FitchRatings

RATING ACTION COMMENTARY

Fitch Places Carlsberg on Rating Watch Negative on Britvic Acquisition Announcement

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Fitch Ratings - Madrid - 10 Jul 2024: Fitch Ratings has placed Carlsberg Breweries A/S's 'BBB+' Long-Term Issuer Default Rating (IDR) and senior unsecured rating on Rating Watch Negative (RWN) following the announcement of its acquisition of Britvic plc.

The RWN reflects the potential negative impact on Carlsberg's financial profile from the recently-announced fully debt funded acquisition of UK soft drinks producer, Britvic, for GBP3.3 billion. The transaction will improve the company's business profile with stronger product diversification and strengthened brands portfolio. However, we estimate it will lead to the group's EBITDA net leverage increasing toward 3.5x in 2025, with only gradual deleveraging toward 2.9x by 2027, which is likely to result in a one-notch downgrade. Deleveraging will be subject to Carlsberg's financial policy execution, including with regards to shareholders distributions, as well as profit and synergies generated by the new asset.

We expect to resolve the RWN following the completion of the transaction, which remains subject to Britvic's shareholders and regulatory approvals.

Carlsberg's rating reflects its stable and resilient trading performance as the third-largest international beer company by volume, with a strong market presence in Europe and Asia. We expect it will show resilient revenue growth in 2024-2027, supported by its premiumisation strategy and expansion in Asia.

KEY RATING DRIVERS

Significant Releveraging Post-Acquisition: We estimate that a fully debt-funded Britvic acquisition with additional DKK31.6 billion debt plus the remaining 40% JV stake in Marston's plc for around DKK2 billion would result in EBITDA net leverage increasing toward 3.5x (2023:1.8x), above our negative leverage sensitivity of 2.5x. We expect leverage to decrease to below 3.0x only from 2027, assuming the company maintains its dividend policy but refrains from share buybacks until reaching its updated target leverage of 2.5x net debt to EBITDA. The acquisition will add around DKK2.6 billion to Carlsberg's EBITDA in 2025 and should generate operational synergies of DKK880 million.

The acquisition will follow a leverage increase in 2024 that we estimate at 2.2x following Carlsberg's purchase of the 33% remaining stake in Indian and Nepalese brewer CSAPL for DKK5 billion.

Enhanced Business Profile: In Fitch's view, the acquisition will strengthen Carlsberg's position in the soft drinks segment, which will represent 30% of total sales volumes upon completion (16% in 2023). We also expect the group's brand portfolio to benefit from increasing sales of PepsiCo's and Britvic's strong local brands. The transaction is likely to improve Carlsberg's competitive position and operating efficiency in the important UK market. We assume limited integration risks, as Carlsberg is already operating in soft drinks segment in some markets in Northern Europe.

Pro forma for the transaction, Fitch estimates combined revenues and EBITDA will grow to DKK97.8 billion and DKK19.5 billion respectively for 2025, versus around DKK80 billion and DKK17 billion, for standalone Carlsberg.

Temporary Pressure on Profitability: We expect the acquisition will put moderate temporary pressure on the group EBITDA margin (2023: 19.9%) of up to 40bp due to Britvic's lower profitability. We expect the EBITDA margin to gradually return towards 21% by 2027 due to sales mix growth and post-acquisition synergies. From the existing businesses, we expect EBITDA margin improvement from ongoing cost-rationalisation initiatives and stronger demand in the more profitable on-trade channel and non-alcohol drinks. This will likely offset continued inflationary pressure and increased marketing spending, while we assume a moderation in price increases.

Modest FCF: We project free cash flow (FCF) will decline to below 2% of sales per year post acquisition compared with an historical FCF margin of 4% to 6%. This will be a result of higher interest expenses linked to acquisition-driven additional debt. Carlsberg's working capital continues to benefit from long average payment terms, which imply a length of 200 days when calculated in terms of the ratio between trade payables and cost of goods sold. We assess the length of total payments at above industry average. If these reduce, it could have a substantial adverse impact on working capital.

Deviation on Financial Policy: The acquisition deviates from the company's previous conservative policy. Carlsberg has also revised its capital structure target toward 2.5x of net debt/EBITDA from 2.0x previously (management-calculated). The new leverage target might not align with the current 'BBB+' rating, despite an enhanced business profile. The group has confirmed its commitment to maintaining an investment-grade rating and to deleveraging. It is suspending its share-buyback programme until the updated leverage target is achieved and we do not rule out some divestments to support it.

Focus on Improving Beer Volumes: Fitch expects Carlsberg's organic beer revenue growth to be driven by its strategic focus on premiumisation and expansion in the "beyond the beer" category (including alcohol-free beers) while also supporting mainstream products, which still represent the core of the business. Carlsberg also plans to continue expanding in Asia, particularly in China, Vietnam and India, which should support its mid-term revenue growth. We expect this should generate low-to-mid organic revenue growth, becoming more balanced in terms of price and sales volumes contribution.

Third-Largest International Brewer: Carlsberg's ratings reflect its market position and scale as the third-largest international brewing company globally by volume, with operations in Europe and Asia. Efforts to improve geographical diversification have allowed it to withstand the permanent exit from Russia and loss of licenses that were also commercialised in other countries without a material impact on its credit profile.

DERIVATION SUMMARY

Carlsberg is smaller and less geographically diversified than Anheuser Busch InBev NV/SA and Heineken NV. Its scale, including EBITDA and profitability, is comparable with that of Molson Coors Beverage Company.

Carlsberg is rated on par with Pernod Ricard S.A. (BBB+/Stable) and one notch above Becle, S.A.B. de C.V. (BBB/Stable). Carlsberg has more limited geographic and product diversification and a lower EBITDA margin (around 20%) than Pernod (30%), but these factors are counterbalanced by Carlsberg's lower leverage (historically below 2.0x compared with 3.5x). The two companies generate comparable annual FCF in the range of EUR500 million to EUR700 million.

We view the business profile of Becle (the world's largest tequila producer, complemented by a smaller portfolio of spirits in the whiskey, rum, vodka and mixers category) as weaker than Pernod's and Carlsberg's due to more limited geographic and product diversification. Its profitability, with an EBITDA margin of 15% in the financial year to end-June 2023, is lower than Carlsberg's.

No Country Ceiling, Parent-Subsidiary Linkage criteria or operating environment aspects were applied to these ratings.

KEY ASSUMPTIONS

Our Key Assumptions Within our Rating Case for the Issuer

- Acquisition of Britvic for DKK29 billion plus around DKK6 billion of its debt

- Acquisition of 40% of Marston's for around DKK2 billion

- Acquisition of the remaining stake of CSAPL for DKK5 billion

- Low-to-mid-single digit revenue growth in 2024-27

- EBITDA margin at around 19.5% in 2024, improving towards 21% by 2027 driven by synergies of around DKK800m and premiumisation of product portfolio

- Capex at 7-7.5% of sales a year over 2024-2027

- Dividend pay-out remaining at 50% of net income and annual dividend disbursements growing over the rating horizon toward DKK4 billion

- Annual share-buyback disbursements close to DKK2 billion in 2024, suspended from 2025

RATING SENSITIVITIES

Fitch expects to resolve the RWN upon acquisition close which is anticipated to take place in 1Q25. Consequently, resolution of the RWN could exceed six months. The proposed transaction not going ahead would lead Fitch to affirm the rating with a Stable Outlook.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

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

- EBITDA margin above 25% and FCF margin sustained above 5%

- Financial policy pursuing EBITDA net leverage below 1.5x on a sustained basis

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

- A final capital structure and a financial policy that are not commensurate with a 'BBB+' rating for the new operating profile could most likely result in a one-notch downgrade

- Weakening market position in key markets or much stronger remuneration of shareholders coupled with an increased M&A appetite, causing EBITDA net leverage to increase above 2.5x on a sustained basis

- Erosion of the FCF margin to below 3% on a sustained basis

- Shift in financial policy towards higher net debt/EBITDA from the previous target of below 2.0x

LIQUIDITY AND DEBT STRUCTURE

Strong Liquidity: Carlsberg's liquidity was strong at end-2023 with DKK13.4 billion cash on balance, as well as access to undrawn committed long-term credit lines of DKK14.9 billion (including a EUR2 billion revolving credit facility maturing in 2026). Although around 60% of debt matures in 2024-2027, maturities are well spread within this period, and we do not forecast any difficulties for Carlsberg in refinancing debt at maturity or repaying it from existing cash flow.

In September 2023, the company issued new EUR700 and EUR600 million bonds maturing in 2028 and 2033, respectively.

ISSUER PROFILE

Carlsberg is the third-largest international beer company globally with operations in Europe and Asia.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

RATING ACTIONS

ENTITY / DEBT	RATING		PRIOR
Carlsberg Breweries A/S	LT IDR	BBB+ Rating Watch Negative Rating Watch On	BBB+ Rating Outlook Stable
	ST IDR	F1 Rating Watch Negative Rating Watch On	F1
senior unsecured	LT	BBB+ Rating Watch Negative Rating Watch On	BBB+

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Corporates Recovery Ratings and Instrument Ratings Criteria - Effective from 13 October 2023 to 2 August 2024 (pub. 13 Oct 2023) (including rating assumption sensitivity)

Corporate Rating Criteria (pub. 03 Nov 2023) (including rating assumption sensitivity)

Sector Navigators – Addendum to the Corporate Rating Criteria (pub. 21 Jun 2024)

APPLICABLE MODELS

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

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1)

ADDITIONAL DISCLOSURES

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Carlsberg Breweries A/S	EU Issued, UK Endorsed

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