reduced or postponed a number of projects.

And now, back to you, Cees.

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

Thank you, Heine. That was all for today. But before opening up for Q&A, a few concluding remarks from my side. So, to summarize on H1 2020, the pandemic has so far had a significant impact on our business. We have taken many steps to protect our people, support our communities and protect the commercial and financial health of the Group. We have been able to mitigate a large part of the financial impact, thanks to our resilient business and our cost actions. We have made significant cash returns to shareholders, kept a strong balance sheet and secured liquidity. And despite of the continued high level of uncertainty, we have today issued a new full year guidance.

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

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Our first question comes from the line of Trevor Stirling of Bernstein. Please go ahead.

<Q – Trevor Stirling – Sanford C. Bernstein Ltd.>: Good morning, Cees and Heine. Just two questions from my side. The first one relates to the guidance, and you did imply that the margin performance in the second half was worse than the first half. Is that purely down to the impact of the delayed marketing investments? Or are there other costs that are delayed or is there country mix playing a role there in the second half?

So, second question, can you talk about what you think may have changed permanently, and you talked about a number of factors, clearly delayed opening of the on-trade but you also alluded to changes in regulation and changes in off-trade channels. I wonder could you give me a little more color there about what your thinking is in terms of those topics.

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

<A – Heine Dalsgaard – Carlsberg A/S>: Good morning, Trevor. So with respect to the guidance for the full year and thereby also for second half, it is clear that the guidance is significantly more uncertain than usual. It's really a very volatile world. And of course, that makes us cautious in our outlook. As said, we expect higher marketing spend in the second half than in the first half but except for that, there are no sort of significant other moves behind this in the other cost groups.

<Q – Trevor Stirling – Sanford C. Bernstein Ltd.>: Great. Thank you.

<A – Cees 't Hart – Carlsberg A/S>: Good morning, Trevor. With regard to the other question, yes, we see across the globe different paces, if you like, with regards to the further development of the on-trade. First of all, when we look at the rest of Europe review, the on-trade sector is gradually recovering but it's not expected to get back to pre-COVID-19 levels in 2020. We think that the price/mix will remain under pressure, due to negative channel and country mix.

In Asia, as we said earlier, the Chinese business started Q3 well, but some of our strongholds in Western China were subject or are subject to renewed lockdowns as we speak, so therefore, H2 remains pretty volatile. Eastern Europe, the direct impact of COVID-19 is expected to be small. A key risk there is the macroeconomic development. So in general, it is a bit of a scattered picture. The situation remains fluid and we continually need to adapt to the new realities.

<Q – Trevor Stirling – Sanford C. Bernstein Ltd.>: Thank you very much, Cees.

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

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

<Q – Sanjeet Aujla – Credit Suisse Securities (Europe) Ltd.>: Morning, Cees and Heine. A few questions from me please. Firstly, just picking up again on the on-trade, what are you seeing in terms of volume declines in the on-trade and footfall into July, particularly in Western Europe? That's my first question.

And then secondly, you talk about the possibility of further inorganic opportunities. Can you just clarify on the geographic remit in terms of M&A, would you be interested in further sort of European assets or is Asia really the priority or even think about other regions outside your existing footprint?

And then my third question is, Cees, you talk about looking to hit price points that appeal to the new reality. Should we think about lowering pricing or increase promotional activity? Is that across the board or more focused on Western Europe? If you can just elaborate on those points, please. Thank you.

<A – Cees 't Hart – Carlsberg A/S>: Yes. With regards to the on-trade in Western Europe, we see, to give an hard but also harsh figure, Q2 Western Europe was down by 50%. We see gradually that number improving, but as we said earlier, we are not yet at all towards the level of last year. So, on-trade in Western Europe is recovering, but at a slow pace.

With regards to acquisitions, Heine, over to you.

<A – Heine Dalsgaard – Carlsberg A/S>: Yes. Good morning, Sanjeet. So, inorganic opportunities, we don't comment for good reason specifically as to where it is that we are looking, but we have a strong balance sheet as you've seen, so we are looking for inorganic opportunities. I think it is important to underline the fact that our primary focus is on SAIL'22, which means that our primary focus is on continuing to organically grow the business. Having said that, of course, there could be opportunities coming up and there are, as you've also seen a few opportunities already in first half, so no specific comments as to where.

<A – Cees 't Hart – Carlsberg A/S>: And then with regards to the price points, Sanjeet, there we indeed see or we think there can come a kind of new reality. Also there, it is different per region. In Eastern Europe, there's a different reality because of competitive actions and also because of macroeconomic impact. There, we very much look at indeed some reduced prices and also increase in promotions. And by that, we gained market share.

What we see in Western Europe that we need to focus even more on value management to ensure that we get the right price points. Also there, we need to maybe tweak a bit with the balance of the number and the depths of our promotions, but we don't have a plan to decrease prices. In fact, our premiumization strategy continues especially with alcohol-free beer and craft & specialities. Alcohol-free beer was very much helping us in our mix. We grew by 10% in Western Europe, and that of course was good news in the first half year. So, no plans for price decreases, rather than increased attention to value management.

<Q – Sanjeet Aujla – Credit Suisse Securities (Europe) Ltd.>: And can I just pick up on the M&A point, the Marston's deal that you announced in the period. Should we view Carlsberg as a – using that as a vehicle to consolidate further the UK market?

<A – Cees 't Hart – Carlsberg A/S>: Well, frankly, I think that's a big word. We saw this as a good opportunity to strengthen our portfolio in the UK. We've always said that we are – or have not been satisfied with our position in the UK. And in our view, this is an excellent opportunity to strengthen our reach to the market and also the total portfolio, as we are now strengthening our position in ale. We see the Marston brands as a strong set of brands. But frankly, I think we are not there to consolidate the market. This is an add-on we strengthen our own position.

<Q – Sanjeet Aujla – Credit Suisse Securities (Europe) Ltd.>: Thank you.

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

Operator: Our next question comes from the line of Simon Hales of Citigroup. Please go ahead.

<Q – Simon Hales – Citigroup Global Markets Ltd.>: Yes. Thank you. Good morning, Cees, Heine and Peter. I've got two or three questions, please. I mean, Cees, how you talked in the presentation around the guidance and the outlook, taking account of the July performance. I wonder if you could just give us a little bit more detail as to how you exited the quarter in June. And how the volume and the sale trajectory has trended as we moved through July by, sort of, region.

And then maybe as an addendum to that and specifically on China, clearly some restocking in the quarter built into the very strong volume recovery. How do we think about the underlying run rate in volumes in China in Q2? And what we've seen coming into July?

And then away from that, just on marketing spend, how do we think about this longer-term? I appreciate, obviously, a rebound in spend in the second half. But as we look into, sort of, 2021 and beyond and the commitment to the SAIL'22 objectives, should we expect a rebound in marketing score back to previous levels of marketing as a percentage of sales? Or do you think you've delivered cost, sort of, savings over the last, sort of, six months, which will be permanent? And maybe let that leverage ratio to remain slightly lower than it has been historically.

<A – Cees 't Hart – Carlsberg A/S>: Thank you very much, Simon. Heine, over to you with regards to the guidance.

<A – Heine Dalsgaard – Carlsberg A/S>: Yes. Good morning, Simon. So on sort of June, July. In June, we saw sort of low- to mid-single-digit volume growth in all regions, helped of course by good weather and some on-trade stocking or restocking in Western Europe. And on top of that also a strong Chinese performance, supported by the IPB [international premium brands], growth of the Wusu brand and also our big cities.

The June rate, it cannot be used to predict the coming quarters. I know there is a lot of talk about exit run rates and stuff like that, but it's really a volatile world out there. Given the circumstances as well, we had a reasonable July. However, the uncertainty and also the volatility remain very high. While we saw very good June numbers in Western Europe, July in Western Europe has been impacted by bad weather, in particular, in some northern European markets.

In Asia, as Cees 't said, the situation really is volatile and we have recently seen some lock downs in Western China and also in Central Vietnam, and the sort of hard-hit countries like India and Nepal and Malaysia are only slowly recovering. And then on-trade is improving in most countries, but the speed of recovery is very dependent on the local government initiatives and consequently remains very volatile.

When it comes to the marketing question, given the circumstances, we are very confident that we took the right calls on marketing in first half. As I said, we are increasing the marketing spend for the second half to support the long term growth of our brands. The full year marketing-to-revenue ratio for this year will be lower than 2019. But to your question, yes, it will be higher than where it is in the first half, and it will be a sort of if you look further ahead, it will be back to where we've been over the last few years.

<Q – Simon Hales – Citigroup Global Markets Ltd.>: That's really helpful. Thank you.

Operator: Our next question comes from the line of Pinar Ergun of Morgan Stanley. Please go ahead.

<Q – Pinar Ergun – Morgan Stanley>: Hi. Good morning. I had a quick follow up to Trevor's question on guidance. Could you give us a bit more color on the key assumptions underpinning your guidance? For example, are you factoring in a potential second wave for COVID? And another one on China, with the asset injection, Chongqing will evolve from a regional to a national player. How does this change the way the business is run? And do you see any room for further synergies? Thank you.

<A – Cees 't Hart – Carlsberg A/S>: Thank you, Pinar, and good morning. Heine, over to you.

<A – Heine Dalsgaard – Carlsberg A/S>: Yes. Good morning. Key assumptions behind sort of the full year guidance, just a few highlights. On government lockdowns, we are assuming no change compared to where we are today. And specifically to your questions, we have not included the risk of another spike in infections across all our markets that may result in sort of government interventions and further change in consumer behavior across the globe. So that's the assumption we've put in, basically that it stays the way it is today. Yeah.

Yeah. So in terms of the project in China, you're absolutely right that that we will be combining our assets. We don't see big synergies going forward in terms of cost there. It is a relatively well-run company. Not only relatively, it is a very well-run company both inside and outside Chongqing, so we don't expect any big synergies.

<Q – Pinar Ergun – Morgan Stanley>: Thank you.

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

Operator: Our next question comes from the line of Laurence Whyatt of Barclays. Please go ahead.

<Q – Laurence Whyatt – Barclays Investment Bank>: Morning, gents. Thanks very much for the questions. Three for me if that's okay. In India, we've heard reports that there are some rollbacks in some of the tax increases in that country across a few of the states. I was just wondering, are you seeing any immediate impacts on volumes as a result of those tax rollbacks?

In Eastern Europe, you say you're getting some benefits from the reductions in pricing in Russia. Have you seen any changes in the competitive dynamic since you put these price reductions through in March?

And then finally, I was wondering if you could give us an update on Habeco following the extended discussions on that asset? Thank you very much.

<A – Cees 't Hart – Carlsberg A/S>: Yeah. Good. Thank you. With regards to India, as you were hinting, it's a very uncertain and volatile environment in India. The number of infections have been very high. The country as a whole is struggling socially and economically. The changes by regulators that is by state by state and city by city have happened very often and very fast, making it very difficult for our Indian colleagues to run the business, and they are indeed also impacting our customers badly.

Approximately 68% of the outlets are open. And then very concrete to your question, do we see impact, it's very difficult of course to distinguish where the impact comes – whether the impacts come from higher excise and higher taxes or basically the COVID consequences. But we see a significant drop in our volume in India. First of all, the country was more or less closed at the beginning of Q2, but also the recovery goes relatively slowly. So, we see a huge impact in India of

COVID-19 because of multiple factors including indeed excise taxes but also some states changing the route-to-market and making it more difficult to obtain the right licenses. So, a difficult country to be in at this moment of time.

With regard to Eastern Europe, we don't see changes in the competitive environment. At this moment of time, we have been pretty successful with our one – our plan B, which was started in February. We are happy, again, with the rebalancing of the Golden Triangle that focuses on regaining some of last years' lost market share. We also wanted to make sure that we had a reasonable capacity utilization. So, at a certain moment we draw a line in the sand with regard of the minimum volume we wanted to have.

And as we have now regained market share, we will now rebalance a bit again towards becoming more profitable. And as we think in Golden Triangles, we want to have a balanced Golden Triangle, which means that we prefer to be a profitable number two, opposed to a marginally run company but being a number one. So basically, we are a bit more optimistic about the regaining of share. We now rebalance further the Golden Triangle towards profit.

On Habeco, probably also because of COVID-19, no further progression can be mentioned here.

<Q – Laurence Whyatt – Barclays Investment Bank>: Okay. Thanks very much. And just follow up on the Russia question, you mentioned capacity utilization starting to improve. I thought earlier in the year before COVID, it was around the sort of 45% level. Could you give us an update on capacity utilization in Russia?

<A – Cees 't Hart – Carlsberg A/S>: Yeah, it's now around 50%, 50% plus. We look in two ways, if you like, capacity utilization but also kind of minimum kind of volume in hectoliters to keep the scale not only in the breweries but also towards our customers and therefore, the current growth in Russia satisfies us. But again, there is a continuation of the investment of our competitors in price and therefore, we continue our journey at this moment of time with a slight bias in the Golden Triangle towards improving our margins.

<Q – Laurence Whyatt – Barclays Investment Bank>: Understood. Thank you very much for the detail.

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

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

<Q – Søren Samsøe – SEB Enskilda (Denmark)>: Yes. Good morning, guys. Two questions from my side. First of all, I just think you mentioned your cost was down 12% excluding marketing spend. Maybe you can elaborate a little bit on which of those cost cuts you can bring into 2021? And which one that you cannot and which will probably be back at the 2019 level when we go into next year?

And secondly, also if you can quantify how many SKUs you have cut? And how many you have in total? Thank you.

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

<A – Heine Dalsgaard – Carlsberg A/S>: Yes. Good morning, Søren. On cost, as said, SG&A declined organically by 16% and excluding, as you're saying here, excluding marketing, 12%. It is important to underline that we here benefit from the transparency, which we got from our OCM tool. And as said, we started our cost-cutting already in January, when we saw the virus hit, sort of, China.

The main drivers behind the reductions have been within travel, within marketing, within supply chain, within administration, within employee-related costs, including elements such as layoffs and hiring freeze as well. Regarding then how that looks for 2021, it is really too early to be very specific on 2021. Some of the costs will, of course, come back in 2021, as the virus, hopefully, comes better under control and we get back to, sort of, a more normalized situation.

But we are looking to make as much of the learnings and also the cost reductions as at all possible stick in 2021. And the tool to do that is really OCM discipline and focus on cost and we will do that. But it's too early to give any specific numbers for 2021.

And then on the SKU part, we don't comment on any number on SKUs. We've done that in the past. The way it is right now is that we maintain discipline, also on the number of SKUs, and we are driving that down, but it is a bit more complicated than just the number. So, we don't sort of comment specifically on any SKU number, but we are saying that we are reducing the number of SKUs. We are taking the opportunity to de-complex our supply chain setup, and there SKU reduction is just a key element.

<Q – Søren Samsøe – SEB Enskilda (Denmark)>: Okay. So, we should not expect those SKUs to come back so to say in terms of new SKUs back in 2021. And then, if that's the case, so you do go into 2021 with fewer SKUs. Do you then plan to put more marketing behind the, you can say, few SKUs that you have.

<A – Heine Dalsgaard – Carlsberg A/S>: So, you're right. That this is one of the areas when it comes to SKU reduction that we want to make sure sticks into 2021. So, yes, you are right that this is one of the areas, where we expect the discipline from 2020 to continue into 2021 and onwards in terms of lower SKUs. And then you are right when we then increase our marketing spend versus 2020, we sort of spread the marketing activity across few SKU.

<Q – Søren Samsøe – SEB Enskilda (Denmark)>: Okay. Thanks, guys.

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

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

<Q – Jonas Hansen – Danske Bank>: Yeah. Good morning, all. And thank you for taking my questions. First question on the Brooklyn and the acquired brand rights here. Could you help us get a sense of how big that business is for you today and what you will be able to do with the brand now that you have the rights instead of a license?

Then a question on the margin development in Asia, impressive indeed. But are you able to say what it would have been excluding changes in marketing spend or how much of the improvement that is sustainable going forward?

And then a more specific question following up on Søren on costs. Your admin cost declined relatively significantly in the first half. Is that sustainable? And should we look at the same reductions in H2? Thank you.

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

<A – Heine Dalsgaard – Carlsberg A/S>: Good morning, Jonas. So, the rationale for the Brooklyn deal, we've had a close cooperation with Brooklyn for, as you know, many, many years. We have now acquired the rights to the brand in our markets compared to what we had previously, which was sort of a long-term license agreement. This new agreement brings several advantages for us.

One is that the enhanced relationship with Brooklyn improves our joint management of the brands. Second, the way it's structured now, it does reduce complexity and it does increase our profitability since we don't pay any license fees. And that also means and that been perhaps the last point, we will increase the investment in and also the prioritization of the brand in order to unlock further premium growth potential across the markets. We don't give specific numbers as to how big it is and – but it is – it's something we do, of course, because we believe in the brand, and we believe in reducing complexity and also that increased profitability increases the focus.

<A – Cees 't Hart – Carlsberg A/S>: With regards to the margin in Asia, the margin development, that's very much dependent on or impacted by country, channel and SKU mix. And you can understand that it has been significantly different than in the past, including significantly reduced SG&A and reduced marketing spend. So, yes, it will be a progression but more a progression on the base of 2019 and further. But I don't think that 2020 should be seen as a new platform for margins in Asia. So that will develop from another level, more exit-2019 level than the exit-2020 level.

And then your third question, over to Heine.

<A – Heine Dalsgaard – Carlsberg A/S>: Yes. On admin cost, you're right. We saw a good decline in admin costs in first half. Just highlighting what we've said before, the discipline on OCM goes across everything we have, from sales to distribution to supply chain and of course also to admin costs. And also that it's sort of looking at costs across the entire organization, whether it's in countries, in regions, or in headquarter. We are really taking out costs and making our cost base more flexible across the board.

So, some of the costs reductions that you see in admin this half year will continue into second half, most of it will into the second half, by the way, but also into 2021 and some simply won't because there's a one-off effect. We will start to travel, for instance, more than we have done in first half but we still expect to travel significantly less in 2021 than we did in 2019. So, yes, a part of it will stick, part of it will come back.

<Q – Jonas Hansen – Danske Bank>: Okay. Thank you very much, gents.

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

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

<Q – Richard Withagen – Kepler Cheuvreux SA (Netherlands)>: Yes. Good morning, all. Thanks for the questions. I have two, please. First of all, on digital, I think COVID-19 has made the need for a good digital infrastructure player. So, you've also indicated in the past to step up your investments and you mentioned e-commerce in your prepared remarks today. So, what have been the main learnings for the recent months? And in which functionality do you need to prioritize investments? That's the first question.

And the second question, yeah, coming back on the Marston deal, can you, perhaps, share your view on the medium-term prospects for the on-trade in the UK, please?

<A – Cees 't Hart – Carlsberg A/S>: Good morning, Richard. Thanks for your questions. First of all, with regard to the digital, we indeed saw a lot of changes in that area, but it's still small. Let me start with China. China is probably the most well-developed e-commerce market. And here, approximately 1% of our volumes go through e-commerce. It is both indirect B2B, but also B2B2C. And we saw in that channel more than 100% growth in H1.

In Western Europe, we have direct B2B via the Carl's Shop. We rolled that out in six Western European markets and one in Asia. And 40% of our on-trade orders go now through Carl's Shop. Obviously, we see huge changes at this moment of time and we'll need to cater for that in the future. We saw, for example, in Italy, Esselunga moving in a couple weeks towards home delivery, which previously they either did not do or on a very low scale. So, COVID have changed if you like conservative markets relatively quickly. And the first and foremost, we look at, to your question, is the e-retail that we are really on top of that. And further that in China, we continue with our successful story at this moment of time. And the third thing is to further develop Carl's Shop. Heine to the second question.

<A – Heine Dalsgaard – Carlsberg A/S>: Yes. Good morning, Richard. So, on the Marston's question and our view on on-trade, we don't comment specifically on sort of forward-looking views on on-trade, but it is clear that this deal will, as Cees also said before, this deal will strengthen our UK business considerably for several reasons. One is significantly improved and also, as said before, very complementary brand portfolios, which will make the JV a more appealing supplier both for on-trade, to your question, but also to off-trade customers.

Secondly, there are some very good cross-selling opportunities. So, Carlsberg brands to Marston's customers utilizing Marston's strong distribution network to 11,000 customers and then Marston's brands to Carlsberg's customers. So, a lot of different good opportunities, and we definitely see Marston's as a very good JV partner to us. Marston's know how to run pubs. They've done that for many years. We know how to run a brewing business. We've done that for many years.

<Q – Richard Withagen – Kepler Cheuvreux SA (Netherlands)>: All right. Thanks. Cees, maybe I'd come back a bit on the digital. Do you think the IT infrastructure at Carlsberg is up to the job to a more digital future or do you think you need to make big investments over the next couple of years?

<A – Cees 't Hart – Carlsberg A/S>: It's always a leading question in terms of are we – at this moment of time, we don't have any big issues in this respect. We think that we have the right technology in-house. We are learning as we go, so there might be some more investments to come. But we don't think that that will lead to investments which are out of balance on the kind of investments we do in IT infrastructure at this moment of time. So, maybe too early to say but we don't expect big changes here.

<Q – Richard Withagen – Kepler Cheuvreux SA (Netherlands)>: All right. Very clear. Thanks.

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

Operator: Our next question comes from the line of Olivier Nicolai of Goldman Sachs. Please go ahead.

<Q – Olivier Nicolai – Goldman Sachs International>: Hi. Good morning Cees, Heine, Peter. Just a three quick question, please. Cees, you mentioned a smaller on-trade channel going forward, obviously for the rest of the year I understand. But just going forward beyond 2020, what are your assumptions at Carlsberg and how the on-trade is going to evolve in Asia and in Western Europe?

Second question is just to quantify something on your share gain in Russia. Are you able to quantify where you are in terms of market share and how are you planning to sustain this position? And just lastly if I may, just a quick follow-up on this inorganic opportunities that you mentioned in the press release, as a reason to postpone the share buyback for H2. Does your definition of inorganic opportunities includes potentially buying back some of your associates? Thank you.

<A – Cees 't Hart – Carlsberg A/S>: Very good. Thank you very much and good morning, Olivier. With regard to the on-trade, I guess, it's more, kind of, a global question, when will the virus be under control. So, we think that the 31st of December, nothing will have changed at the moment, that there's no vaccine against C-19. So, yes, we plan for 2021 for an on-trade, which is smaller. And we have different scenarios for that in different countries and on the basis of that, we adapt our plans for the future. We very much focus on that, of course, in Western Europe. We are gradually recovering, but not yet at all, at the level of pre-COVID. And we think that that will take during 2021 to come back. And, obviously, that is very different at the moment, that there is a vaccine. But if not, we think, again, it will be below 2019 levels.

Asia might be a bit different in that. It is, maybe, a bit more on the, kind of, V-shape. Either there's a lockdown and there's nobody or, and I'm talking more about then, for example, China or everything is open and then only, if you like, the night entertainment is impacted. It's very different because on-trade is more in the general market structure in Nepal and India. But very specific to on-trade, we have different scenarios for different regions, because of customer behavior is very different. But coming back to the initial or the key question, do we see this continuing in 2021, well, as our mantra is more or less, we hope for the best but we plan for the worst, in that respect.

Then back to Russia. Russia has a market share of 28.5%, at the latest reading. That is the highest in 18 months. Also is a kind of reasonable Golden Triangle. So, yes, we have invested in it and we've lost some margins, but it's all relatively in balance. And as I said earlier, we'd rather be a profitable number two than a marginal number one. And therefore, we might reduce a bit our focus on promotions going forward to rebalance the Golden Triangle. But obviously, we don't want, I'd say around 28%, 29% market share is something we would like to remain.

With regard to inorganic options and opportunities, Heine.

<A – Heine Dalsgaard – Carlsberg A/S>: Yeah. So, hi and good morning. So, whether the inorganic opportunities include buying back minorities, it's a very good question and a very good reflection, and it definitely does. We've done that over the last few years and to the extent possible, we will continue to do that. So the short answer is, yes, it does include that.

<Q – Olivier Nicolai – Goldman Sachs International>: Sorry, I meant associate, not minorities?

<A – Heine Dalsgaard – Carlsberg A/S>: Yeah, but it's the same.

<Q – Olivier Nicolai – Goldman Sachs International>: Okay. Perfect. Very clear. Thank you.

<A – Cees 't Hart – Carlsberg A/S>: With that, could I have the last question please?

Operator: Thank you. In that case our last question comes from the line of Alyssa Gammoudy of ING. Please go ahead.

<Q – Alyssa Gammoudy – ING Bank NV>: Thank you very much. Good morning, gentlemen. With regards to the change in the regional structure, can you give some color on how that will change the exposure to the on-trade channel? Because if I heard it correctly, Eastern Europe is now more or less 5%, how will that change in the new situation? Can you give an update on to what extent your credit facilities are drawn or undrawn? And if I may, the third question, can you give an update on the hard seltzer trials that you planned to launch this year?

<A – Cees 't Hart – Carlsberg A/S>: Good. Thank you very much. With regards to the regional change, frankly, there is consideration with regard to trade channels there. It is just because of the fact that we have 9 or 10 very big countries in, let's say, Western Europe, and we have also currently in Western Europe a number of relatively small countries. We thought we would balance this better in terms of attention and focus to bring them together with Eastern Europe by that also the balance in net revenue and EBIT will be a bit more equal across the three regions. So, there's nothing, if you like, in terms of trade channels that triggered this change.

With regard to the credit facilities, Heine, over to you.

<A – Heine Dalsgaard – Carlsberg A/S>: Yes and good morning. Credit facilities, it is again a very relevant question. That's something that we have had a lot of focus on during COVID-19 and particularly, of course, in the beginning of it to make absolutely sure to the extent that it's possible these days, to do whatever we can to ensure that we have sufficient credit facilities available. And that's also the reason why we took as you know, two bonds, two 500 million Eurobonds in the market in March and in June. That is exactly to secure credit facilities. We have sufficient credit facilities available end of June. The committed credit facilities amount to DKK 47 billion in total.

<A – Cees 't Hart – Carlsberg A/S>: And then, Alyssa, with regards to your question on hard seltzers, indeed we have done some consumer testing in a number of markets and have a good understanding of the main drivers and liquid composition and the content. And the research results have highlighted some potential for the category, but there are also a number of challenges.

One of the test markets we used was Norway, and we launched the Garage hard seltzer. It is still a very small category in Norway. It is 5% of the RTDs. The first signs in Norway are, however, encouraging. We have after a few months of strong market share in that segment of 30%, but is a small segment as we said earlier. And we are tracking better than expected against the 12 months plan. However, it's still early days and we are evaluating the progress and potential launches in other markets. But, in general, we are positive of the opportunity. I hope that answered your question, Alyssa.

<Q – Alyssa Gammoudy – ING Bank NV>: Yeah. Definitely. But going back to the – sorry, yeah?

<A – Cees 't Hart – Carlsberg A/S>: Yeah. I was trying to close the call. But go ahead, Alyssa.

<Q – Alyssa Gammoudy – ING Bank NV>: No. Just – sorry, just one more little follow-up question on the regional change because I wasn't necessarily implying it's changed because of the channel exposure on-trade, off-trade, but because Eastern Europe is now more or less 5%. Will it still be around that 5% including – in the new situation with the new countries including in Central Eastern Europe? Or is it difficult to answer right now?

<A – Heine Dalsgaard – Carlsberg A/S>: I don't know what you refer to in terms of 5% because the – in terms of total portfolio of – sorry. Eastern Europe is – well, Russia, on its own, is 8% of our net revenue. So it will be higher. I think it will be – the total region will be slightly around – well, around 20% in the new situation, if that's what you refer to. And otherwise, you can of course pick up that with Peter. He will give you the answer on your question.

<Q – Alyssa Gammoudy – ING Bank NV>: Sure. Thank you very much.

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

Thank you, Alyssa. With that, I would like to close the call for today. Thank you for listening in and thank you for your questions. We are look forward to being in touch with you in the coming days and weeks. For now, have a nice day. Bye-bye.

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