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Speakers: Cees ’t Hart, CEO
Christopher Warmoth, SVP

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Presentation

Operator

Ladies and gentlemen, welcome to the Carlsberg Strategy conference call. Today I am pleased to present Carlsberg President and CEO, Cees 't Hart. For the first part of this call, all participants will be in a listen-only mode and afterwards there will be a question and answer session. Just to remind you, this conference call is being recorded. Speakers, please begin.

Cees 't Hart

Thank you. Good afternoon everybody and welcome to this presentation of Carlsberg's revised strategy. My name is Cees 't Hart and I have with me, Senior Vice President for Asia, Chris Warmoth, who is heading up Funding the Journey; Head of Finance, Jan Thieme Rasmussen, who is currently Interim CFO and Vice President of Investor Relations, Peter Kondrup.

Please turn to slide 1. We have, this morning, announced our revised long-term strategy, which we have named SAIL'22. As the name suggests, we are embarking on a journey, a journey that will see Carlsberg transform into a business that will deliver long-term, sustainable value creation. During the past six months, the top 60 leadership team of Carlsberg has worked together and identified, evaluated and concluded on a range of strategic options. The engagement of the top leadership team in this process has been very important to ensure that we tap into the vast knowledge base in the company, that we start driving a team-based culture and that we also will be able to roll out and embed faster.

As we have indicated several times, SAIL'22 is not a revolution but an evolution, as we felt a revolution was not needed. We will remain in beer and we will continue with a business built around three regions. We will now create a stronger business, as we will do that by ensuring that we fully exploit and leverage our strengths while also positioning ourselves for future growth. We see appealing growth opportunities in the increasingly dynamic beer category and we will adapt a targeted approach to capture the most promising opportunities.

To guide us on our journey, we have a compelling new ambition. We are also fundamentally changing how we prioritise and operate. We will focus our efforts against a narrower and more precisely-defined set of priorities. We will foster a greater sense of ownership; we will rigorously follow up on delivery of results and we will drive a high-performance, team-based culture. This will lead to increased shareholder value.

Please turn to slide 2 and a few comments on why we believe beer offers many interesting opportunities. Beer has a long and exciting history. Nevertheless, it is still a vibrant and dynamic category, where we see many attractive opportunities. It is also a large and, typically, a very profitable category. Globally, beer is the most valuable beverage category. Moreover, the beer category continues to grow, both in volume and especially in value terms. Volume growth continues in emerging markets and even in some major markets we see some interesting pockets of growth. More importantly, the category delivers positive value growth rates across most markets globally, driven by premiumisation and innovations. This trend is driven primarily by the growth of international premium brands in emerging markets and by a growing demand for speciality products in mature markets.

As we evaluated our strategic options, we analysed key global trends to ensure that the strategy fully reflects future consumer needs and expectations. We identified four specific global trends which we believe will shape the future beer category. First, sensory and indulgence, which sees consumers becoming increasingly interested in new tastes and more willing to experiment. Second, smart and connected, whereby digital is becoming more and more important, with consumers constantly connected and e-tailing and business-to-business e-commerce expanding. Third, urbanisation, which is bringing an acceleration in the speed in which consumers are moving to big cities, where we see a higher beer consumption per capita and more premiumisation. And lastly, health and wellness, with consumers being more and more sensitive to healthy lifestyles, something which impacts their consumption of beverages. With SAIL'22 we are making some clear choices designed to position us to capture these exciting opportunities. These choices will fundamentally change the approach we adopt and the plans we make.

Slide 3 please and an overview of our three diverse regions. While SAIL'22 recognises the changes within the global market, one important element of SAIL'22 is that we will continue to operate in our current three regions. Following the significant growth in our Asian business in recent years, and the marked decline of the Russian beer market, our portfolio of markets is better balanced. In all three regions, we have very robust local businesses, with strong market positions and promising portfolios of local and international brands, all driven by very committed and engaged people. We believe that our current markets offer many opportunities and that these can be realised by building on the strong assets that we already have. SAIL'22 builds on our strengths and heritage.

Please turn to slide 4, where we will go through some of the key strengths. The Carlsberg Group indeed has many strengths and coupled with a rich heritage, we have a solid foundation upon which we can build a stronger future for the group. Our 22 number-one and number-two country positions account for approximately 80% of global EBIT. Moreover, the majority of our profits are generated in consolidated markets. We have a strong portfolio of 140 brands, consisting of local and international brands, as well as speciality products and together this portfolio of brands means a broad range of consumer needs. The Carlsberg research centre, with its 150 employees has excellent R&D capabilities and a strong track record. The focus areas of the research are grains, mainly barley, yeast, fermentation and brewing technology. The centre has been crucial in the development of improved barley strains, technology breakthroughs like our proprietary DraughtMaster one-way keg system and the successful Somersby innovation. Our in-depth local knowledge and consumer insights in the markets where we operate provide insightful guidance for our R&D work, as well as for our commercial priorities.

Coming from the outside, it is clear to me that the great strength of the Carlsberg Group is our distinctive history and heritage and this is not confined to just Carlsberg, but is true for many of our other brands and businesses, some of which also date back more than 100 years.

Finally, we have a long-term, committed and value-oriented main shareholder that wants Carlsberg to deliver long-term, sustainable value growth to the benefit of all shareholders.

Slide 5, please and our new ambition. We have defined an uncompromising and overriding ambition that has guided us in developing our strategy and that will guide us in everything we do going forward. Our ambition is to be a successful, professional and attractive brewer in our markets. To be a successful company, we will drive top- and bottom-line growth by finding the optimal balance between beer volume market share, gross profit after logistics margin and operating profit. To be a professional company, we will excel in our ability to service our broad range of customers by strengthening our capabilities within consumer insights, customer management, category management and execution and innovation in the logistics area. To become an attractive company, we will focus on creating value for shareholders by delivering consistent earnings growth and improving return on invested capital, for employees by creating a great working environment and actively encouraging a high-performance culture and for society, by operating a responsible and sustainable business.

Please turn to slide 6. To realise our ambition, we have defined a set of clear priorities. We will strengthen our core, we will position ourselves for capturing growth and we will foster and create a team-based, winning culture. Priorities of strengthening the core and positioning for growth represent the sail of the boat and as a sail, they will attractively leverage the winds around us to propel us forward. The winning culture is the crew sailing the ship, making sure that we move in the right direction, fast but securely. The sail and the crew will bring us successfully towards our 2022 destination and as we do so, we create value for our shareholders.

Let's now dive into the four priorities. On slide 7, we go through the overall priorities. For each priority, we have made clear choices, which we believe are the ones that will deliver success. Our approach is to have a narrow focus and this will ensure that the chosen priorities get the required investments, capabilities and overall resources to succeed. This is a fundamental change for the group. On the next slides, I will provide more insights into each of these choices.

Slide 8, please. I will start with strengthen in the core, where we have made three distinct choices: Leverage our strongholds; Excel in execution; and Funding the Journey. And if you turn to slide nine, I will go through the first of our priorities.

Leveraging our strongholds requires two critical actions, the first being to revitalise our core beer. Core beer is defined as our local and international premium brands. Since they account for more than 80% of net revenue, their revitalisation will drive growth in top-line, market share and profits. Within core beer, a disproportional part of the profits comes from a relatively tight set of brands in specific markets, where we usually hold a strong market position. We will revise our portfolio strategies, streamlining them as appropriate at both brand and SKU level. This will help ensure that we have strong and efficient presence in the key market segments and at the same time will enable us to win in the markets and drive category growth. We will redirect and refocus investments behind those key brands which deliver the core of our current profit and also have margin growth potential. Of these brands, we will ensure we have excellent brand fundamentals and renovation plans, backed by consistent and solid investment levels. Finally, we will improve the OBPPC processes. This stands for occasion, brand, pack, price and channel. This helps ensure that we balance and optimise our brands and profitability across locations, by securing the right packaging and price in the relevant channels to meet consumer needs and expectations.

Slide 10 and Russia. The second point under leveraging strongholds is transforming our business in Russia. Even though it now only accounts for 16% of group EBIT, Russia remains our single largest market and remains important to us. We want to transform our business in Russia and we understand what will be required to make this happen. Although Russia currently faces major economic challenges, we believe that the market offers many opportunities. We will navigate through the challenging times and ensure that we are ready to capture the opportunities as they arise. Our starting point in Russia is good. Our Russian business is already strong and profitable. We have a unique brewery footprint, a second-to-none route to market and a distinctive portfolio of international, national and regional brands. To help drive the transformation of our Russian business, we see an opportunity to further strengthen our portfolio. We will ensure that we have the optimal range of national and regional brands to meet consumer needs which are changing as the country itself undergoes change. We see an opportunity to more fully leverage our industry-leading supply chain and production network, which we already consider as a clear competitive advantage. Additionally, we will improve our in-store visibility, enhance our position in the growing modern trade and reduce costs in all areas.

To ensure that we deliver, execution is key. Please go to slide 11 and a few comments on how we will achieve that. We will excel in execution. In the beer category, there are a limited number of ways to differentiate ourselves and therefore quality, impact and efficiency of execution are key to success. Excelling in execution is fundamental to making the boat sail fast and in the right direction and while this may sound obvious, the reality of excelling in execution is far from easy and requires intense focus.

We have defined the critical areas where we need to excel. These are, first, our approach to managing our brand portfolios, which have to be more consumer-occasion and benefit driven. Second, complexity management, where we need to eliminate unnecessary complexity, leaving room only for smart complexity. Third, execution at the point of purchase. Fourth, step-changing our digital agenda to connect with consumers and customers more efficiently. And lastly, consumer-driven R&D with focus on our strategic priorities and a faster, simpler and more impactful process. We are now developing detailed plans on how to master these capabilities and ensure that these are embedded across the organisation.

One example of a relevant tool is what we call our FIT programme in some countries in Western Europe. This focuses on execution at the point of purchase. We will now further develop FIT and consistently roll it out across our geographies, making it an almost automatic part of the daily routines of our sales people.

Slide 12, please and a few comments on Funding the Journey. Funding the journey is the programme we announced in November 2015, designed to improve efficiency across our value chain and provide funding for our strategy. The expected net benefits of DKK 1.5 billion to DKK 2 billion remain unchanged. We expect to reinvest about 50% of the benefits in SAIL'22, while the other 50% will improve profits. As we said when launching the programme, the net impact will be relatively modest in 2016. We expect to generate some benefits but we will also start spending behind SAIL'22. There will be a more substantial impact in 2017 and then a strong impact in 2018. Funding the Journey brings together into one overall programme both existing and new efficiency initiatives. This puts in place support programmes to help ensure delivery and have established rigorous tracking across all elements of Funding the Journey. Initial signs are promising, indicating that the newly installed discipline and focus are generating results. By 2018, we expect key elements of Funding the Journey, such as value management, supply chain efficiency and OCM, or operating cost management, to be part of our daily business.

Slide 13 please and our growth priorities. While 'strengthen the core' is focussed on extracting more value from our existing brands and businesses, we see interesting opportunities to generate additional top-line growth by moving into new categories and occasions. In addition, we see further growth opportunities coming from the increasing global urbanisation trend and from our Asian region. A fundamental change compared to the past is that we will appoint dedicated teams with sufficient resources to drive our efforts in these areas.

Slide 14, please and the interesting craft and speciality category. We will actively shape the craft and speciality category, offering portfolios that cater to the requirements of both consumers and customers. The craft and speciality category is particularly interesting in mature markets; it is expected to grow 15% per annum, globally, in volume terms. And on top, its profitability significantly exceeds that of mainstream beer. To take advantage of this opportunity, we can make full use of our heritage and also existing selected brands in our portfolio. On brands, we aim for a clear and tight portfolio, built on what we already have in place and then extend where relevant. Our portfolio will include speciality brands, such as Grimbergen, authentic craft propositions such as Jacobsen, the Nya Carnegiebryggeriet and other similar brands, and accessible, crafty line extensions from local brands, such as Brewmasters Collection. We will employ smart complexity to deliver craft quality at scale, manage COGS and increase category profitability and we will significantly increase our marketing support behind craft and speciality. We already have a number of proven successes in Scandinavia.

Slide 15, please. Another category where we see attractive growth opportunities is non-alcoholic beer, which is also benefiting from the growing global health and wellness trends. Non-alcoholic beer is growing three-times faster than the overall beer market and offers some excellent margin opportunities. We have unique insights into the non-alcoholic beer segment and we will leverage our R&D capabilities to drive growth. We will actively shape the category and market a full portfolio of both line extensions and specialised own brands and do this in both existing and new markets. We will significantly increase our investment in both technology and in marketing. We already have a number of successful non-alcoholic products, such as Tourtel in France and Nordic in Denmark.

Slide 16, please and a few comments on potential geographical expansion. The second key initiative for driving growth is a targeted approach towards big cities. As we have mentioned, this taps into the market global urbanisation trend. It will not only deliver volume growth, but more importantly, be an attractive driver for value growth, due to the premiumisation in urban centres. We aim to build profitable businesses in big cities and countries where we already have operations but have gaps in key big cities within those countries. We will also target big cities in countries where we do not operate; our approach will be focussed both in terms of portfolio and sequencing. We will establish an asset-light model for capturing these opportunities, building on the learning from our growing and successful export and license division. In that division, we already have proven successes, for instance in Toronto where, with a local sales force, we have built an interesting position in imported premium beer and cider.

Please turn to slide 17 and Asia. The last growth initiative is Asia. Our Asian business has been, and will remain, a key growth driver for us. We are well placed to capture further volume and value growth in the region and will consequently invest accordingly. We will achieve this by increasing our focus on our premium portfolio and further strengthening our number one and two positions in the growth markets of Nepal, Laos and Cambodia, as well as in the more mature markets of Malaysia, Singapore and Hong Kong. Moreover, we will specifically build our position further in the large beer markets of China, India and

Vietnam, through product launches, geographical expansion and successful management of a portfolio of brands, designed to meet a broad range of consumer benefits and price needs. In these very large markets, we will drive leadership in certain regions.

Slide 19, please and culture, whilst our priorities on strengthening the core and positioning ourselves for growth are the right ones, we will not be able to achieve our ambitions without the right people and the right corporate culture. We are therefore making fundamental changes to the way we operate, with the objective of generating a strong, team-based, high-performance and winning culture. This has already led to changes in our leadership team and more than 10% of the top 60 has left us. We will embed our new values and the new performance management system based on the triple 'A's. Alignment: we will drive a proactive alignment on our destination point on the horizon; we are one team with one aspiration. Accountability: we are all being accountable for the actions we chose to pursue. And lastly, action: we will ensure that decisions are implemented with speed and rigour. We will ensure delivery of our plans across all businesses by putting in place a tightly-run follow-up process. As part of this, we will track progress against agreed targets for both Funding the Journey and SAIL'22. We will create a strong sense of ownership and accountability for delivering results by encouraging and incentivising higher-performance behaviour. This also means having a tight alignment between management incentive plans and financial objectives. For example, long-term incentive schemes for the leadership are now directly linked to delivery of Funding the Journey benefits and short-term incentive schemes are linked to metrics such as market share, GPaL [gross profit after logistics] margin, absolute EBIT, solid cash flow and improved ROIC. Typically, 80% of annual KPIs will be linked to these financial objectives and the remaining 20% will be personal KPIs.

Slide 20, please. The choices which I have just been through aim to develop a sustainable business model which will deliver value for our shareholders. We will focus on two key metrics: organic operating profit growth; and return on invested capital. We also think it's appropriate to provide clear targets on how we intend to allocate capital. With that I would like to hand over to Chris who will go through our financial commitments. Chris.

Christopher Warmoth

Thank you, Cees. Please turn to slide 21 and our first financial commitment. This is to deliver consistent and continuous organic operating profit growth, the measure reflecting our ability both to grow top line and to reduce costs. As such, it represents an important confirmation that our strategy is right and that we're executing well. Achievement will be a clear change compared to recent years where we have seen flat or slightly negative earnings growth.

Slide 22 please and ROIC. Our second financial commitment is to improve return on invested capital. The ROIC improvement will be driven by the aforementioned operating profit improvement and by optimising our capital base. We'll sweat our fixed assets through improved utilisation and exercise a strict financial discipline when making investment decisions. We believe that we can keep CAPEX below depreciation for a while, although we may divert slightly from this low level when we need to invest behind some of our growth initiatives. In addition, we are looking critically at those businesses that currently do not deliver satisfactory returns and evaluating how that can be changed. We will continue the successful focus of recent years on improving trade working capital. As a result, we will be able to deliver a high cash conversion in the coming years.

As an aside, we have been impressed by the geometrical ability of some analysts which has been skilfully employed to convert the EBIT bar on the previous slide and the ROIC dotted line on this slide into specific numbers, even to two decimal places. We are sorry to disappoint, but the 2022 bar on the EBIT chart and the ending point on the ROIC chart are purely illustrative, designed to show our strong intention to reverse, in a positive way, the trends of the recent years. And for information, we don't own the boat in the pictures either and with our desire to keep CAPEX under tight control, at this point we have no plans to acquire it.

Please turn to slide 23 and a few comments on capital allocation. When looking at our capital allocation traces our first priority is to invest behind those strategic plans critical to deliver sustainable long-term growth. Secondly, we will reduce financial leverage and increase dividends. We will run our business with a solid balance sheet and, given our business profile, we believe a net interest-bearing debt to EBITDA ratio of less than two times is required. This ratio will give us some financial flexibility and make it easier for us to refinance our debt when we need to do so in the future. When we've reached a leverage below two-times EBITDA, which we should be able to attain within a relatively short-time horizon based on the expected cash flow, we'll target a dividend pay-out ratio of 50% compared to the 30% we have today. That will bring us in line with other consumer staple companies. When both targets are achieved, we'll return excess cash to shareholders, either as buybacks or extraordinary dividend. Today we don't have any preference here, but when the time comes we'll make the decision after consulting our major shareholders.

SAIL'22 is about strengthening our business organically, so acquisitions currently have lower priority. That said, if we see opportunities for strengthening our business through acquisitions, we will pursue them. If we do make value-enhancing acquisitions, we are willing to deviate temporarily from the above leverage and pay-out targets. On divestitures, if we see attractive opportunities for disposals of businesses or brands, which may be of higher value to others than to ourselves, we will consider them. The disposal of the malt business earlier this year is a good example of that. And with this, I'd like to hand back to Cees.

Cees 't Hart

Thank you, Chris. And please turn to slide 24 and an overview of our priorities within SAIL'22. In SAIL'22 we have established clear priorities to strengthen the current business and drive future growth. We've assessed our strengths and will build on these. The end result is a narrower set of priorities than in the past and this will enable us to put more focus on, and more efficient allocation of resource behind, the key priorities. We will also step-change our commitment to deliver results. We've put in place rigorous mechanisms to track performance.

Slide 25 please and a few concluding remarks. We believe that SAIL'22 will bring more clarity both internally and externally on how we will drive the Carlsberg Group forward. In this presentation I've tried to answer the WHAT, the HOW and the WHY facing us. The WHAT is our ambition of becoming a successful, professional and attractive brewer in our market. The HOW is fewer and clearer strategic priorities and the WHY is our commitment to deliver value to our shareholders and our stakeholders. This of course cannot be achieved without a high-performing team. To create a true team-based winning culture we will focus on the three 'A's: alignment; accountability; and action. We are making fundamental changes in how we work, how we set targets, how we prioritise and how we follow-up. With SAIL'22 our leaders now have a strong blueprint which they can use to drive and embed the necessary changes. The co-creation process of the strategy by the top 60 has already brought us a significant step forward.

Before opening up for questions I would like to draw your attention to the appendix of the presentation where you can find supporting proof points behind our priorities. With that final remark I would like to open up for questions.

Q&A

Operator

Thank you. Ladies and gentlemen, if you have a question for the speakers please press 01 on your telephone keypad and you'll enter a queue. After you are announced please ask your question and please hold until we have the first question.

Our first question comes from the line of Tobias Bjorklund from Danske Bank. Please go ahead, your line is open.

Tobias Bjorklund

Yes, good afternoon to you all. I have a question regarding these financial targets or lack of some of them. I mean, you're not disclosing a ROIC target or an EBIT margin target and, you know, the question is how we should measure your success and how we should look at that? And I wonder why you don't disclose them? Is it because you've had some bad experience from setting targets previously or there's some other reasons for it? That's my first question.

The second question is about increasing your Chinese presence and how you intend to do that as you are already pretty strong in the regions where you're active?

And then the last question was about this licence and licensed deals, now you say that 30 out of 50 cities Carlsberg is not present. I wonder, could you give some thoughts on how these licensed operations normally are set up? Thank you.

Christopher Warmoth

So let me take the first two questions. On the financial targets, we have decided not to give more specific EBIT and ROIC targets for a couple of reasons. The first is that, several of our largest shareholders have advocated for us not doing that. And we are going to be measuring ROIC and EBIT of course and we'll do that externally. Internally, we have a rigorous measurement system and we discussed some of those today. GPaL, market share, EBIT, cash and they are tightly linked to our incentives.

The second reason we're not giving more specific targets is the macroeconomic uncertainty in Eastern Europe, which frankly does make it difficult to set specific targets with sufficient confidence on EBIT and ROIC.

And your second question in increasing presence in China. You're right, we have a good footprint, but even within the provinces where we are; take Yunnan where we have a good business; there are parts of Yunnan where we're much stronger than other parts. And maybe linking a little bit to the big cities points, there are certain big cities also where we're not very strong. We have a business which is part of the East coast, is a licensing-type business. We see an opportunity to extend that. And then thirdly, as I think you know, we've had a lot of success with the Tuborg brand in China. That's still in roll-out mode. There are parts of our existing geographies where Tuborg is really only just getting started, so we see an opportunity to continue to build on the success of Tuborg.

Cees 't Hart

With regard to our licensing deals, I guess you want to know a bit more about our big city approach. What we see is that we have already been pretty successful with our Export & Licensing department in some of the cities. And we see as well that if you look at the globe at this moment of time, there are not bright spots any more in terms of countries where the competition has not already taken the number one and number two position outside where we are ourselves. Probably the last market where we are all now is Myanmar. In our analysis, we saw the urbanisation. We saw the attractiveness of the markets or the cities, big cities and you can immediately do conclusions that these kind of cities are in fact larger than many of our markets. We were in the top 60 for example in Shanghai and as you know there are 20 million inhabitants and that's more than our Nordic countries together. So we came to the conclusion that there is an opportunity outside and inside our current footprint to extend our efforts in big cities. And we do that with already experienced teams, as well with new technology being rolled out and further developed to enable the growth there. You can think about the new draught beer technology, DraughtMaster, as we call it. And as well new brewing technology that allows us to get fresh beer closer to the consumers outside our core geographies. So basically, there is a lot behind that and it is part of the choices we have made for improving our growth trajectory.

Tobias Bjorklund

Okay, thank you.

Cees 't Hart

Thank you.

Operator

We have a question from Søren Samsøe from SEB. Please go ahead, your line is open.

Søren Samsøe

Yes, good afternoon. Just first a question; a follow-up question regarding margins and return on invested capital. I understand you can't give firm targets, but can you maybe explain whether you believe you can reach – in your main geographies, if you can reach the same level or maybe even above the same level as your comparable peers? Do you expect to be able to do that?

Christopher Warmoth

So I think on ROIC we are, as we explained, very committed to improving our top line. We're very committed to keeping a tight control on our asset base. As we've explained today we have a heavy focus around our core markets, so as our ROIC improves, I think you can certainly expect it to improve in our core markets. Of course, we have different competitors by markets so direct comparisons may not always be so relevant. But I think what you will see is the trend. And we're very committed to improving year-on-year that trend and that, frankly, is our focus.

Søren Samsøe

Okay. Then a question regarding – you mentioned some of these growth initiatives that you're going to initiate. When can we expect to see the first effects of them?

And a second question also linked to that is: you expect to reinvest around 1 billion in brands. What will be the timing of these investments? i.e. will they be equally distributed over the three years in Funding the Journey? And when will we see the effects of these reinvestments? Thank you.

Cees 't Hart

Thank you. For the first effect – first of all and foremost, this is a strategy with priorities and obviously after the hard work of putting this strategy together now, the hardest work start with making sure we execute it and for that we are going to appoint new teams and we will attract new talent as well. And that's the task of the coming weeks and months. And it all depends of course, but take for example the big cities, we hopefully within a few weeks from now, we put together the team. And then I think by the end of this year/beginning of next year they have the first, let's say, city where we are landing and then we take it from there.

On the other hand, on our portfolio choices that is something that we can focus on as we speak and we do already. We came to the conclusion that from the 140 brands we have, only 20 brands make 70% of the profit. And if you look then at these 20 brands or brand/market combinations, 13 of these do not have the appropriate support. So these are the kind of things we can do immediately at the moment that Funding the Journey and our results over the coming months are allowing us that. So it will be indeed a kind of first wave of getting the savings accompanied by investing, starting to invest in the teams and then the investment in the markets will come later.

Obviously, the real impact of SAIL'22, with the kind of programme we have, I think is realistic to say, that by 2018 you should see the top line really moving because of that. The underlying performance of the business like margins and so on we should see that as well. As we speak almost you talk about what you call the golden triangle, that is what the markets are now focusing on and hopefully you see that for the first time in the first half year.

Søren Samsøe

Thank you for that.

Operator

We have a question from Ian Shackleton from Nomura. Please go ahead.

Ian Shackleton

Yes, good afternoon Cees. You've talked a lot about leveraging strongholds. I'm aware obviously back in November, you flagged that a few non-core businesses like the East China effectively you would exit. It strikes me that there's quite a lot of businesses you've got that aren't really included in what you've been saying today i.e. markets where you're not a top two position like Italy. You haven't talked about soft drinks bottling at all. You haven't talked about Malawi. Are we right to feel there is quite a lot of scope for disposing of assets here to get back to the strongholds you've talked about?

Cees 't Hart

Hi, Ian. Thank you for your question. And obviously we expected this question a bit because by strengthening core we mean strengthening our core business which is further strengthening our number one and two positions. Further build and strengthen our strong local portfolios and indeed improve our capabilities and continue to take out cost. Where we sell some of these markets, as you discussed, during the process we have evaluated all businesses and as you have seen we have already announced the disposal of some of the business. However, the discussion has to be more nuanced than just we sell everything where we are not number one and number two in the market because in the brewing industry, you can have businesses that deliver strong profitability and strong returns by following for example a niche strategy. Like, for example, of a city, or a part of a country like Northern Germany or Western China, or a specific category, draught in Italy and Perotti is, I think, a nice example of a craft brand which you probably would not see in a number two position in Italy.

Over time however, I'm sure we will prune the portfolio of businesses but we currently don't have a long list of assets up for sale which we would like to announce because, obviously, these assets would immediately decline in value and I think that's not in the interests of the company.

Ian Shackleton

And the position of being a soft drinks bottler for Pepsi and for Coke in some markets, you haven't referenced that. But is that still an important sort of tactical thing to be involved in?

Cees 't Hart

Well, as you know that is mainly in the Nordics and some other countries around the globe, including some of the Asian countries. Those are very important partners for us and we continue with them of course. But as you've seen in our strategy 80% of our profit comes out of beer. That's the first and foremost focus which we have. But obviously we, together with our partners, build further strength in the distribution areas where we can do that. But the beer is our focus.

Ian Shackleton

And just a final question from me. Going back to the big cities strategy, it strikes me the largest opportunity there must be in the US where obviously you're very, very small. But obviously to enter that market in any sensible way will cost a lot of money. Are you really thinking about a major marketing push into the US import category?

Cees 't Hart

Well at the moment we would announce the cities we would prepare our competitors. So let us surprise you where we're moving. But obviously we have listed these countries on different criteria in terms of attractiveness. And we are not going to do that in the most expensive areas as a kind of way forward and the first cities we're moving into. So we have a good view on not only attractiveness of the markets in terms of younger people or for example Tuborg is excelling towards. But as well in terms of distribution partners, but as well about the density of the competition. So I'm not sure the territory that you mentioned will be the first on the list.

Ian Shackleton

Very good. Thank you for that.

Operator

We have a question from Jonas Guldborg from Carnegie. Please go ahead.

Jonas Guldborg

Yes, hello everybody. I have three questions. First, if you could elaborate on what you will do differently in the modern trade in Russia to improve your position?

Number two is on dividends for 2016: was it rightly understood that you need to be below two times net interest-bearing debt to EBITDA before you raise your pay-out ratio to 50%?

And then lastly, if you could just confirm that your target of two times or below two times net debt to EBITDA means that you're targeting around two times and not that you want to deleverage further to say one and a half or even only one time EBITDA?

Cees 't Hart

Thank you. Well, I think what we do differently in the Russian modern trade is that we're going to focus again on that one. Frankly, in 2015 we lost a bit of focus on that part due to all the kind of issues we had in the trade, especially in the traditional trade especially, because of some of the older stocks, but as well when the fast change from traditional trades to modern trade, and obviously that had a lot of operational consequences, as you can imagine. So by, let's say, September or October, we came to the conclusion that we were losing rapidly market share in modern trade, which is obviously unacceptable. And we are now refocusing on that: we've got new people on that, have new operating targets; get new kind of investment in coolers; have as well a range difference between national and regional brands. And it's much too early to say we have a victory there at all, but at least on the last two Nielsen readings, we see modern trade market share coming back, and that's a trend we want to see.

Christopher Warmoth

On the question on the debt and dividend, our target is to be just below two. We're not pushing to be a long way below two. We think two is the critical number. In terms of priority, we are clear, our first priority is to get just below two and then we will start to increase the dividend. As you would have seen on slide 38, which is a slide in the appendix, we did make very good progress in 2015, reducing the ratio from 2.7 to 2.3. So we will keep that focus on cash and we are targeting, as we said, to get below two as soon as possible.

Jonas Guldborg

Understood, thank you.

Operator

We have a question from Stephanie D'Ath from Bank of America. Please go ahead.

Stephanie D'Ath

Yes, hi. Could you please quantify the – in terms of streamlining, if you have an idea of the percentage of SKUs you could rationalise?

Then my second question please: in terms of the cost savings dropping through, could you maybe time what you expect to drop through in 2016 – I think, at least from what you guided from previous conversation – and 2017 and 2018?

And, finally, my third question would be on, so you mentioned that non-alcoholic beer were higher margin, so that would be accretive to get more exposure to non-alcoholic: would that be true as well for Craft, and how quickly do you expect Craft, or special beers, versus non-alcoholic beer to take a share in the mix? Thank you very much.

Christopher Warmoth

So on SKUs, we continue to work on that. The process has already started. Our latest analysis suggests we can take out about 15% of our SKUs without doing really any disruption in the market. Those SKUs are identified and we're now actually slightly above 15%, so we're well over 1,000 SKUs. Of course they'll take some time to come out. We don't want to get into throw-away situations.

In terms of cost savings dropping through, we are committed that the Funding the Journey benefits of 1.5 to 2 billion are net benefits, and we're saying 50% of those net benefits will be reinvested behind SAIL'22 initiatives and about 50% should then drop to the bottom line. So yes the cost savings should start dropping through. We expect more to drop through in 2017 and 2018 than in 2016, though Funding the Journey is off to a good start. You know, we've been doing it now for three or four months, and we're getting some good momentum.

Cees 't Hart

Let me go back to your question on NAB higher margins versus Craft and Specialities. Maybe I can refer you to page 39 in the appendix where you see the Craft and Specialty, which is growing in some of our Nordic countries. We see as well that the net sales per hectolitre is far above the average beer net sales per hectolitre, and you see the same for the gross profit per hectolitre, so in that respect this is an attractive segment for us in the future. At this moment of time, we have between, let's say 4% or 5% of our total turnover in NAB, Craft and Specialities – we want to increase and improve that, and we will have that in the budget for 2017 as a first step.

Stephanie D'Ath

Okay. Thank you very much.

Operator

We have a question from Simon Hales from Barclays. Please go ahead.

Simon Hales

Thank you. Good afternoon everybody.   Three questions, if I can please. Sorry to labour the point just on the dividend pay-out, but can I just be clear that – I appreciate what you say in terms of your focusing on deleveraging as roughly as possible, but should we assume for 2016 that dividend pay-out will remain at around that 30% level; you don't really expect to see a change in that this year?

And then secondly, your Craft and Speciality beer focus: does M&A really form part of your thinking within that space, or is it more around internal development of that part of the portfolio?

And finally, maybe could you just remind us of the changes you've made to your incentive programmes internally as part of aligning rewards with delivery?

Christopher Warmoth

Let me take on the dividend. Really not much more to add. We are at 2.3. We're seeing good progress on cash generation. Our target is to get below that two. As soon as we get below that two, then we start to look at the dividend. Quite how long that will take, we're not really giving guidance on that but you've seen the trends we've had and, you know, we intend to keep heavy focus on it. So it is first get below two, and then we'll start to increase the dividend.

Cees 't Hart

Regarding our Craft and Speciality portfolio, we do not intend to have an aggressive acquisition momentum there. As you've seen maybe on, again, page 39, we have brands in our portfolio like Grimbergen, 1664 Blanc, Brooklyn, Jacobsen, Carnegie and these have proved to be very successful in the markets where we start, so we feel that with that, we first have the first wave of initiatives that we can bring to the market without needing big acquisitions. Obviously if there's something attractive, we will do but at the moment we missed that in our portfolio.

With regard to incentives, maybe you refer as well to the past there. I gave as an example in the past as well: if the managing director of France would have a target, 80% is on France and only 20% maybe either on the broader perspective of maybe even just individual targets. What we've done now is that we have the so-called short-term and the long-term incentives. The short-term is for, for example the managing director in France, 40% on the results in France, another 40 on the region, Western Europe and 20% on Total Group. So that redirects the attention from an only purely local focus to more regional and global focus. In the schemes in this 40/40/20, we have metrics such as market share, GPaL margin, absolute EBIT, but as well cash flow and improved ROIC. Then in terms of the longer-term incentives, we've chosen for the top 60 being incentivised on achieving the Funding the Journey target of the 1.5 billion of the 2 billion, and it means at the moment that we have a net result of 2 billion, then they would get one year of their salary as an extra bonus. So everybody is committed to that as well, within these kind of targets I think.

Simon Hales

Perfect, thank you.

Operator

We have a question from Richard Withagen from Kepler Cheuvreux. Please go ahead.

Richard Withagen

Yeah good afternoon. Thanks for the question. I have two questions on the growth initiatives. First of all you talked about a number of the initiatives to position Carlsberg for growth, but how is that embedded in the long- and short-term incentive schemes? Is it only to the market share target you just mentioned, or are there any other ways that you at least make sure that the growth is also a focus within the organisation?

And then the second question: also you mentioned that the CAPEX could be increased for specific growth initiatives, what kind of initiatives do you have in mind?

Cees 't Hart

Yeah, with regard to the target for this year we focus on the metrics I just said, so not yet on the growth agenda because frankly at the moment that we set these we were not very explicitly yet – on the growth agenda, so that will be part of the short-term incentives for 2017 and further. And maybe on an aside to that, what we will do is that we will translate the strategy, and what I call, nine-box for every year, which means that we get priorities on the must-win battles, the gross territories and the building of the capabilities, and on the basis on the performance of that we will allocate short-term incentive targets. The longer-term incentive targets will change of course at the moment that we have achieved Funding the Journey because then we move towards our SAIL'22.

With regard to CAPEX, well take for example India, we moved successfully from state to state and that means as well that in that perspective, we will need – and gladly need – to invest in building breweries at the moment that we enter new states. So far I think we have been doing that in a very disciplined way. We first focus on getting the number one or number two position in such a state, and only when we are successful and profitable we move then further to a new state, and that's what we tend to do. So I think our comment on CAPEX you need to see in that light. The same of course at the moment, that urban cities or other parts of the strategy becomes further to light, that might require some capital investments.

Richard Withagen
Okay, thank you for that.

Operator
We have a question from Sanjeet Aujla from Credit Suisse. Please go ahead.

Sanjeet Aujla
Hi, just a couple of questions please. Firstly, you haven't really talked about cider and how that fits into your portfolio, so I'd be interested in your thoughts on that category, and whether that plays a role going forward?

And secondly just on the reinvestment, can you give us a sense of how much of that reinvestment will actually go into increasing marketing spend or how should we measure that in the P&L going forward? Thanks.

Cess 't Hart
In terms of cider, we said we need to make clear choices and for cider we have been very successful for Somersby, and then of course the seduction is to move further into the category and we felt that we'd then to expand or add brands in the cider category. We decided to focus on Somersby as a brand. We see it more as if you like a speciality: very good in some of our markets, doing very well, growing further, but we are not planning to further move into the cider category with other brands and other propositions. But Somersby, that'll be part of our portfolio and in some countries an important add-on in our specialities.

Christopher Warmoth
In terms of reinvestment, as I mentioned earlier, the plan is that half of the Funding the Journey does get reinvested and a lot of that will go the marketing spend. We talked about revitalising the core – a sharper portfolio strategy; as we define our portfolio strategies, we expect to increase investment behind the priority brands. I think that will be a big part of the reinvestment, but we will also be investing in capabilities, which we discussed under Excel in Execution; so digital both towards consumers and customers in terms of market insight capability and so on, which does require investment in personnel and expertise. So it'll be both, I think with a skew towards marketing spend directly facing consumers.

Sanjeet Aujla
Thanks. And just a follow-up on Asia. You talked about expanding regionally within India, China and Vietnam. Just on the China piece, my sense is that you've pulled out of having a physical presence in the East but when you talk about geographical expansion within China, please can you just clarify where that would be? Thanks.

Christopher Warmoth
Yeah. So as I think you know, we're strong in various provinces like many of our competitors and our stronger provinces are towards the West. Our business in the East was a tag along with our acquisition of Chongqing Brewery and indeed, you know, that is not a strong business but our business in our own provinces is very strong. We see some opportunities in adjacent provinces, so we're very, very strong in Chongqing City. We see an opportunity, for example, in East Sichuan, where we do have a business but it's not as strong as in Chongqing City. As I mentioned earlier, we have a good presence in Yunnan, which is a big province, but our presence is a little bit scattered. So it's filling out white spaces in adjacent territories, all within provinces where we already have a presence I think is a clear opportunity.

Sanjeet Aujla
So it's still very much sticking towards the West and just expanding more there?

Christopher Warmoth
Yeah. And one other point which, you know, I referenced earlier is Tuborg clearly – and I think we had a slide on that in the deck – Tuborg in both India and China has got real momentum and in some of the – it's actually slide 36 – Tuborg is still very much in rollout mode. Tuborg does particularly well where we already have a strong base, where we have a sales and distribution network, so that's another way we can, if you like, fill out white space with entering into the sub-premium category.

Sanjeet Aujla
Many thanks.

Operator
We have a question from Hans Gregersen from Nordea, please go ahead.

Hans Gregersen
Good afternoon. A couple of questions please. If we look on your Funding the Journey, the cost takeout, can you give us any, sort of, guidance or your thoughts about how they are going to be faced in terms in cost-out and the reinvestment; will there be any differences between those two?

Secondly, on reinvestment, you mentioned that we should start to see growth from these investments schemes from 2018, but can you be a little bit more clear on what we should expect in terms of targets or how much you expect to gain from this investment?

And then finally, as a third question, you mentioned quite a few things here in Sail '22. Seen from the outside, what can we actually measure you on going forward? Thank you.

Christopher Warmoth
So on Funding the Journey, the cost is starting to come out. I think what we said is, in 2016 you should expect less cost-out than in 2017, as the programme really hits its momentum. And I think the same is true on reinvestment, in that SAIL'22 is just starting. So as we get to 2017, we would expect more opportunities in which to reinvest that money. So I think 2016 we will see some drop to the bottom line; that was reflected in our guidance, and we'll start to see some reinvestment. But 2017 will be the year we'll see both of those pick up the pace.

Hans Gregersen
But if I hear correct, Chris, if I hear correctly, then what you're saying is that the cost take-out will be larger than your investments in 2017 and then you could see a reversal of that going into 2018. Is that, sort of, a correct reading?

Christopher Warmoth
Yeah. I don't think we've got that granular because the SAIL'22 investment opportunities, you know, are still under preparation and Funding the Journey is only three or four months old. So we're more at the conceptual stage than having every penny identified, so – but I think conceptually, you see the build-up of savings happening in 2016, some dropping to the bottom line to support our organic growth. And then in 2017 we should be seeing Funding the Journey really delivering funding, both organic improvement and funding SAIL'22 initiatives.

On your second question, I think it was very much linked, which was reinvestment from 2018, I think that's a continuation. Our objective is that, going into 2018, we will have full savings from Funding the Journey. It's a two-year programme that will then be fully delivering in year three, which in this case is 2018. We will maintain the type of activities which are driving Funding the Journey value management, while our supply chain programmes, our equivalent as ZBB or OCM, we will maintain those into 2018, and of course that will continue to provide fuel for SAIL'22.

Cees 't Hart
With regard to where you should measure us on in the coming years, first of all when we talk about most successful, as you see it on page 7, we talk about the triangle: market share, margin and actual to the EBIT level, so we should – you should see that, hopefully, continuous improvement. And where we talk about most attractive, we talk about an improvement on the ROIC, as well the improvement of cash flow, or at least the continuation of very strong cash flow, by which we can deleverage and then, at a certain moment, improve our dividend. So these are, if you like, the kind of indicators or metrics we hope you will follow us quickly on.

Hans Gregersen
But Chris, if I could go back to the answer in question two, if you look on that reinvestment, if I make it more directly: what sort of return should I look to, let's say for 2018 to 2020, in terms of additional growth on the top line and margin expansion?

Christopher Warmoth

Yeah. I mean, it's a fair question, but, you know, we're launching SAIL'22 today. I think we have ideas or I think we have good ideas. Quite honestly, you know, we have done a financial analysis for SAIL'22, but it's too early, I think, to be getting as granular as I understand you would like us to be.

Hans Gregersen

Okay. Thank you.

Operator

We have a question from Michael Rasmussen from ABG. Please go ahead, your line is open.

Michael Rasmussen

Thank you. So you've changed the incentive plans for, kind of, the top 60 and top management levels. What about the sales staff? I guess, you know, they will drive the execution. Have you changed any incentives for the guy on the floor, so to say?

And in terms of Funding the Journey, I see a small change in the redundancies on white-collar workers. Where is this and does that have an impact to the range, so to say? Thank you.

Cees 't Hart

Yep. In terms of the sales guys, we have not changed that everywhere, so the companies have been – operating companies, have been pretty hard. We're moving away here as well from only focusing on, let's say, the hard volume sales, so they get as well a target on some of the SKUs that are more profitable, so that's work in progress. So the first, let's say, the fair assessment would be that we have, I think, in the top 200 now rolled out and secured these targets, which I mentioned earlier. Which means not only for the leadership teams, but for all the parts of the operating company, and below that, that will be cascaded. And my assessment is we could then know from two or three countries, that they have done that already, that is limited to these, kind of, two or three countries, but that will follow through as time progresses.

Christopher Warmoth

On the headcount reduction programme, you're right, the number we gave here was 2,100 and last time we talked about 2,000. We actually didn't change our internal targets; this is the number now we get bottom-up from the countries. So we actually have a very good database; each month we track exactly what's happening in the markets. And the latest submission, which was this month, actually had that number moving up.

So I think the very good news, from our point of view is, is the programme has real traction. It's at the point where, you know, we're not having to push; people are seeing new opportunities, and of course we're happy for them to take those opportunities. And just to remind you, this doesn't include the headcount reduction related to the move to Genpact and shared services, that's additional to this. And we do it as additional because that is, if you like, moving work from us to somebody else, albeit more efficiently and more cost-effectively, but we're not including that in our headcount targets.

Michael Rasmussen

Great, thank you very much.

Operator

We have a question from Andrew Holland from Société Générale. Please go ahead.

Andrew Holland

Yeah. Two if I may. Just firstly on – coming back to the dividend. How should we expect the pay-out ratio to move? I mean, you've said it's not going to move until net debt EBITDA is below two times, you've been very clear on that. Is it then, in whichever year that happens, going to jump up to 50%, or should we assume it goes 30%, 35%, 40%, 45%, in that sort of progression? Any help there would be very useful.

And secondly, just coming back – obviously, we keep asking you about targets – it's probably reasonable to think that in consumer staples, most companies aspire to perhaps 4% to 6% organic sales growth. Is that something that you would aspire to in the medium-term as well?

Christopher Warmoth

So on the dividend, I think it's – the plan, as I said, is we get the net debt to EBITDA ratio below two and then we start to increase the dividend. Our expectation is it won't suddenly jump up from 30% to 50%. Of course it depends how we do, but our expectation is it would glide towards it rather than jump there in one go. And of course, as we mentioned in the comments, it depends a little bit on acquisition opportunities and so on. In terms of top line growth, you know, I think we're, as we've mentioned, we're more focused on value than volume, and I think it's – we're certainly not putting any guidance out there on the top line, but if SAIL'22 works as we expect, and we see these opportunities to premiumise, we do expect to see the top line working, and that's why we're saying EBIT is a good measure, because it's going to measure both top line growth and our cost control.

Cees 't Hart

Could we have the last question please?

Operator

The next question comes from Tristan van Strien from Deutsche Bank, please go ahead.

Tristan van Strien

Good afternoon, Cees and Chris. Three questions, if I may. I guess the first one is really about your choices here, and I guess the questions is: what choices didn't you make? What were the hard strategic choices where you said, we'd like to do that, but we're not going to do that?

The second one is really a bit more depth on Tourtel. Your second largest market for Tourtel, if I recall, is in Italy, but the brand of course is owned by Birra Peroni at the moment. We have Asahi buying them, is there a change of control provision there that you can activate and get the brand back in that particular market?

And the third one is, we spoke about six of your top 60 left, that's about a 10% attrition rate, which to me sounds like a normal corporate attrition rate. Is that quite unusual for Carlsberg? Is that quite a cultural change within the business?

Cees 't Hart

Yes, so the things we do not do or would have liked, and we obviously have, we have looked in big markets like Russia, the UK, and it's all still part of it, it not only enjoys what we do not do, but as well, what do we continue to do, I think. One of the other parts is really focusing now on specialities as well as crafts, so that's a positive choice. Another positive choice you'll see is big cities which could bring us out of the current footprint. A thing not to do further is, for example, segmenting further the portfolio in ciders. Not to do is big acquisitions in the coming period, as that could be, let's see, an attractive path to move further in terms of growth. But as you know, we do not see ourselves in the right position, and we do want – and that's probably what you'll see reflected in our strategy – we want, in the coming two years, to get our house in order, and then to move to the growth opportunities we have verbalised. Does that answer your question?

Tristan van Strien

Yes.

Cees 't Hart

Chris, over to you.

Christopher Warmoth

So, finally on Tourtel in Italy, our focus in Italy is very much on our beer business. So I think you're right about the brand ownership of Tourtel, but at this moment, that isn't a topic we've really discussed.

Tristan van Strien

Okay, thank you.

Cees ‘t Hart

With regard to the management team, an attrition of 10% is not big indeed, but basically, it’s in three to four months, so probably the speed is different than the rate. And as well, we have renewed half of our ExCom and reduced on top of that. So we’ve changed, reduced, and probably that’s something – not on ExCom but on the top 60 – we will continue, depending of course on the performance. And that’s a consequence of performance culture. And that’s what we need – we will see soon. So in that respect, I think in totality, by the way, the Group only has received this culture change so pretty positively, maybe not for the ones who have left, but sometimes it’s even more important for the people that remain in the company to see that we’re serious about performance, and that has been, by many people, seen as a good signal for the future.

Tristan van Strien

Thank you, that’s very clear.

Cees ‘t Hart

Thank you very much for all your questions and challenges. I’m sure we’ll meet each other in the near future. Thank you for the time dedicated to us, and we’re happy to explain more in the coming days and weeks. Bye-bye for now.