Carlsberg A/S
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FY 2019 Financial Statement Conference Call
Speakers:
Cees 't Hart, CEO
Heine Dalsgaard, CFO

PARTICIPANTS

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Søren Samsøe – Analyst, SEB Enskilda (Denmark)
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MANAGEMENT DISCUSSION SECTION

Operator: Hello, and welcome to the Carlsberg Full Year 2019 Financial Statement. So today, I'm pleased to present CEO, Cees 't Hart, and CFO, Heine Dalsgaard. And for the first part of this, all participants will be in listen-only mode. And afterwards, there will be a question-and-answer session. Just to remind you, this is being recorded, and a transcript of this will be made available online.

Please begin, gentlemen.

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

Good morning, everybody, and welcome to Carlsberg's full year 2019 conference call. My name is Cees 't Hart, and I have with me CFO, Heine Dalsgaard, and Vice President of Investor Relations, Peter Kondrup.

Let me first briefly summarize the key headlines for the year. We delivered strong financial results with healthy top line growth and strong profit and margin improvement. We see good growth coming from our SAIL'22 priorities. We are again increasing cash returns to shareholders, and we are well-prepared for 2020. I will go through some strategic highlights and the regions, and Heine will take you through the financials and 2020 outlook.

Please turn to slide 3, right after the disclaimer, and let us start by taking a look at the financial, strategic, and organizational health of our company. Financially, it continued the positive trajectory and delivered a strong set of results for 2019 with solid top line growth and an organic operating profit growth of 10.5%. We had another good year of operating margin progression, a healthy ROIC improvement, and a strong free cash flow.

Our Golden Triangle remains a very important performance tool. We are satisfied. It is overall balanced for the year, although we are not satisfied with the volume development in Eastern Europe. During the past 12 months, we have returned a significant cash amounts to shareholders with a combined value of dividends and share buyback amounting to DKK 7.2 billion. On the back of the strong 2019 results and confidence in the future progress of the group, the board has decided to launch a new 12-month share buyback program of DKK 5 billion. In addition, the board will, at the AGM, propose a 17% increase in dividends.

Strategically, we saw good progress on our priorities with strong growth in our Asian region, as well as for craft & speciality and alcohol-free brews. Also for our core beer business, we saw good momentum in many markets. Looking at our sustainability agenda, we made progress on our priorities, which include ambitious targets for CO2 and water.

Generally, we view the long-term strategic health of the business as good. We have a balanced portfolio of markets and a product portfolio consisting of strong local and international brands, craft & speciality, and alcohol-free brews, the combination of which we believe offer appealing growth opportunities.

Looking at the organizational health of the business, we are pleased to see that our winning culture has taken solid root in our business. Important evidence of this was provided by the employee survey conducted in 2019, which showed even higher employee engagement and satisfaction. The survey also revealed a high level of commitment to our team-based performance culture. In addition, we experienced a significant improvement in the quality and capability of our leaders that benchmarked against external candidates, resulting in a high-level internal recruitment for vacant management positions at all levels.

Slide 4 please, and a few comments on the progress of some of our important strategic priorities. Our core beer brands delivered solid revenue and profit growth of 3%, while volumes declined slightly by 1% due to tough comparables in Western Europe and difficult market conditions in Eastern Europe. Tuborg continued to grow, particularly driven by Asia and Southeast Europe, partly offset by decline in Russia.

Carlsberg volumes grew in markets such as Russia, Malaysia, Singapore and Vietnam, but this was offset by the decline in the UK and India. Excluding the UK, volumes for Carlsberg were flat.

Our craft & speciality portfolio grew by 16% with strong growth seen in all three regions. The key growth markets were France, Russia, Ukraine and China. Our two international craft & speciality brands, 1664 Blanc and Grimbergen, grew by 29% and 3% respectively. Our cider brand, Somersby, is the leading international cider brand with a global presence in more than 60 countries. Somersby volumes grew by 14% with particular strong growth in Ukraine, Poland and Australia.

Alcohol-free brews grew by 7% with 10% growth in our Western European markets. In Eastern Europe, the growth of 3% was impacted by tough comparables and the challenging competitive situation in Russia.

The very strong progress in Asia continued with good volume growth also for our international premium brands. I will return to Asia in a moment.

We also made progress on the digital transformation of our business with examples including testing machine learning for demand forecasting, the digital development of DraughtMaster and developing various apps to enhance the business of our on-trade customers. We continued the rollout of our B2B platform, Carl's Shop, and the number of customers on the platform more than doubled and even more importantly, revenue tripled.

Slide 5 please, and a few words on sustainability. As part of our sustainability program Together Towards ZERO, we have set clear targets for CO2, water, health and safety and responsible drinking, and in 2019, we made progress on all of these. We are particularly pleased to report that we reduced carbon emissions at our breweries by 13%. Comparing to our base year of 2015, we have delivered a consistent improvement and the total reduction is now 30%. We now have five carbon neutral sites in Western Europe. We reduced our water usage by 3% to 3 hectoliter water per hectoliter beer in 2019 taking us to a total reduction of 12% compared with 2015.

In order to achieve our goal of 1.7 hectoliter water per hectoliter beer in 2030, we need to move faster than our current speed. We are therefore investing in the latest technology to transform how we work with water, and in 2019, we announced the investment in a pilot waste water treatment plant at the Fredericia brewery in Denmark that will make it the first brewery to literally eliminate water waste, moving to the usage of 1.4 hectoliter water per production of 1.4 hectoliter beer. We will apply the learnings we get here across our brewery network to speed up the improvement of our water performance.

We are working hard to achieve a ZERO accidents culture. Despite the 15% reduction in lost time accidents in 2019, and the 44% versus our 2015 baseline, we still recorded a lost-time accident rate of 3.7. We will continue to work with our employees and contractors to ensure compliance with health and safety rules and regulations.

On responsible drinking, we were pleased to be able to offer alcohol-free brews on DraughtMaster for the first time in 2019. This will be an important lever for growing sales of alcohol-free brews in the on-trade.

Slide 6 please and some comments on the regions. Starting in Western Europe where our main focus is on driving value and margin. On the back of tough volume comparables from the warm 2018 summer, revenue growth was driven by premiumization and value management. We achieved good growth for craft & speciality and alcohol-free brews, growing by 12% and 10% respectively.

We saw value growth across the region, this price/mix developing very favorably in all markets, but Finland and Norway. Most markets saw good organic operating profit growth. In addition to price/mix, the growth was driven by our Funding the Journey culture, which continues to enforce strict focus on costs and efficiencies.

Organic operating profit grew by 12.8% and 14% in reported terms, which was in line with our expectations. The higher reported growth was due to the increased ownership in Super Bock. Operating margin improved strongly by 200 basis points to 17%. Our focus on delivering a consistent margin improvement will continue. This will be driven by premiumization, focus on operating expenses, and efficiencies in supply chain.

Slide 7, and a few country-specific improvements. In spite of the very warm summer last year, the Nordics delivered 1% organic total volume growth. We saw strong performance in Denmark, good development for CSD businesses, craft & speciality, and alcohol-free brews. In Finland, we had a big customer contract for the summer, which we didn't have in 2018. Our Swiss business delivered a solid set of results. Our portfolio of craft & speciality and alcohol-free brews all performed very well while total volumes declined slightly due to the loss of certain third-party brands and tough comparables.

In a slightly growing French market, we saw growth for our premium brands while total volumes were impacted by lower volumes of the mainstream Kronenbourg brand and a lower level of promos due to the bottle shortage issues. Price/mix continued to improve, driven by favorable brand mix.

In Poland, we achieved mid-single-digit price/mix, mainly driven by favorable mix, including strong growth of Somersby for which the new flavor variants have gained very good traction. Our volumes declined slightly in line with the market.

In the UK, our market share is stabilizing following the relaunch of Carlsberg Pilsner in April. Volumes were down high-single-digit percentage due to tough comparables, price increases on Carlsberg Pilsner, and market share loss of Carlsberg Export. Our profitability in the UK improved significantly.

Slide 8 and Asia. The Asia region had a good year. The main driver was China where we delivered very strong results. Revenue grew organically by 12.3%. This was the result of 6% organic volume growth and 6% price/mix. Reported revenue growth of 18.6% was higher due to a positive currency impact and the acquisition of Cambrew in 2018. Organic operating profit growth was very strong at 23.4%. In addition to the strong top line, operating profit benefited from continued strong cost control. Reported operating profit growth was 24.3% as the positive currency impact more than offset the loss in Cambrew.

The operating margin improved by 90 basis points to 21.3%. As expected, H2 was weaker than H1 despite the positive impact from the reversal of a pension provision in Chongqing. There were several reasons for this, including higher marketing investments made in China, regulatory changes in a few Indian states, market decline in Nepal and the rebuilding of the Cambrew business.

Slide 9 and a few market specific comments on Asia. Our Chinese business delivered strong results. In a slightly declining market, organic volume growth was 8% and organic revenue growth 19%. The volume development was due to several factors. Firstly, we saw growth for our premium portfolio. Tuborg grew by 7% and 1664 Blanc by almost 50%. Secondly, our big city expansion showed good progress and thirdly, a few of our local power brands such as Wusu and Dali achieved strong growth. Price/mix of 10% of the result of premiumization, price increases and lower VAT.

Our Indian volumes grew by 1%. The year started very well but our business deteriorated during the year. The weakness in H2 and especially Q4, was driven by several factors including changed excise duties and regulation in a few states. Supported by price increases and lower rebates, revenue growth was in the high-single digits.

Our business in Nepal had a challenging year due to a weakening consumer sentiment, which led to a high single-digit beer market decline and an import ban on energy drinks, which negatively impacted our local Red Bull business. During the year, we had ongoing discussions with our partner in India and Nepal related to a possible dissolution of the partnership.

In Laos, we achieved solid volume growth for all categories, beer, water and soft drinks. Price/mix strengthened due to the positive mix within the beer category which more than offset the negative category mix coming from the growth of water and soft drinks.

In Vietnam, we achieved double-digit volume growth. Our local power brand, Huda, and the line extensions, Huda Ice Blast, were key drivers. Price/mix improved due to price increases and positive brand mix from higher sales of Carlsberg.

Cambodia has been a disappointment. Several initiatives have worked well such as the strengthening of processes and compliance, building capabilities and strengthening routes to market. However, the relaunch of the Angkor brand in the second half of the year, which came as a new campaign and changed promotional structure, didn't work well. Particularly the promotional structure was unsuccessful, leading to around 25% volume decline in Q4 and it is therefore being changed as we speak.

Our business in Malaysia and Singapore continued to deliver solid performance with good results for our premium offerings such as 1664 Blanc and Somersby.

Slide 10, Eastern Europe, where our Russian business had a challenging year because of changes in the competitive environment and the retail landscape. Revenue declined organically by 0.4% with a solid 5% price/mix being offset by the volume decline. The price/mix improvement was driven by price increases in all markets and growth of premium, craft & speciality and alcohol-free brews. Due to lower profits in Russia, operating profit declined organically by 17.9% and operating margin to 17%. All markets except Russia delivered solid operating profit growth. In Russia, profits were impacted by lower volumes, particularly in H2, input cost inflation and higher marketing costs.

Slide 11 please. The Russian market grew again in 2019, however, the competitive environment was very challenging throughout the year. We increased prices and had lower presence in lower price offerings in certain key accounts and consequently, lost market share. Our volumes declined by 8% while price/mix was 3% due to price increases, mix improvements and solid growth of craft & speciality. We are making significant changes to the Russian business in order to reverse the volume trend and a range of different initiatives are implemented. However, catering for the new competitive situation and catering for the current situation will take some time.

Our Ukrainian business delivered high-single digit organic revenue growth driven by double-digit price/mix. The strong price/mix was due to both price increases and positive brand mix with strong growth for brands such as 1664 Blanc and Somersby. Our business in Belarus delivered solid performance improving revenue, earnings and market shares. Our business in Kazakhstan did particularly well. The market was growing and we grew well ahead of the market, driven by growth in all segments resulting in good growth of revenue and earnings. Over to Heine now.

Heine Dalsgaard, Chief Financial Officer, Carlsberg A/S

Thank you, Cees and good morning everyone. Please turn to slide 12. Revenue grew in reported and organic terms. The organic growth was driven by the price/mix of 3%, which was the result of both premiumization and value management. The reported growth of 5.4% was due to the acquisition effect from Cambrew and currencies.

Gross margin declined by 50 basis points due to higher input costs, declining volumes in Russia due to the challenging competitive environment and the consolidation of Cambrew. Gross profit per hectoliter grew by 3% as the positive price/mix more than compensated for the 3% COGS per hectoliter increase.

We maintained our consistent focus on tight cost disciplined and operating expenses declined organically by 1%. We continued to increase marketing investments to support top line growth and marketing expenses grew organically by around 1% or 8.5% of revenue. Excluding marketing expenses, operating expenses therefore declined by 2%.

Organic operating profit growth was 10.5%. In reported terms, growth was 12.2% mainly impacted by net positive currency effect in Asia and Eastern Europe. The positive margin in trajectory that we experienced in recent years continued and our operating profit margin improved by 100 basis points to 15.9%.

Slide 13 please and a few comments on the items below EBIT. Net special items were impacted by the gain of the sales of the former brewery sites in Norway and Germany, partly offset by one-off restructuring cost in Western Europe and Eastern Europe and provisions related to the disposal of real estate.

We already announced the disposal of the Norwegian site in the first half, and in the second half we relocated our Hamburg brewery which meant that income from the disposal in 2016 was recognized in the P&L. In total, the two sites resulted in a gain of around DKK 1 billion.

Net financials were minus DKK 738 million. Excluding currency gains and losses, net financials amounted to minus DKK 650 million, a reduction of DKK 108 million compared to 2018 mainly due to lower average funding costs following the refinancing of our revolving credit facility and our bond refinancing. The tax rate for the year was 26.9%. This was 110 basis points lower than in 2018. We continue to work with tax in a prudent and fully compliant way and we see opportunities for further improvement.

Non-controlling interests primarily relate to our businesses in Malaysia, Chongqing and Laos and amounted to DKK 908 million. This was DKK 84 million higher than in 2018 reflecting growth in the business, but also the reversal of a pension liability in Chongqing. Excluding this one-off, non-controlling interests would have been around DKK 840 million.

Net profit was DKK 6.6 billion. The significant improvement of 24% versus 2018 was due to the operating profit growth, lower financials and tax rate as well as the gain on the sales of the brewery sites in Norway and Germany. We continued the consistent EPS growth, delivering a 16.5% increase in adjusted EPS to DKK 41.

And some comments on the cash flow on slide 14, please. Maintaining a strict cash discipline has been and will remain a key priority for us. For 2019, we had yet another good year when it comes to cash generation and reported a strong free cash flow of DKK 10 billion. A key driver was 12% EBITDA growth to DKK 15 billion. In addition, trade working capital improved again in 2019, although the improvement was less than in 2018. As a percent of revenue, trade working capital reduced further to minus 16.8% from minus 16% in 2018. The improvement was mainly driven by the Asia region. Other working capital of DKK 634 million was impacted by provisions, VAT, and other accruals.

CapEx was DKK 4.6 billion or 7% of revenue. As expected, CapEx in Asia increased significantly in support of our continued growth. The cash flow from disposals of DKK 1.8 billion related to the sale of the former of brewer sites in Trondheim and Hamburg. The reason why the sale of the Hamburg site, which happened in 2016, is recognized as a disposal in 2019 is that the transfer to the buyer did not take place until November 2019. This is in line with our previous communication.

Slide 15 and net debt, please. We maintained a very strong balance sheet in 2019, ending the year with a net interest-bearing debt to EBITDA of 1.25 times, slightly down compared to 1.29 times in 2018. The development in net interest-bearing debt is shown on this slide. As you can see, the strong cash flow was offset by the recognition of lease assets according to IFRS 16, the acquisition of the remaining 25% of Cambrew and the 1.2% of Carlsberg Ukraine of a total of DKK 1.7 billion, the share buyback during the year of DKK 4.1 billion, dividends to Carlsberg's shareholders of DKK 2.7 billion and dividends to non-controlling interest of DKK 850 million. Investing activities – or net CapEx – of DKK 2.2 billion was positively impacted by the sales of the former brewery sites in Norway and Germany. At the end of 2019, net interest-bearing debt therefore increased to DKK 18.8 billion.

Slide 16, please, and a few comments on our cash return to shareholders. As already said, the Supervisory Board will propose to the AGM a 17% increase in dividends to DKK 21 per share due to the consistent strong financial performance of the group and in line with our dividend policy of an adjusted payout ratio of around 50%. The DKK 4.5 billion share buyback program launched in February last year was successfully concluded on January 30. In total, we bought back 4.9 million shares with a daily volume representing an average of around 8% of daily trade volumes on Nasdaq Copenhagen. The Supervisory Board will propose to the AGM on March 16 the cancellation of 4.4 million shares.

As we continue to see a very healthy state of our business in terms of earnings growth, margin improvement, returns and low leverage, the Supervisory Board has decided to initiate a new share buyback program of DKK 5 billion starting today. As last year's program, this year's program will be split into two tranches of six months each in order to maintain financial flexibility. Each trance has a value of DKK 2.5 billion.

The Carlsberg Foundation will continue to participate pro rata in the share buyback corresponding to their economic interest. Further details are described in the announcement on page 19 and 20. This means that on the back of the 2019 result, the group will return in total more than DKK 8 billion to shareholders in the coming 12 months.

And now please turn to slide 17, and the outlook for the year. For 2020, we will continue to drive organic revenue and operating profit growth by executing our SAIL'22 priorities, including craft & speciality and alcohol-free brews, in addition to our Funding the Journey culture with its strict cost control and cash discipline. Based on this, we expect mid-single-digit percentage organic growth in operating profit. As previously communicated, we are facing some challenges in 2020 like the difficult competitive environment in Russia and the lost CSD business at the German/Danish border. In addition, we're experiencing a more volatile business environment, including the coronavirus outbreak in China.

Our key focus currently in China is of course to ensure the safety of our employees. We have taken several initiatives to ensure this, including restricted traveling. At this time, no infection among employees has been reported. The on-trade market is, however, severely impacted with a widespread closure of night entertainment and dining outlets across the country. Off-trade outlets are also impacted, but to a lesser extent. We are monitoring the situation very closely, but it's too early to evaluate the full impact on business performance as it will depend on how long the outbreak takes and how wide it spreads. At this time, we are putting even more emphasis on and we are reinforcing our Funding the Journey culture to ensure that we can further accelerate efficiencies and cost reductions to mitigate the challenges and risks for the year.

Other assumptions underlying our earnings expectations for 2020 are a currency impact on operating profit of plus DKK 50 million based on spot rate on February 3. 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 26% to 27%. Our CapEx expectations are around DKK 5 billion in constant currencies. The higher amount than in 2019 is mainly due to increasing investments in China, primarily packaging lines.

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 on slide 18. We are pleased with our results in 2019. During recent years, we have strengthened our business considerably and we will continue to execute on our SAIL'22 priorities, further reinforce the Funding the Journey culture, supporting a sustainable long-term growth and value creation for shareholders.

So, to summarize for 2019, we delivered strong financial results with healthy top line growth and strong profit and margin improvement. We see good growth coming from our SAIL'22 priorities, we are again increasing cash returns to shareholders and we are well prepared for 2020.

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

QUESTION AND ANSWER SECTION

Operator: Thank you, sir. [Operator Instructions] And our first question is over to the line of Jonas Guldborg at Danske Bank. Please go ahead, sir. Your line is open.

<Q – Jonas Guldborg – Danske Bank>: Yeah. Good morning, Cees and Heine. A couple of questions from my side. First of all, if you could put some more color on the situation in China right now. How is the consumers behaving? How hard hit is your sales? And maybe give kind of a flavor on the impact per month in China from the virus outbreak?

Then, for Asia in general, what are you expecting for 2020? We have this uncertainty in China. We have the turnaround of Cambodia, which I – maybe you could also put some words on for 2020. And then in India, as I understand, we've seen these tax increases. So they will also have a negative impact in 2020. So in general, for Asia, what are you expecting for 2020? Thank you.

<A – Cees 't Hart – Carlsberg A/S>: Thank you. Good morning, Jonas. With regard to China, first of all, it's a very sad situation for China and its people, of course. As you know, the Chinese government is taking it very seriously and they implement a series of significant initiatives. And obviously, we hope that the government will succeed to stop the virus spreading. We are monitoring the situation closely. The key focus currently is the safety of our employees. And at this time, no infection among employees have been reported.

We have seen – we have not seen any major lockdowns of cities or areas where we are present. So, in that respect, we are outside at this moment of time of, let's say, the zone where the virus is presumably present, but sales across the country will be impacted by closure of outlets. As you might have heard, on-trade is significantly impacted. Almost all night entertainment outlets are closed. More than 50% of dining outlets are closed. And also the off-trade is impacted, but at a lot less than on-trade level. We estimate that a double-digit percentage of off-trade outlets are closed. So it impacts the whole country.

So in summary, the virus will affect our business negatively. We had a very good start in January up to the New Year, but then the breakout was there. At this moment of time, it's very difficult to make any estimate or even a guesstimate about the impact. The impact really depends on how long it lasts and how widely it spreads. But obviously, we're implementing different initiatives, as Heine had alluded to, to mitigate the potential impact.

In terms of the expectations for Asia, over to Heine.

<A – Heine Dalsgaard – Carlsberg A/S>: Yeah. Good morning. Hey, Jonas. So, as always, markets in Asia can be quite volatile. We will see and are expecting market growth in some markets such as Laos and Vietnam and then a declining in India, Nepal and the Hong Kong for the reasons we've been through. The Chinese market is uncertain due to the virus, but will likely be impacted negatively especially in the on-trade. We will continue to see positive price/mix from premiumization and from price increases.

Due to the leverage from growth, we expect increasing margins, although volume decline in Nepal and in Cambrew will mean a pressure on the margins, but overall positive on Asia. Overall, Asia will continue to be our growth region.

<A – Cees ’t Hart – Carlsberg A/S>: Then with regard to your question on India – sorry. Go on, Jonas.

<Q – Jonas Guldborg – Danske Bank>: Yeah. It was on the mitigating efforts in China follow-up. Just will that include closing down of production or has it already done that?

<A – Cees ’t Hart – Carlsberg A/S>: No, no, no. The production sites are at this moment of time closed until the 10th of February. This is in line with the situation in China, so that is as well as for the entire industry. We will reopen on the 10th of February.

<Q – Jonas Guldborg – Danske Bank>: Okay.

<A – Cees ’t Hart – Carlsberg A/S>: Then, your question on India. I said many times India has three steps forward and two steps back. We are currently taking two steps back after three steps forwards in 2018 and the first half year of 2019. It has to do with the price and excise tax increases in a number of states and we see as well in another state there is a change from private to governmental shops resulting in significant market decline. So the market needs to, if you like, adapt to the new reality, especially in pricing. And in that respect, we think that further in 2020, we should be able to continue our growth trajectory. So far, with regard to your question, Jonas.

<Q – Jonas Guldborg – Danske Bank>: Thank you very much.

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

Operator: We are now over to the line of Søren Samsøe at SEB. Please go ahead. Your line is open. Sorry. I do apologize. It’s actually Simon Hales of Citi. Please go ahead.

<Q – Simon Hales – Citigroup Global Markets Ltd.>: Thank you. Morning, Cees. Morning, Heine. Morning, Peter. Three questions, please. Can I just start just by following upon the comments around China and the coronavirus? I just want to be clear that your mid-single-digit guidance for 2020 as it stands doesn’t include any assumptions as to the potential impact at this stage of the corona?

Secondly, can I ask you about marketing spend a little bit? I think obviously market spend up 1% in the year, but I was surprised that still as a percentage of sales year-on-year it was down. Is there anything I should read into that, anything in particular that’s driven that? Is it just timing of spend or are you happy broadly now with marketing spend as a percentage of sales at the group level?

And finally, could I ask you a little bit more about Vietnam? There’s been quite a few press reports lately with the drink driving legislation coming in more aggressively at the beginning of this year. Have you noticed a significant change in consumer behavior since the beginning of January and what sort of volume decline rates have you seen? We’ve heard numbers of 25% declines in the press. Is that something that you would confirm?

<A – Cees 't Hart – Carlsberg A/S>: Thank you, Simon. The first two questions will be taken by Heine. Heine?

<A – Heine Dalsgaard – Carlsberg A/S>: Hi. Good morning, Simon. On the coronavirus and the impact on the guidance, as we've said, the full impact of the virus is unknown, but it will have an impact for the year. We will, of course, and we are taking mitigating actions that is gap closings to offset the negatives and we are already taking additional Funding the Journey initiatives to adjust our cost base.

In general overall, sort of we are assessing potential impact from all the many risks and opportunities out there including the coronavirus and that is properly reflected in the guidance of mid-single digits. We have a firm plan for 2020 that includes a balanced view on risks and opportunities. We will execute our plan and the mid-single-digit guidance is based on that.

And then as to your question on marketing spend, so marketing spend is as you're saying actually slightly up versus last year, which is in line with our focus on making sure that we continue to invest into top line growth, into craft & speciality beer, into alcohol-free and into Asia and growth in Asia. Overall, we arrived now at 8.5% of revenue which is broadly where we feel we should be and that is versus 8.6% last year, so broadly in line with last year and slightly up.

<A – Cees 't Hart – Carlsberg A/S>: Then Simon, with regard to your question on Vietnam and the impact on the drinking driving regulation and enforcement. We've seen some impact in the on-trade general in large cities like Hanoi and HCMC. Frankly what we can say is that the kind of figures that have been quoted are not in line with our experience that we see some impact, but not as material as the 25% that you mentioned. Outside Ho Chi Minh City and Hanoi, we see minimal impact.

<Q – Simon Hales – Citigroup Global Markets Ltd.>: Brilliant, got it. Thank you very much.

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

Operator: Okay, we now go to the line of Søren Samsøe at SEB. Please go ahead, sir. Your line is open.

<Q – Søren Samsøe – SEB Enskilda (Denmark)>: Yes. Thank you for that. Two questions. First of all, in terms of your guidance, I was a little bit surprised, you could maintain a mid-single-digit organic growth despite the coronavirus uncertainty. But is this – should we see this sort of a sign that you have become so strong on cost control and so agile on your cost? And a follow-up to that. Does this mean that we should expect a decline in cost in the first half year-over-year and then an increase in the second half so that cost will be back-end loaded this year? And then, on the CapEx side, what does your sort of increase of CapEx to DKK 5 billion consist of? Is there any IFRS effect in that or do we see a real underlying increase in CapEx in 2020? Thank you.

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

<A – Heine Dalsgaard – Carlsberg A/S>: Yes. Good morning, Søren. Well, we are, for good reasons, not surprised about our guidance outlook of mid-single digits. You are absolutely right in assuming that we are well in control of our costs. And when we see negatives hitting us, we immediately take action and initiate gap closing plans. And that's exactly what we are doing right now, initiating gap closing plans on costs, basically across different cost groups, including travel and entertainment, facility services, professional services, consultancy, technology to make sure that we continue to grow our top line and our bottom line. So, that's the way it is. We're not commenting specifically on how we see the cost develop in the first half versus second half. Overall, what we can say is that we remain focused on Funding the Journey. Funding the Journey is not a diet but a change of lifestyle and that change will stay forever in Carlsberg.

With respect to your question on CapEx increase to the DKK 5 billion, that is basically a few specific areas in particular investments in can lines in China. So that is to support our growth in the country.

<Q – Søren Samsøe – SEB Enskilda (Denmark)>: Okay. Thank you.

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

Operator: We are now over the line of James Edwardes Jones of RBC. Please go ahead, sir.

<Q – James Edwardes Jones – RBC Europe Ltd.>: Good morning. The – on your description of why gross margin – the movement in gross margins. You mentioned that volume decline in Russia should be the reason for gross margin weakness. Can you give us some indication of how gross margin in Russia compares with the group average now?

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

<A – Heine Dalsgaard – Carlsberg A/S>: Yeah. Good morning. So, definitely, gross margin in Russia or margins in general in Russia are significantly below our group total earnings and that is due to the changed competitive landscape and the intensified competition over there. As we've said, we are taking firm actions. We have taken actions here in the second half and we will continue to take actions in 2020.

<Q – James Edwardes Jones – RBC Europe Ltd.>: So shouldn't volume weakness in Russia as you have been beneficial to the margin mix given that they're lower than the group average?

<A – Heine Dalsgaard – Carlsberg A/S>: No, you can't say that. First of all, it's difficult to conclude too much based on Q4 volumes for Russia and for Eastern Europe based on Q4. It's relatively speaking not that important. It is more – from an overall perspective, it's more the impact that it has on operating margin and it is actually going down.

<Q – James Edwardes Jones – RBC Europe Ltd.>: Thank you.

Operator: We are now over to the line of Trevor Stirling at Bernstein. Please go ahead. Your line is now open.

<Q – Trevor Stirling – Sanford C. Bernstein Ltd.>: Morning, Cees, Heine and Peter. Just one follow-up on Russia. I appreciate it's been a very difficult pricing environment now for well over a year. Any sign at all that the pricing environment is getting any better or do you expect really unchanged trends as you go into 2020?

<A – Cees 't Hart – Carlsberg A/S>: Thanks, Trevor, and good morning. I think the long and short is that we don't see any change. So, we recalculate this continues, let's say, pressure on promotions and focus on even very deep promotions and hence we are adapting our own commercial strategy and focus much more now on volume and market share.

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

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

Operator: We are now over the line of Laurence Whyatt at Barclays. Please go ahead, sir. Your line is open.

<Q – Laurence Whyatt – Barclays Capital Securities Ltd.>: Sure. Good morning, everyone. Thank you so much for the questions. Could you give us an update on China sort of ex-coronavirus? How your capacity is in the country of in terms of capacity you have in our breweries and whether you have the availability to continue this sort of strong level of growth that you would normally expect, like I've said, without the coronavirus?

And then secondly, in Russia, the margins were down quite significantly in Eastern Europe. Could you confirm to us the timing of the promotional slots? Were you able to get some promotional slots in Q4 or are they all to come in FY 2020? And therefore, should we still expect the margins in FY 2020 to be in the 15% to 16% range for Russia? Thank you very much.

<A – Cees 't Hart – Carlsberg A/S>: Thank you very much and good morning. In China, for the time being we still have enough capacity. I think the issue is more that whilst we increase the number of cities, we, if you like, have a larger cost for the logistics because they're further away from our breweries. That will not impact us in the coming one to two years but as for the moment, we need to decide whether we basically build a new brewery in the East or do some contract producing. But for the, let's say, foreseeable future, let's say, two years, we do not see any issue with that.

Then with regard to the Russian situation, well, frankly, we try to get some slots in Q4, but the investments needed for that were very, very expensive because one of our competitors went extremely deep in pricing. And hence, we decided not to erode the pricing in Russia even more.

We see indeed at the moment that this situation continues, a Russian margin development of around 15%, 16%. That is what we, let's say, calculated with for 2020.

<Q – Laurence Whyatt – Barclays Capital Securities Ltd.>: Okay. Thank you very much.

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

Operator: We are now over the line of Richard Withagen at Kepler Cheuvreux. Please go ahead, sir. Your line is open.

<Q – Richard Withagen – Kepler Cheuvreux SA (Netherlands)>: Yes. Good morning, all. I have two questions, please. First of all, on the alcohol-free beers in Western Europe, how do you see growth developing in the next two to three years as growth rates seem to be slowing? And what particular initiatives do you have planned for the next two to three years in alcohol-free beers?

And then the other question I have is I guess for Heine you said that standardization of processes will be an important contributor to efficiencies in the next few years, so how far are you advanced in Western Europe specifically with this, can you perhaps give a percentage is it 50% done or 70% and what specific projects are you focusing on this year? Thanks.

<A – Cees 't Hart – Carlsberg A/S>: Thank you, Richard. We are very satisfied with our performance in alcohol-free beer, in Western Europe we grew by 10% and obviously that's at a higher level than 2018. So at a certain amount, we might see some diminishing returns or diminishing growth. But for 2020, we really will focus on AFB [alcohol-free brews] in Europe, therefore, we expect higher percentage growth than the 10%. One of the investments we will do is the launch of the DraughtMaster in or with alcohol-free brews which the initial experience is extremely positive and hence, we are really positive about the further development of alcohol-free brews in Western Europe. Heine?

<A – Heine Dalsgaard – Carlsberg A/S>: And good morning, Richard. On your question on standardization of processes, it's difficult to give a sort of an exact percentage of where we are. We can say that we've come a long way over the last few years but it's not because of very strong processes. So there is certainly still a good potential for us. The kind of projects we are working on specifically in Western Europe right now is to standardize and automate our processes primarily within sort of core finance or what's called "record to report". So, it's basically fundamental finance processes where we need standardization across our countries in Western Europe and then we need to automate. And that also includes further professionalizing our shared service center set up in Poznań, and also as we continue the journey to move more processes into our shared service in the platform.

<Q – Richard Withagen – Kepler Cheuvreux SA (Netherlands)>: And, Heine, just as a follow-up to that, would that mean that your investment CapEx on IT are going up the next couple of years?

<A – Heine Dalsgaard – Carlsberg A/S>: No, we don't see that and not specifically as a consequence of this. It is actually something that we've invested in both 2019 and also to a certain extent in 2018. So, it's already in the numbers, and it's not something that drives significant CapEx investments.

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

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

Operator: We are now over to the line of Alyssa Gammoudy at ING. Please go ahead, ma'am. Your line is open.

<Q – Alyssa Gammoudy – ING Bank NV>: Yes. Thank you very much. I was wondering with regards to your leverage ratio initially at the start of SAIL'22, the target was to be below 2 times and you are far below 2 times now. Will that extra space in the balance sheet perhaps use to tap into new categories as beer is not really growing, non-beers also slowing down, and perhaps a category like hard seltzer can be interesting? How is your view there?

<A – Cees 't Hart – Carlsberg A/S>: Thank you. Yes, indeed, it's true that with our exceptional cash generation, we are below our own expectations. We are continuing with the further development of our SAIL'22 strategy, including AFB [alcohol-free brews] and craft & speciality. We see ample opportunities for growth there. We're looking also at the hard seltzer's. There have been a few players announcing launches in the category in Europe, but it's still small, and we are continuously monitoring this category and the development across our markets. We have done some consumer testing, so we more or less know what we're talking about. We have a good understanding of the main drivers and the liquid composition and the content. So, we're looking at it. We might do one or two test markets in 2020. So, that's one of the, if you like, further evolutions. Could be one of the further evolutions of SAIL'22.

<Q – Alyssa Gammoudy – ING Bank NV>: All right. Thank you. And then another small question. Is it an option to let some of the underperforming regions go or will you continue to invest in the – on the short term?

<A – Cees 't Hart – Carlsberg A/S>: No. I mean, we don't anticipate any of that. We're very glad with the kind of footprint we have. We see opportunities for the future to improve further our shareholder returns. So, there's no – any plan for that.

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

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

Operator: Okay. We are now over the line of Frans Høyer at Handelsbanken. Please go ahead.

<Q – Frans Høyer – Svenska Handelsbanken AB>: Hi. Good morning. Thank you. I just wanted to reconfirm the margin outlook for Eastern Europe. You've mentioned earlier that there would be pressure going into 2020. Could you just to reiterate or confirm that and perhaps offer some numbers? And also on China and Asia, it sounds like the on-trade is in the firing line of this virus situation. How important is on-trade in China as a percent of China? And how important is China as a percent of Asia?

<A – Cees 't Hart – Carlsberg A/S>: Okay. Frans, good morning. And over to Heine for the margins in Russia.

<A – Heine Dalsgaard – Carlsberg A/S>: Yeah. So, good morning, Frans. So, the margin outlook for Eastern Europe, you are right that that has continued into Q4 and it will continue also going forward. So, what we are seeing for the next the period is for Russia a margin of around let's say 15% to 16% and then for the region, so the Eastern European region a few percentage higher than that.

<Q – Frans Høyer – Svenska Handelsbanken AB>: Okay.

<A – Cees 't Hart – Carlsberg A/S>: With regards to the question on Asia, on-trade of course in beer always very important including in China and basically broadly in Asia. Off-trade is if you like very important and upcoming is the e-commercial, all of them if you like have their own dynamics and are important. If you look at China as percentage of the group, it's around 12%, 13%, so it's an important part of our portfolio.

<Q – Frans Høyer – Svenska Handelsbanken AB>: Was that volume or revenue or EBIT?

<A – Cees 't Hart – Carlsberg A/S>: That's EBIT.

<Q – Frans Høyer – Svenska Handelsbanken AB>: Okay.

<A – Cees 't Hart – Carlsberg A/S>: And in net revenue, volume is a bit bigger.

<Q – Frans Høyer – Svenska Handelsbanken AB>: And I have to come back to this, I'm not 100% certain that I understand your guidance regarding the virus situation, but okay, so there is a – obviously going to be some fallout, but it's not anything more than you can manage within your Funding the Journey efforts and offset that impact is that how we should read it?

<A – Heine Dalsgaard – Carlsberg A/S>: It is as said, very difficult to assess and the specific risks relating to the coronavirus outbreak. What we do every year and what we include in our outlook and our guidance is to address and assess impact from all the different risks and opportunities out there including this time then, the coronavirus. And our view right now, which is then depending on timing and how widely it spreads, is all included in our guidance of mid-single digit. But it is as it is. Right now, it's best man's best guess, and that can of course change. It really depends on how long time this takes and how widely it spreads. But right now, we've included best man's best guess.

<Q – Frans Høyer – Svenska Handelsbanken AB>: Okay. Thank you very much.

<A – Cees 't Hart – Carlsberg A/S>: And within – Frans, within that, we've looked as well in – what happened with previous viruses and the consequences of that and how many months that took. Obviously, based on that, we took our risk assessment.

<Q – Frans Høyer – Svenska Handelsbanken AB>: Okay. Thank you very much.

Operator: We now go to the line of Fintan Ryan of JPMorgan. Please go ahead. Your line is open.

<Q – Fintan Ryan – JPMorgan Securities Plc>: Good morning, gentlemen. Two questions from me please. Firstly, in terms of the COGS per hectoliter outlook, would you able to give some color on what you would be expecting for 2020 and how that potentially can vary by different markets?

And then, secondly, just within your Western European region, would you expect beer volumes there to turn back to modest growth within 2020? And specifically within the regions around Nordics, France, and UK, what are your expectations for volume growth there?

<A – Cees 't Hart – Carlsberg A/S>: Thank you, Fintan. We first move to Heine.

<A – Heine Dalsgaard – Carlsberg A/S>: Yeah. Morning. So with respect to COGS per hectoliter, as you know, we are well-hedged also for 2020, but we don't disclose the exact hedging. We expect slightly increase in COGS per hectoliter basically coming from two factors, lower barley and aluminum but then higher glass, sugar and paper in some regions. So, slightly increase in COGS per hectoliter due to these different factors. We don't give specific comments per region or per category.

<A – Cees 't Hart – Carlsberg A/S>: Then with regard to your question on the beer volumes in Western Europe, first of all, we expect flattish markets. 2018 as you know was extremely good. 2019 we had if you like flattish results in the top line after a very good summer in 2018. So, we were, if you like positively surprised. For 2020 in beer, we think we will have a flattish outlook, maybe flattish-plus. However, there will be a decline of non-beer volumes due to the German/Danish border. That decline will be 5% to 10% of non-beer in Western Europe. And then, we plan for a positive price/mix from volume management including price increases and premiumization. And we will continue with our trajectory of margin improvement in Western Europe.

<Q – Fintan Ryan – JPMorgan Securities Plc>: Yeah. Thank you. Very clear.

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

Operator: Okay. We'll now go to the line of Toby McCullagh at Société Générale. Please go ahead. Your line is now open.

<Q – Toby McCullagh – Société Générale SA (UK)>: Hi there. Good morning. Just a couple of residual questions on margins. First on Western Europe, I guess Western Europe's role in the strategy has been to drive margins. With those now being 17%, from memory this was a medium-term target at one point. So, now that you've got there, what might be a realistic target for that region in the medium term?

And then, secondly, also just on margins, Cambrew presumably was quite loss-making in 2019. Is it feasible that this might be breakeven by 2020?

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

<A – Heine Dalsgaard – Carlsberg A/S>: Morning, Toby. So, in Western Europe, you're absolutely right that margins – it has been the key focus of us to drive margins up. We are right now, as you see, at 17%. The journey continues and there is still a further potential in Western Europe with respect to driving margins upwards. We don't give guidance specifically as to how much, but the journey with respect to margin improvement and margin progression in Western Europe will continue.

<Q – Toby McCullagh – Société Générale SA (UK)>: Could you expect – sorry, can I just jump in? Do you expect that Western Europe will continue to be the primary driver of further margin expansion from here?

<A – Heine Dalsgaard – Carlsberg A/S>: Well, we don't split our margin guidance. So far, you can see that it has been a key driver and it will continue to be a key driver. We don't give sort of specific percentages, Toby, as to how much. But Western Europe will be a driver still behind the continued margin progression. You know we're targeting the 17% for the group and the key driver behind that will continue to be Western Europe.

In terms of Cambrew, you're right. It's loss-making. We will turn it around into breakeven. We don't – it's too early simply to comment specifically as to when this happens. We, of course, have our internal plans. We have said that it's a few-year journey to turn around the business and that remains sort of our view. It just takes a few years to turn around the business.

<Q – Toby McCullagh – Société Générale SA (UK)>: Okay. Thanks very much.

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

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

Operator: Okay. We're now over to the line of Andrea Pistacchi at Deutsche Bank. Please go ahead, sir. Your line is open.

<Q – Andrea Pistacchi – Deutsche Bank AG>: Good morning. I have another two please on China. There was, I think, quite a significant marketing spend step up in China. I mean, you've been consistently spending a lot, but particularly in H2. What flexibility do you have to pull marketing spend back in China at within a sort of short time space should you need given the situation now?

And then the second question, I think earlier you said that you don't have much presence in the areas where there is a major lockdown in China, which I imagine is Hubei. In what provinces or what areas is most of the city expansion that you're doing in China? Thank you.

<A – Cees 't Hart – Carlsberg A/S>: Thank you, Andrea, and good morning. Well, I think in terms of marketing spend, we are relatively flexible, and that's of course one of the mitigating factors we look at, at this point of time. So, I think it is not decent to support our beers at a moment that people are suffering from the virus. So, we use that flexibility of course at this moment of time.

With regard to our city expansion, then you move – basically you need to think about more moving into the east – Northeast. Indeed not – we don't have cities in the Wuhan province. So, basically, at this moment of time, we are not exposed to any lockdown so far. The province that is the closest by is Chongqing, but again, there, everything is still under control as we speak.

<Q – Andrea Pistacchi – Deutsche Bank AG>: Very clear. Thank you.

<A – Cees 't Hart – Carlsberg A/S>: Thank you, Andrea. Can I have the last question please?

Operator: Okay. So, the last question for today is over the line of Tristan van Strien at Redburn Partners. Please go ahead. Your line is open.

<Q – Tristan van Strien – Redburn (Europe) Ltd.>: Hi. Good morning, gents. Few follow-ups please. Let's start with China. Can you just – maybe just be more specific on your current channel split in China including within on-premise where you're exposed and how that index is relative to the market?

The second one maybe some color on what's happening in France in terms of your bottle issues. Are you seeing the competitive environment getting better?

And then the third one is just, as I look at European margins has improved, obviously a big part of that has been the reduction of your wholesale footprint. Are you happy with your current wholesaler footprint or is there further opportunity to optimize that?

<A – Cees ’t Hart – Carlsberg A/S>: Tristan, good morning. Thanks for your questions. In terms of the channel split, I guess we see each other in the coming days. Let me come back on that one. I don’t have at this moment in time all the detail that probably will satisfy you.

Then in terms of France, what we see in France is to a certain extent an healthy development of the market because there’s a lot of focus on premiumization. There are three big parties now driving the markets. We are really doing well also in the top segment. Kronenbourg brand is a bit under pressure.

We are in 2019 a bit disadvantaged by the bottle production. As you know, we didn’t have the right bottles at the right time. And so, we needed to postpone some of our promotion slots until the very end of this year – or in 2019. We have seen the positive consequences of that. But in terms of further development of the French business, we’re optimistic.

With regard to our wholesale business, we don’t have any other plans. We are satisfied with where we are at this moment of time. We don’t intend to increase the number of let’s say businesses that includes wholesale. But we are where we are, and we do well where we are at this moment of time.

<Q – Tristan van Strien – Redburn (Europe) Ltd.>: Thank you very much.

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

So, Tristan – and that was the final question for today. Thank you for listening in and thank you for your questions. We are looking forward to meeting some of you during the coming days and weeks. Have a nice day. Bye-bye.

Operator: This now concludes the call. Thank you all very much for attending, and you can now disconnect your lines.

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