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Speakers: Cees 't Hart, Chief Executive Officer
Heine Dalsgaard, Group CFO
Christopher Warmoth, Executive Vice President

Operator

Ladies and gentlemen, welcome to the Q2 Trading Conference Call. For the part of the call, all participants will be in a listen-only mode. Afterwards will be a question-and-answer. Just to remind you, this call is being recorded. Speakers, please begin.

Cees ‘t C. Hart

Good morning, everybody, and welcome to Carlsberg's First Half 2016 Results Conference Call. May name is Cees Hart and I have with me our new CFO, Heine Dalsgaard; Executive Vice President or Corporate Strategy, chris Warmouth; and Vice President of Investor Relations, Peter Kondrup.

Before we go through the half year results in details, we will give you an update on our strategic priorities. Please turn to slide 3.

An important milestone for the company was the launch of our new strategy SAIL'22 in March. I'm pleased with the way it has been received across the organization. As we expressed in the presentation of our new strategy, our ambition is to become a successful company. The key KPIs to measure our progress towards becoming that are gross profit after logistics margin, operating profit, and market share. We want to strike the optimal balance between these KPIs as we believe that striking this is key in order to drive sustainable top and bottom line growth going forward. Therefore, we are also building them into our plans and they are integrated into incentive schemes.

Looking at the first six months of this year, we delivered a very solid GPaL margin improvement of 140 basis points which was mainly driven by favorable price/mix. On organic operating profit growth, we also saw a solid delivery of 8%.

This was driven by the GPaL growth and tight control of SG&A costs. We estimate that our market share was stable in Asia, increased sequentially in Eastern Europe and declined in Western Europe. All in all, volumes declined organically by 1%. This decline is partly due to some deliberate decisions to go out of margin-diluted volumes in support of margins and profits.

For the six months, we were very close to getting the balance in the golden triangle right. However, we need to make a little adjustment to ensure that our market share doesn't slip too much. All in all, we are pleased with the good performance so far this year and we are confident with the progress of Funding the Journey and SAIL'22.

Before I hand over to Chris for the review of the progress of our new strategy and Funding the Journey, I would like to comment on a few changes in the executive committe in support of the strategic and operational agenda of the Group. Chris, who will present in a moment, has been appointed Executive Vice President of Corporate Strategy. Graham Fewkes took over Chris' position as Head of Asia. Michiel Herkemij, who joined Carlsberg in April is now responsible for Western Europe. And as you already heard, Heine has joined us as CFO.

I will now hand over to Chris for an update on SAIL'22 and Funding the Journey, following which with Heine will go through the key financial data for H1. Chris.

Chris Warmouth

Thank you, Cees. Please turn to slide 4 and a few comments on the progress of our strategy. We launched SAIL'22 in March and received positive feedback throughout the organization. Because SAIL'22 was co-developed with our top 60 leaders, we've been able, within a very short period of time, to share and explain the strategy with our employees in both central functions and across all our markets. We're now actively implementing the strategy. We have established work streams and appointed dedicated teams to drive each priority forward. On top, sale related initiatives are being incorporated into current activities and are being reflected in the planning for 2017 and beyond. So, we're seeing good traction behind SAIL'22.

Slide 5 please and Funding the Journey where the program is progressing well. Funding the Journey covers four key areas: value management, supply chain, OpEx and right-sizing. And for each, we've developed detailed output KPIs, supported by specific projects with their own metrics.

At the heart of Funding the Journey, is having quality and consistent data, making sure that this data is regularly available and regularly published to those who need it. And then, most importantly, driving a rigorous monthly routine to assess progress and find opportunities using a zero base mindset. This formula of quality data, readily available and routinely monitored, is proving fruitful.

A few specific comments on each of the four key areas. On value management, as Cees already mentioned, our approach is helping us find a more optimal balance between volume market share and profitability. By leveraging a range of focused and appropriate tools and a series of good metrics, we're delivering a more profitable mix of brands, channels, pack sizes and promotional activities. Our progress is reflected in the first half with its strong 5% positive price/mix and the 50 basis points organic margin improvement .

On supply chain efficiency, we have specific programs and targets for production, material costs, logistics and savings from specification changes. Delivery of savings is well on target and we've seen good development on COGS and logistics with both being down in Asia and Western Europe, and the increase in Eastern Europe is due to material price increases related to currency.

Another example of progress is SKU rationalization where we're cutting tail SKUs. We so far deleted 2,107 with more to come. And we're now taking the next step, which is to roll out a program addressing SKUs which create particular inefficiencies in the total supply chain, so-called pain SKUs.

Within operating expense efficiency, 2,018 white collar employees have left or been notified since the start of the plan. We've almost completed the transfer of well over 200 roles from Europe to our external service provider in India and we're now working on additional similar opportunities.

OCM or operating cost management is also working for us. Costs are organized into 15 cost groups and then into about 120 sub-groups. Each cost has a local and regional owner and cost group owners then look at their groups horizontally across the organization on travel costs, or facilities costs, or professional fees, or training costs or maintenance costs and so on. This yields new insights and new savings.

In terms of right-sizing, a number of actions have been taken on top of what we did at the end of 2015. This year, we've closed six sites in China, which brings the total number of closures to 11. We've continued the restructuring of our UK business, announcing in June the intention to outsource secondary logistics operations. In addition, we sold the Danish Malting Group, the Vung Tau Brewery in southern Vietnam, completed the Wusu asset swap in China and the recently sold our shareholdingin Malawi.

So, in summary, we're making big progress to all the four areas. And based on this progress and on our plans for the second half of the year, we anticipate to deliver this year around one quarter of the DKK 1.5 billion to DKK 2 billion Funding the Journey benefits.

Slide 6 please, and the three main regional priorities for the year which we communicated back in February. These three priorities were margin improvements in Western Europe, continued growth in Asia, and mitigation of the currency impact and market decline in Eastern Europe.

For the first half year, the status on these priorities is as follows. In Western Europe, we've improved price/mix and GPaL margins and this led to an improvement in operating profit margin of 70 basis points. In Asia, we grew organic revenue by 4% in spite of the weak Chinese market and we delivered organic growth in operating profit of 6%. In Eastern Europe, we delivered 19% organic operating profit growth. However, we were not able to fully offset the combined market and currency headwind and the business delivered a decline in reported operating profit.

And now, I'll hand over to Heine for the first half results.

Heine Dalsgaard

Thank you, Chris and good morning, everybody. Before I go through the half year result, I just like to say that I'm very pleased with being part of the Carlsberg team. We are at the beginning of implementing a new strategy and delivering on Funding the Journey and I'm really excited to be part of this and to move the company forward. I'm still in the process of getting to know the business and I look forward to meeting with all shareholders and analysts in the coming days and weeks to get your insights and views on Carlsberg.

And now please turn to slide 8 for a few financial highlights.

For the first six months, we delivered 4% organic net revenue growth as we benefited from a positive price/mix in all three regions. The price/mix of 5% was sufficiently strong to offset lower volumes, higher cost of goods sold and higher sales and marketing investments to such an extent that the operating profit grew organically by 8%. However, we faced quite significant headwind from currencies and, in addition, tax was negatively impacted by a one-off expense that I will explain in details later.

Reported net profit grew strongly by 25% and so did free cash flow. We thus reduced net interest-bearing debt by DKK 2.7 billion versus year-end 2015. I will go through more details on the following slides, so please turn to slide 9.

On this slide, we show the development in net revenue. As you can see from the slide, all three regions contributed positively to the organic growth in net revenue. The impact from currencies of minus DKK 2.2 billion more than offset the organic growth, and reported net revenue declined by 4%. The currency impact was primarily related to the ruble, the Chinese RMB, the British pound and the Norwegian krone.

Then, please turn to slide 10 and some flavor on the operating profit development in the first half of the year. Again, as you can see, all three regions contributed positively to the organic development in operating profit which, in total, was up DKK 286 million or, as said. 8% compared to last year. Cees will go into more detail per region shortly, so I'll just make a comment on the development in central costs. These were, as you can see from the slide, up DKK 147 million compared to the first half last year. This increase was mainly due to higher marketing investments than last year as we incurred the final cost related to the Euro 2016 sponsorship. Consequently, we have somewhat higher central costs in the first half than in second half. We expect second half central costs to be broadly in line with last year.

The currency impact of minus DKK 389 million reflected adverse development in most currencies across our geographies with the most pronounced impact coming from the Russian ruble, resulting in a reported operating profit of DKK 3.4 billion.

Slide 11, please. On the individual P&L items, COGS per hectoliter was up organically by 4%. This was mainly due to the negative transaction impact of input cost denominated in hard currency in Eastern Europe. The positive price/mix of 5% was more than sufficient to offset the higher COGS, as well as the lower volumes, and gross profit increased organically by 5%. Measured per hectoliter, gross profit was up 6% organically.

Operating expenses were up 3% to 4% organically and around 2% in reported terms, and the main driver of the increase was sales and marketing costs as these were impacted by the UEFA Euro 2016 sponsorship. Special items amounted to plus DKK 406 million. They were positively impacted by the sale of Danish Malting Group and the asset swap in Wusu Beer Group in China.

Opposing these were impairment and restructuring measures, particularly the UK and China and also in India. In India, the impairment was solely related to the brewery activities in Bihar where the state in April of this year implemented a complete ban on alcohol.

Net financials were minus DKK 703 million. This was an improvement of DKK 67 million versus last year. This is explained by lower average funding costs, and interest expense that declined by DKK 135 million. Other financial items were up compared to last year as they were impacted by currencies and a one-off charge related to the final ruling in a tax dispute we've had in Finland.

Effective tax rate was 33%, and therefore higher than we expected at the beginning of the year. The tax rate was negatively impacted by a one-off tax expense related to a lost tax case in Finland. The case relates to a different opinion on tax payments in Finland in the years 2006 to 2010. We paid all taxes in 2010, appealed the case but lost the appeal case earlier this year. Consequently, we now had to expense the tax. The tax expense has no cash impact of this year.

Net profit was very strong at DKK 1.867 billion, equivalent to an EPS of DKK 12.2. It was positively impacted by special items which offset the negative impact from currencies and tax. Corrected for special items after tax and also the effects of the one-off tax expense, EPS or earnings per share would have been DKK 11.2.

Slide 12, please. And here, some comments on the DKK 3 billion free cash flow improvement in the first six months of the year. The free cash flow was DKK 5.2 billion compared to DKK 2.2 billion last year. This strong development was the result of better working capital management, lower net interests and tax paid in the first half of the year, as well as lower

CapEx in addition to the proceeds from the sale of the Danish Malting Group and the gross proceeds from the asset swap in China.

Looking at the total working capital, the change was plus DKK 860 million, comprised of plus DKK 1.4 billion from trade working capital and minus 0.6 from other working capital. The very strong improvement was partly due to our continued focus on reducing the ratio of trade working capital to revenue. On a rolling 12-month basis, trade working capital to net revenue was minus 7.5. Other working capital was among other impacted by pension obligations, primarily in the UK.

Net interest paid was DKK 119 million. This was a decline of DKK 584 million compared to last year, which was mainly due to lower average funding costs, as well as the proceeds from settlement of financial instruments which were positive this year while negative last year.

Tax amounted to DKK 869 million. This was a decline versus last year of DKK 439 million, but the decline was due to an unusually high level last year, as well as lower taxable income this year. Net operating investments amounted to DKK 1,480 million and was mostly related to maintenance capacity in Asia and sales equipment in general.

All in all, free cash flow was DKK 3.8 billion, an improvement over last year of DKK 1.7 billion. Finally, financial and all the investments were positively impacted by, previously mentioned, the Danish Malting Group and the asset swap in China.

Please turn to slide 13. As a result of the strong cash flow in first half, net interest-bearing debt was down DKK 2.7 billion compared to year-end. Net interest-bearing debt to EBITDA was, thereby, reduced to 2.16 times by the end of the first half, bringing us in the right direction towards the strategic target of the below 2 times. 83% of the gross debt is long-term, and 87% of the net financial debt was at fixed interest rates as per end of June. It is here worth highlighting that we have a sterling bond of £300 million at a coupon of 7.25% that matures this November. Slide 14, please.

And here, some comments on invested capital and return on invested capital. Investment capital was down DKK 21.9 billion in June versus end-June last year. Around 40% of the decline was due to the significant impairments done in the second half of last year, as well as some in the first half of this year following the restructuring and right-sizing initiatives from the Funding the Journey. The remainder is related to weaker currencies and that CapEx is below depreciation.

ROIC improved by 110 basis points to 8.9%, driven by the lower capital employed. Per region, the picture differs with earnings improvement also contributing to a higher ROIC in Western Europe and Asia. Excluding the impact from last year's impairment, the ROIC improvement would have been 50 basis points.

Slide 15, please. And here, some comments on the 2016 outlook. As already mentioned, the key focus for the year is executing Funding the Journey, implementing SAIL '22, improve margin in Western Europe, grow in Asia and mitigate the impact from external factors in Eastern Europe. By end June, we are well on track for all of these. And based on the first half year performance, we maintained the outlook for the year of a low single-digit percentage growth in operating profit.

As we delivered 8% in the first half, this implies less organic growth in the second half. This is as expected. In the first half, it was cycling an easy comparable in the Western Europe and also in Eastern Europe due to last year's poor weather conditions in northern Europe and the destocking in Russia, which predominantly impact the first six months.

To add a little extra color on the beginning of Q3, we have seen good performance in Eastern Europe due to very warm weather while Western Europe has been soft, which seems to be caused by the fact that there were still some stocks from the system following the euro-related sell-in in June. For second half as a whole, we also expect to start investing in SAIL'22 initiatives.

Financial leverage reduction was another part of our financial outlook. And with the strong cash flow in the first half, we are also well on track to deliver on that. With regards to assumptions underpinning the outlook, which were communicated in our February announcement, there is an adjustment to the expected translation impact on operating profit.

Previously, we assumed a negative impact of around DKK 550 million, but based on spot rates on Monday, including a euro-ruble rate of RUB 72, the impact is now assumed to be around DKK 600 million negative.

Finally, we now expect the effective tax rate for the year to be around 33% compared to the previously expected level of 28%. As mentioned, the increase mainly relates to a one-off tax expense. Going forward, we see an effective tax rate of just below 30%.

And now, Cees will go through the regions. Cees?

Cees ‘t C. Hart

Thank you , Heine. Please turn to slide 17 on Western Europe. We estimate that the overall beer market in our Western European region grew by around 2% for the six months. Our regional market share declined mainly due to the reduction of margin-diluted volumes in UK, Finland and Poland. Net revenue grew organically by 2% as a very solid 3% price/mix more than offset a 1% organic volume decline.

The positive price/mix was largely driven by our new value management approach, which implies a greater focus on profitability by brand, SKU and channel and on promotional activity profitability. Adjusting for the margin-diluted volumes, volumes would have grown by an estimated 3%.

In spite of a significant step-up in marketing investments, of which a large proportion was related to the EURO 2016 Championship, organic operating profit grew by 9% and operating margin improved by 70 basis points.

This improvement was, to a large extent, driven by the actions related to Funding the Journey as these supported both price/mix, as well as capital costs under control. In addition, we had easy comps due to the bad weather in northern Europe and early summer of last year.

Slide 18, please, and a look at some of our key businesses in Western Europe. Our Nordic business performed strongly compared to last year. Markets grew by approximately 3% to 4%, and we delivered growth in Norway, Denmark and Sweden. Volumes declined in Finland as a result of last year's withdrawal from a supply contract. Price/mix showed significant improvement due to growth in craft and specialty, value management efforts and less low price volumes. All four markets delivered profit growth with particular strong results in Finland.

Our shipped volumes in France grew by 3% in line with the market. The growth was mainly driven by our premium brands such as Carlsberg, Tourtel, Skøll and Grimbergen. The EURO 2016 was well-executed by our team and supported the growth of our premium brands, as well as market share gain in the on-trade channel. The competitive pressure in the off-trade channel intensified and we lost share in the channel.

The Polish market remains very competitive. We delivered flat underlying volumes if adjusted for the withdrawal from a substantial margin-dilutive customer contract. In the UK, we see good initial signs from our value strategy. Price/mix grew by double-digit percentages, driven by our intensified focus on brand development, innovations and recently launched products in the craft and speciality category. The restructuring of the business is proceeding according to plan. And in June, we announced the intention to exit the porterage business, as well as outsourcing the secondary logistic businesses.

Most other markets in the region delivered very solid performances with market share growth, GPaL improvement and growth in operating profit with the most pronounced contributions coming from Italy, Greece, Bulgaria and Germany.

And now, slide 19, please, and Eastern Europe. The Eastern European beer markets remain under pressures because of the ongoing macroeconomic challenges. Our volumes were flat for the half year, reflecting a deterioration in Q2 due to more difficult comparables as last year's destocking among wholesalers and distributors in Russia was less pronounced in Q2 compared to Q1.

Price/mix was solid at 8%. As expected there was a notable slowdown in price/mix in Q2. In Q1, we had very easy comparables, whereas we in Q2 were lapping last year's many price increases. This year, price increases in the region have been less pronounced than in 2015. Organic operating profit grew strongly by 90%, and operating profit margin increased by 100 basis points. The earnings growth was driven by a number of factors, including easy comparables and Funding the Journey benefits, as price/mix improvements and tight cost control.

Slide 20, and a few comments on Russia and Ukraine. The macro environment and consumer sentiment in Russia continue to be very challenging, and we estimate that the beer market declined by around 2% for the six months. Our volumes declined by 2%, as we were cycling the easy comparables due to last year's destocking. Our market share reached 34.8%. This was a solid sequential improvement when comparing with the second half of last year, with a decline year-on-year.

We saw good performance of brands such as Carlsberg and Baltika 0 and 9, while Tuborg and Baltika 3 declined. We increased prices across the portfolio in H1 by an average of 5% with a significant variation between brands. We applied this selective approach to achieve a clearer distinction between categories and brands. For instance, we reduced the price point of the Carlsberg brand to make it a more affordable international proposition for consumers. With this, we entered the summer season with a more competitive portfolio offering than last year.

For the remainder of 2016, we expect the Russian market to remain difficult due to the macro economy and the implementation of the alcohol registry system, EGAIS, which we believe we will have some negative impact on the traditional trade retail universe in the second half of the year.

Finally, although the ban of PET of more than 1.5 liter does not come into effect until January 1, 2017, we will stop the sale of the above 1.5 litre PET already in Q4.

In Ukraine, the market decline continues as the economy remains in a deep recession. We estimate that the decline was around 6%. We gained market share as a result of strong performance of our local power brand, Lvivske, along with Carlsberg, which was also supported by the EURO 2016 activation and, finally, a very successful launch of the Garage brand.

Please move to slide 21 where you see that our Asian business continues its positive performance. Regional volumes were impacted by a combination of the market development and brewery closures in China, declining organically by 3%. Adjusting for the closures, volumes would have declined by an estimated 1%.

In spite of the volume decline, net revenue grew organically by 4%, driven by a very solid price/mix of 7%. The price/mix was achieved through our ongoing premiumization efforts on our local brands; continued push behind our international premium brands, among which, Tuborg in particular, continues to grow rapidly; and, finally, the reduction of low-priced volumes in Eastern China.

Likewise, the earnings growth continued. Operating profit grew by 6% organically and operating margins improved by 60 basis points.

Again, Funding the Journey benefits are coming through and the business delivered price/mix improvement, kept cost under control and executed brewery closures. In addition, our business in India has started to deliver meaningful profits.

Slide 22, and a few market specific highlights. The Chinese market declined by an estimated 6% in volume terms, as it was impacted by the soft economy, socio-economic changes and by anti-extravaganceefforts and bad weather. We have accelerated the network optimization program, resulting in a closure of 11 sites, with a few more still under evaluation, the sale of two incomplete sites and a considerable fixed cost savings.

Our Chinese volumes declined by 8%, impacted by the general market decline as well as the brewery closures in the Eastern provinces. We gained market share in most of our core provinces and in the premium segment. This is offset by lower economy brand sales in non-core provinces where we have also closed unprofitable breweries.

We remain optimistic on the value opportunities as mix premiumization continues fast, particularly as a growing middle class starts trading up into international premium brands. These now deliver one-third of our China revenues, led by Tuborg. It is now a clear number two international premium brand, more than twice the size of the next competitor. Super premium specialty sales also increased at over 50%, led by 1664 Blanc The cost reductions and premium growth led to a strong GPaL margin improvement that, we believe, we can continue.

In India, volume growth continued and we delivered a growth of 17% in spite of the alcohol ban in the Bihar State as of April. Our volume share in India is now around 16%. Profits improved significantly, driven by volume growth and mid-single digit price/mix. Tuborg continues to deliver strong growth rates and Carlsberg Elephant also showed a very strong performance for the first six months.

Tuborg was launched in Vietnam in April and the initial signs are very positive and ahead of our initial expectations. The Vietnamese market grew by an estimated 8% and regained market share. Our volumes were impacted by destocking in

December, ahead of the Tet festive season, and in advance of the duty increase of January 1. Volume development, therefore, improved quite substantially throughout the half year.

In Laos, we saw good growth of our beer volumes, while the soft drinks and water business came under pressure due to intensified competition. In June, more than 100 Beerlao rocket festival events were carried out across the country.

That was all for today. But before opening up for Q&A, a few concluding remarks on slide 23. The Group had a good start to the year. Funding the Journey is on track, SAIL'22 has been well received by our people, and the implementation is now ongoing across markets and functions, and H1 delivered positively towards our regional priorities for the year.

In addition, SAIL'22 includes some very specific financial priorities. Our delivery against these were also satisfactorywith 8% organic growth in operating profit, ROIC improvement versus H1 last year, as well as full year 2015 and a strong cash flow and reduced net interest-bearing debt, leading a further decline in leverage.

With satisfactory execution so far this year, we are able to maintain our organic operating profit expectations for 2016. And with this, we are now ready to take questions.

Question & Answer Section

Operator

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

Michael Vitfell-Rasmussen

Thank you very much, and good morning. And Heine, welcome aboard. So, I would like to ask three questions, please. First, on working capital. Well done on that one. How about going forward, what should we see here? I mean, looking at inventories to sales, it seems a little bit just like a normalization versus 2012, 2013, 2014. And also in terms of payables, looking back over the past four to five years, you have been able to improve that line by about 1 percentage points to sales per year. Is this going to continue in second half and into 2017, please?

My second question, if you would just give us a little bit of support on how to model in the divestments in Malawi and South Vietnam, i.e. how much will hit the special items line and the cash flow lines in the second half, please.

And finally on the Russian market, you mentioned that you believe the market was down 2% in first half, you still guide, I believe, the 5-10% decline for the full year. Is second half really going to look that bad? And also, note that your competitor, Efes, was out yesterday saying that they now saw a low- to mid-single digit decline in the Russian market. Thank you.

Cees ‘t Hart

Michael, thank you very much. And for your first two questions, we were glad that we have Heine on board. Heine.

Heine Dalsgaard

Yes. Good morning, Michael. [Inaudible] So, it was a strong first half. And sort of going forward, we don't see that continuing. Bear in mind that when you look at trade working capital, there is a reclassification, so you have to see trade working capital together with other working capital. So, the net impact, net improvement is around DKK 800 million. Strong first half, going forward, we will continue the strong performance we've had historically broadly in line with previous years.

In terms of Malawi and Vung Tau divestments, there will be a special item impact in the second half. It is not something we comment on specifically for good reasons. So, there will be no numbers here, but there will be a positive impact from both of them in second half.

In terms of cash, there will as well be a positive impact in particular from the Malawi divestment. Then, also remember in terms of leverage that Malawi also was a relatively profitable business.

Cees ’t Hart

Thank you Heine. With regard to your first question regarding Russia, we assume in our budget for H2, a Russian market a decline of mid-single-digit percentages for the full year, so basically moving towards 5%, 6% decline.

We see the consumers remain under pressure and, especially, EGAIS was implemented and enforced from the 1st of July. And as a result, we have seen a reduction of the universe as some smaller outlets didn't install the system. We need to see the impact from the market on that.

And the other reason that we are may be a bit different from others is that to comply with the PET ban that comes into effect on January 1, 2017, we will stop production and the market probably will stop production already during H2 for the 1.5-liter PET. So, these are the reasons that we are a bit concerned or careful for the outlook for Russia for the second half.

Michael Vitfell-Rasmussen

Great. Thank you very much.

Operator

Thank you. Our next question comes from the line of Søren Samsøe from SEB. Please go ahead. Your line is now open.

Søren Samsøe

Yes. Good morning, guys. First question regarding Funding the Journey, which you say, is on track. But could you maybe just explain to us the timing of the earnings delta you expect to see from Funding the Journey before marketing investments, just so we know when we should expect the biggest delta from that.

Chris Warmoth

Yes. Thanks for the question. So, as I explained, Funding the Journey has three elements: getting good data, making it available and then, routinely monitoring it. We're not just moving to that third phase. So, that's why we're saying for 2016, we're expecting to deliver about a quarter of the net benefit. You will recall, the net benefits are 2018 versus the baseline of 2015, DKK 1.5 billion to DKK 2 billion. We would expect an acceleration very much in 2017 as that aggressive routine monitoring comes in. And then, from 2018, the program should be completing the delivery and then sustaining going forward.

Søren Samsøe

So, the largest effect will be in 2017, is that correct?

Chris Warmoth

It builds up. So, we're saying DKK 1.5 billion to DKK 2 billion in 2018 versus 2015. We're saying, about a quarter this year. We would expect an acceleration the following year and then, full delivery in 2018.

Søren Samsøe

Okay. And then, regarding China and the closure of different sites, you say you now closed down 11. I think, I remember, you said eight after Q1. Is that correct? So, there's been three net closures in Q2?

Yeah. So, we closed 11 in the two years, you're right. Three since Q1. We have also sold off, which we haven't talked about before, two half-completed sites. So, they've gone. So, we are now nearing the end of the program, but we are still evaluating a couple of further sites.

Søren Samsøe

Okay. And then, just a question regarding cost of goods sold. Will you see more headwind from that in second half than in first half? Is that one of the reasons why you think earnings growth will be lower in the second half?

Heine Dalsgaard

That is correct. There will be a transaction impact in Russia in second half.

Søren Samsøe

Okay. But nothing in Western Europe or Asia particularly?

Heine Dalsgaard

Not something significant. The big part is the transaction impact in Russia.

Søren Samsøe

Okay. Okay. Thank you.

Operator

Thank you. Our next question comes from the line of Simon Hales from Barclays. Please go ahead. Your line is now open.

Simon Hales

Thank you. Good morning, everybody. A few quick questions from me, if I can. First, just going back to Russia. You talked about the volume outlook for the second half. Where are we on pricing? Have you taken any further pricing as we've gone into Q3? What are your expectations there?

Secondly, you talked about a slow-starting Western Europe to Q3 given some destocking post-European Championship. Are you able to provide a bit more detail as to markets where you're seeing that? And perhaps some idea of the scale of that destocking.

And then, thirdly, obviously, SKU rationalization looks to be well on track, if not ahead of plan. The pain SKU rationalization that you talked about incrementally, I assume that is all incremental to what you'd initially identified in the DKK 1.5 billion to DKK 2 billion of savings you expect from Funding the Journey. How quickly should we expect some of those pain SKUs to be able to be taken out of the business?

And then, just finally, just as a point of clarification on the tax issue. Is it right as I understand that there is no incremental cash impact from the loss of the Finnish tax ruling, you just have to expense that now in the P&L in the second half of the year?

Cees ‘t Hart

Okay. Thank you very much, Simon. With regard to Russian pricing, as you know, I've seen the inflation went down. And we want to remain to be priced in a competitive way. So, after 2015, where we raised the prices significantly, almost around 15%, we have been a bit more careful in the first half of the year by 3% to 4%. And we expect another 1% to 2%, depending on the channels for the second half of the year.

Regarding Europe destocking, frankly, it's difficult to estimate after one month, so we need now to see how August moves further. But we have seen, in a majority of the European countries, there was a good focus and rightly so on delivering in Q2, and making sure that the stock was in the trade for potential uplift.

We have seen uplift, as you've seen, that in our figures for Q2. But there probably are some stocks still in the trade. And after we have seen and finalized August, we probably know better how much that has been.

With regard to the SKUs, Chris?

Christopher Warmoth

Yeah. On SKU rationalization, so you should really see these as two rather different programs. One is about cutting a tail of low value SKUs. That's where we've already made good progress, and there are still further SKUs to come out, as we've explained before. We're doing that sequentially, so we can maintain the shelf space and, in some cases, replace SKUs. The pain program is a little different. It's less about quantity. It's more about taking out maybe a relatively small number of SKUs, but SKUs which are quite disruptive to the supply chain. It can be particular liquids, particular bottle shapes and it's a little bit site-specific.

We've developed a tool, which is now rolled out, whereby we assess the pain factor of each SKU. And those SKUs, which have a high pain factor, we then either take them out or we address the pain underneath them. And that's work which has now started. We piloted it in two markets. The tool is now expanded across the company. And, I think, that's going to take 12 to 24 months until we get to the end of that program.

Heine Dalsgaard

And a comment on and answer on the question regarding tax. So, the tax case related to 2006 to 2010, the tax was fully paid in 2010. But we appealed the decision by the Finnish tax authorities to the court system. And then, we lost, actually, in a Supreme Court decision in May this year. That's why we've now expensed everything. But you're absolutely right in assuming that there will be no significant tax impact – cash impact this year because the tax was paid in 2010.

Simon Hales

That was very clear. Thank you.

Operator

Thank you. Our next question comes from the line of Jonas Guldborg from Carnegie. Please go ahead. Your line is now open.

Jonas Hansen

Yeah. Good morning and thank you for taking my questions. First, a couple of OCM related questions and then on net working capital. First, you note in the report that you don't see that same substantial savings against targets on OCM in Western Europe as you do in Eastern Europe and Asia. Is there any color you can put on that, please?

And then, you also say that your OCM savings are well ahead of targets. Does this mean that initial targets are going to be raised or just that you will reach them quicker than expected?

And then, finally, on the net working capital. Can you say how much of the DKK 550 million negative development in other working capital that is explained by these pension obligations? Thank you.

Chris Warmoth

So, on OCM, remember that we started this program in Asia last year. So, on those three steps, I mentioned before about good data readily available, routinely monitored. Asia's been at it for 8 to 12 months longer than Western Europe. So, I think, Western Europe is where we would expect it to be at this point in time. It's similar to where Asia was at a similar point in time. So, as I explained to the earlier question, it's ramping up now and getting this routine monitoring in place does require some focus and effort. But, I think, there's no reason to believe at all that the goods won't come.

In terms of OCM savings, I mean OCM is just one part of Funding the Journey. It's really a support element that delivers primarily against OpEx, but it does also impact cost of goods. And we have 15 cost groups. Our targets were set on the assumption it would take time for the program to ramp up. So, the fact we're delivering a quarter is a bit more than we'd expected because we are getting good traction behind it. Will we reach quicker than expected of us? Because it is part of the total program, I think, you should stick to the assumption of DKK 1.5 to DKK 2 billion net benefits in 2018 versus 2015, with the ramp up I mentioned earlier. A quarter this year, acceleration next year and then, full delivery in 2018.

Jonas Hansen

Okay.

Heine Dalsgaard

In terms of the net working capital or the working capital question, and the minus DKK 555 million, remember, in here is the reclassification to trade working capital and then also, a pension contribution, a cash contribution, and the pension cash contribution is around DKK 250 million.

Jonas Hansen

Okay. Thank you. Very clear.

Operator

Thank you. Our next question comes from the line of Hans Gregersen from Nordea. Please go ahead. Your line is now open.

Hans Gregersen

Good morning. In the initial presentation, Chris, there were some comments on the big city and craft and speciality driver. Can you shed a little bit more light on where we are and what you see coming from this?

Question number two. India, you mentioned meaningful profits, what does that mean? And the brewery closures you have done, what will that do to the business? And then, finally, the Malawi divestment, when do you expect to get the cash from that? Thank you. And then finally, why do you expect such a continued, very high level in unallocated cost? What's driving that in the second half? Thank you.

Christopher Warmoth

Okay. Thanks, Hans. With regards to the announced elements of SAIL'22, we are now preparing ourselves with finding the right people to be on top of the program. We just announced our previous CEO of Sweden to be the head of the big cities. He's forming a team, as we speak. He's going to develop the program. And by the end of this year, we will have a discussion in ExCom how we're going to start and implement and roll out the big city strategy in 2017.

So, we are focused very much on, first of all, delivering Funding the Journey and whilst we are doing that, preparing ourselves for the strategic thrusts, making sure that we have the right people in the right place. And, again, as we speak, that is being done. And, now, we move forward for implementing our program to start with budget 2017.

Hans Gregersen

But when do you expect to be able to communicate more clearly on it?

Cees 't Hart

I think after – obviously, when we talk about, for example, big cities, we don't want to announce which are the big cities we're going to conquer. Maybe it's a big word, but at least to enter. So, at the moment that we have landed in the big city, we will, for sure, update the market.

Chris Warmoth

So, on India, recall that this was a greenfield entry going back to 2008. And as you would expect in a greenfield entry until now, until last year, it was very much investment mode. Last year, as we mentioned to you, we got to breakeven, which actually was ahead of the plan we'd put in place a couple of years before. And this year, when we talk about meaningful profit, it's still single-digit margin, but it's starting to be attractive.

And you mentioned Bihar. Bihar was 7% to 8% of our Indian volume. It's now disappeared. It was actually one of our more profitable states. And despite that, our profitability is still quite satisfactory and ahead of where we'd expected a couple of years ago.

Heine Dalsgaard

And on the question regarding Malawi, very pleased to confirm that we have received the money in August, so that's very good. In terms of your question, Hans, on second half, unallocated, it is right that we have said that unallocated cost in second half is going to be broadly in line with last year, of course subject to SAIL'22 investments. And that is really why it's going to be at that level in the second half. It is because of the investments into SAIL'22 initiatives which, of course, are then made to ensure the long-term profitability of the company.

Hans Gregersen

If I understand your answer correctly, does that mean all SAIL'22 related expenses will be booked as unallocated costs?

Heine Dalsgaard

No. It definitely doesn't. But it does mean that some of the initiatives under SAIL'22 starts with us making plans and doing investigations and analysis. And these analysis are done at Group level. So, the initial parts will be heavy towards corporate costs.

Hans Gregersen

Thank you.

Operator

Thank you. Our next question comes from the line of Richard Withagen from Kepler Cheuvreux. Please go ahead. Your line is now open.

Richard Withagen

Yeah. Thanks and good morning. Just three questions. First of all, on the organizational changes, the changes in the ways of working within Carlsberg and, I guess, the more centralized structure. Cees, perhaps you can say a bit or talk a bit about how that has been picked up by the organization in the past year and where do you still see some room for improvement in execution?

Second question is on the golden triangle. You said that you may have to do some adjustments to reduce your market share losses. If you can give some more background on that as well.

And the last question I have is can you tell us how much your marketing to revenues were up in the first half of the year compared to the last year?

Cees ‘t Hart

Okay. Thank you. With regard to the organizational changes, we basically started off after Q3. You've seen quite some changes in the top structure. And as we go forward, we discuss with people in our top 60 how we move forward. And, of course, at the moment that they feel really onboard we continue and at the moment that we feel that they cannot contribute that much to our changes, we might make a change.

We have changed more or less 15% of our top 60 now. But, frankly, over time, that will become a natural process of people that come in and go out of the business. The program, as such, has picked up very well, especially the golden triangle, as you were alluding to, but as well the changes as such that we focused much more on implementation of the plans, getting the savings ready, getting the savings to the bottom line. We see very good traction of Funding the Journey. We see a lot of progress on the preparations of SAIL'22.

So, all in all, looking back over the last year, I think the changes we have implemented got very good traction. And, in that respect, I'm really satisfied as well with how the new team comes together. We focus very much on performance management and have good monthly review sessions on how the business performs. That's different from the past and that serves us well.

With regard to the golden triangle, we've implemented the golden triangle as we want our business to strike the right balance between the three metrics. And when you implement such a significant change from previous – you know, Carlsberg is more focused on market share – when you implement such a significant change, there will be businesses that adopt it very fast and successfully, while other businesses need a little longer and more guidance to strike the right balance. And that's what I meant in my remark.

Heine Dalsgaard

And on your question regarding marketing investment relative to revenue, on a reported basis, marketing investments in the first half are up 3% to 4%. And the main reason here has to do with the EURO 2016 investment.

Richard Withagen

All right. Thank you.

Operator

Thank you. Our next question comes from the line of Tristan van Strien from Deutsche Bank. Please go ahead. Your line is now open.

Raoul-Tristan van Strien

Good morning, gentlemen. Three questions if I may. The first one, just for clarification. The step up in sales and marketing in Western Europe, is that in addition to the DKK 150 million or so you have now allocated or in the unallocated bucket essentially for Europe?

The second question, in Russia, just a bit of color on your pricing ladder now that you've reduced the price of Carlsberg. What is the weighted average market price of Carlsberg relative to the market and where was it a year ago? And where does it sit now relative to Tuborg where it was a year ago?

And then, the third question just on Malawi. Does the sale include your Southern Bottlers Coke franchise? And is there a change in control cost there from Coke that Castel has to deal with? And if it does, if they do do a change of control, does Castel have any recourse back to you guys, if they lose the Coke franchise? Thank you.

Cees ‘t Hart

So, thank you very much. First, Heine?

Heine Dalsgaard

Basically, on the sales, marketing investment from Europe, in Western Europe and the reason why that it goes up, that primarily has to do with the investments in EURO 2016 as well.

Raoul-Tristan van Strien

Just a clarification. So, that margin in Western Europe, that includes the additional cost of EURO 2016 which is an addition to the unallocated bucket.

Heine Dalsgaard

It is. That is correct.

Raoul-Tristan van Strien

Okay. Thank you.

Cees ‘t Hart

Just regarding Russia, The Carlsberg price was lowered in the beginning of the year by 35% to 40%. As we said here, we have a new commercial program for the 2016, which – well, the summer is going on there. The season is going on as we speak. So, we need to see what the consequences are. But we have, indeed, decreased the price of Carlsberg. We're focusing much more on key accounts. We have a better mix of national and regional brands, and we focus more on DIOT. So, these are the four pillars of our commercial plan for this year.

Again, Carlsberg, our price point was lowered. The Carlsberg brand has had an insignificant share in Russia. Our other international premium brands like Tuborg and Holsten are much more important. It was done to reposition Carlsberg as an affordable international proposition. And as consumers are under pressure, they are looking for more affordable alternatives. And what we can mention now is that the first signs of this adoption of the new pricing is really successful. But it's early. We are early days in the season. But the first half of the season, this has been successful.

Raoul-Tristan van Strien

So, just a follow-up on that Cees. So, is Carlsberg now positioned below Tuborg at the moment in the market?

Cees ’t Hart

It is. Yes.

Raoul-Tristan van Strien

Okay. Thank you.

Chris Warmoth

And on Malawi, you asked about the Coke franchise. We sold the business as is and it's now Castel's responsibility to manage Coke in whatever way they feel best.

Raoul-Tristan van Strien

So, if they take away the franchise like the Morocco years ago, there's no recourse to you, guys?

Chris Warmoth

That is correct. Yeah.

Raoul-Tristan van Strien

Okay. Thank you.

Operator

Thank you. Our next question comes from the line of Trevor Stirling from Bernstein. Please go ahead. Your line is now open. Hello, Trevor. Are you on mute? Okay. So, then, we'll go to the next question of Olivier Nicolaï from Morgan Stanley. Please go ahead. Your line is now open.

Olivier Nicolaï

Hi. Good morning. I've got two additional questions, please. First of all, in Western Europe, you've lost share in a few key markets. Are you expecting to stabilize your market share in H2? I mean, thinking about Poland, France and the UK and more specifically in the UK, excluding the Tesco impact, are you able to say you maintain share in exiting channels where your products are sold?

And just one last question on Vietnam. You sold a brewery to Heineken in July. Could you give us an update on your strategy in Vietnam going forward, if you just focus on the north of the country? Thank you very much.

Cees ‘t Hart

Thank you. We're going through the share. Obviously, we try to balance the share loss. Some of that we will not be able to recuperate in the second half of the year just because of the fact that we lost a contact in the UK and we finish ourselves in Poland and Finland contracts that were loss-making and the consequence of that, you have seen in the improvement of the margins. So, in that respect, our share probably will be still a bit on the pressure in the second half of the year.

With regard to France, that's a different issue. We have focused very much on the preparation of the Euro event. We have been very successful in the on-trade during the event, although, the number of visitors of fan zones was lower than we expected or was expected, and the terrorist threats and the very, almost brutal weather, especially the beginning of the tournament has played its role. But the share in on-trade has developed very positively.

And we were focusing on, if you like, normal promotions in the off-trade channel, whereas some of our competitors went in with *bogofs* [buy-one-get-one-free]. That has surprised us, these kind of very steep price reductions. And by that, we have lost some share in the off-trade which, obviously, we want to gain back. After three years of gaining share in France, this is a bit of a setback in especially in the off-trade and, obviously, we want to correct that.

With regards to Vietnam, indeed, we focus on the territory where we are. We have a footprint, which we would like to improve at the moment that the privatization is being implemented. As you know, the Habeco is something we talked about earlier. We are very satisfied with the launch of Tuborg. That's really a success. We are gaining share there. And we have high expectations for the second half of the year on Vietnam to prolong the success of Tuborg.

Olivier Nicolaï

Thank you very much.

Operator

Thank you. The next question comes from Andrew Holland from Société Générale. Please go ahead. Your line is now open.

Andrew Holland

Yeah. Hi. Two questions, if I may. Firstly, on your SKU reduction, I think we talked before about how that was a target of previous management and didn't seem to make much progress. Can you just remind us what you think your total number of SKUs is if you're targeting to even a short 2,900 to get rid of? That sounds like a very ambitious program. So, how many have you got? And when you talk about that, is that a net or a gross number? Because, presumably, you're introducing new products. And which regions are most of those SKUs coming out of? That's question one. That's about five question ones.

The second question was on the Russia retail, this new regulation for retailers. Can you give an idea of how – what proportion of your business in Russia is likely to disappear as a result of those retailers not being able to comply with the new regulations?

Chris Warmoth

So, on SKUs, we started off with just under 10,000, so it is a substantial number. The number we're giving you is a gross number. So, like any good business, we are doing innovations, but we're trying to hold and successfully holding the number we're introducing to about half of what we're taking out.

In terms of regions, we're seeing progress across all of the regions. And in terms of sustainability, it really does come back to what I mentioned before. We have a monthly scorecard of SKUs planned to take out. We have a monthly report on how many SKUs did come out, how many new SKUs went in. And then, we keep a tracking total. So, it really comes back to that philosophy of having the data and routinely monitoring it to prevent the creep coming back in.

Cees ‘t Hart

With regard to Russia, thank you, Andrew, for the question. Basically, we had a few big trends going on in Russia, as you know. The modern trade is coming up. It's close to 40% of the total market. On-trade is 10%. It means that traditional trade is still 50% of the market, but declining.

We think that EGAIS could reduce the number of very small outlets, outlets that need to incur costs to introduce the system of EGAIS. It has not been enforced until 1st of July. So, we now need to see what the impact is.

A specific answer on your question, I think that 5% to 10% of the distribution is in the area of very small. That doesn't mean that that will disappear. But these are, if you like, the mom-and-pop shops that some of them might conclude that they don't want to invest in the EGAIS system.

So, that's, if you like, a part of the distribution that, at a certain moment, might be under pressure. Not meaning or not indicating that it will disappear at all but part of that could disappear.

Andrew Holland

Okay. Thank you. That's very clear.

Operator

Thank you. Our final question comes from the line of Carl Walton from UBS. Please go ahead. Your line is now open.

Carl Walton

Thanks, everyone. Just a couple of very small follow-ups. One on the Russia pricing you've taken. Is the competitive dynamic sort of normal in the sense that competitors are following maybe with some small normal amount of lag or is there more aggressive move from competitors on pricing in Russia?

And then the last one, just on the tax rates. You did say that obviously, excluding the Finnish one-off expense, the underlying is moving to just below 30% which – so, ignoring the Finnish expense is a little bit higher than the sort of circa 28% guidance there we'd seen before. Is there anything significant to flag in that? Is it just generally rising rates or geographic mix or anything significant to flag there on the underlying tax rate? Thank you.

Cees 't Hart

Thank you, Carl. With regard to the price increases in the Russia, we can say that the competition has increased the prices as well. So that's different than we have seen in 2015. With regards to the tax, Heine?

Heine Dalsgaard

On the tax part, you're right. We're seeing now just below 30%, and that is not 28%. So, it is a little bit higher than what we have said in the past. It basically has to do with the distribution of our profit, including also Russia with the lower profitability, and also some inefficiencies we have in our tax structure in some emerging markets, in particular in China. So, you're right, just below 30% is not 28%, and the main reason has to do with the distribution of profits across legal jurisdictions.

Carl Walton

Very clear. Thank you.

Cees 't Hart

Thank you and that was the final question. Thanks 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

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