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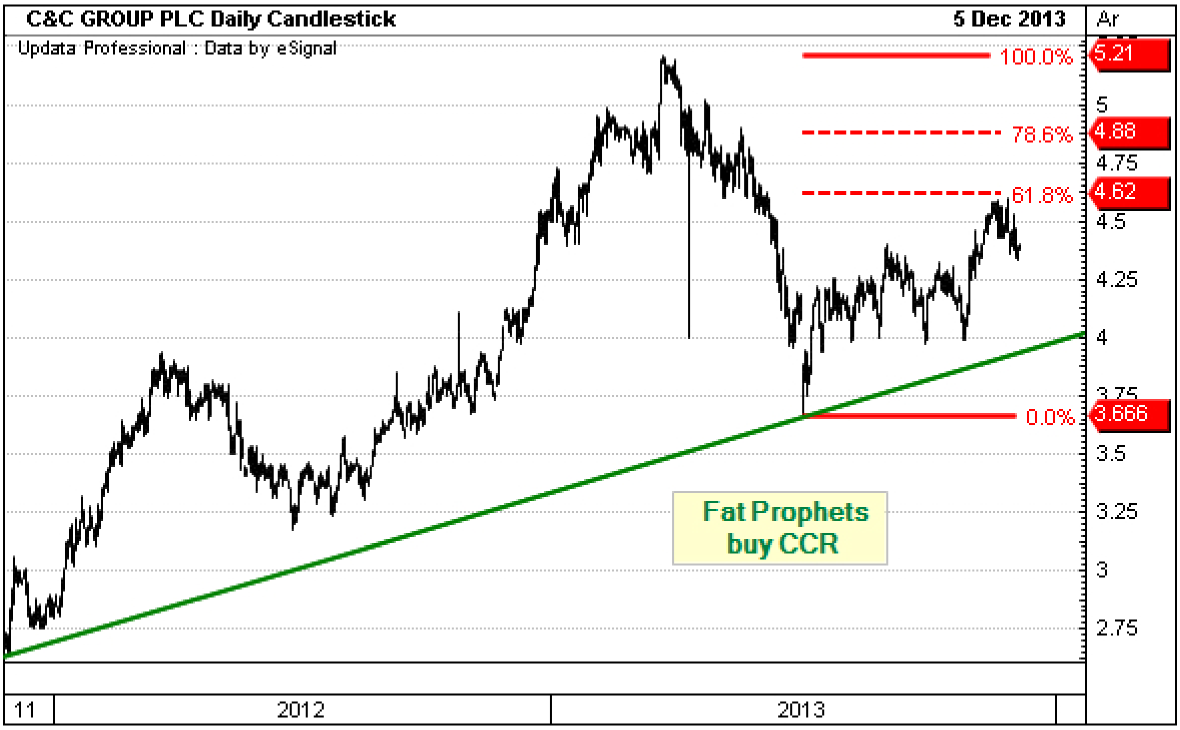
C&C Group 05/12/2013 **FAT-UK-516**

C&C EUR €4.42 Special **MED.** **B**

Return of the Tiger

The old adage that people drink more in a recession may not always hold true but something that does change is where they drink. Irish beer and wine maker C&C Group (LSE, CCR) can certainly vouch for this. The company's primary Irish market has seen bar sales fall by a third since 2007 drinkers abandoned bars for the cheaper option of drinking at home.

Whilst the Celtic Tiger is not quite back to full throttle yet the Irish economy appears to have turned a corner which is supportive of groups like C&C. The UK market remains one of the bigger challenges however management appears to have the right strategy to regain momentum and is also continuing to invest in its international business.



Looking at the charts, after reaching a multi-year high of €5.21 at the start of the year, the share price drifted lower. However, upward momentum successfully re-emerged in the middle of 2013, with the share price currently trading just below the major Fibonacci retracement level of 61.8%. The decisive break above this boundary would yield a move towards the €4.88 region over the medium term.

Background

Dublin based C&C group manufactures, markets and distributes a range of cider and beer, with the company’s primary offerings being cider brands Blackthorn, Bulmers, Magners, Gaymers and Shepton Mallet Cider Mill along with Tennent's beer. The company also owns Woodchuck and Hornsby’s, two of the leading craft cider brands in the United States.

C&C has an Irish wholesaling subsidiary, Gleeson Group, which manufactures Tipperary Water and Finches soft drinks. The company also distributes a number of other beer brands in the Scottish, Irish and Northern Irish markets, mainly on behalf of Anheuser-Busch InBev.

Source: Company Presentation

The company has manufacturing operations in all four geographic locations in which it has a presence, with sites in Co. Tipperary, Glasgow, Somerset, and Vermont in the US. .

C&C has a proud history which dates back to the founding of the business by William Magner in 1935. Over the last 80 years the company has grown through acquisition which has expanded the brand portfolio and geographic footprint. The most recent deals were for Irish wholesaler Gleeson and a 50 percent stake in Wallaces Express, a Scottish drinks wholesaler.

Recent Years

Recent years have proved a challenging time for the company with overall alcoholic beverage consumption diminishing in core markets. A rotation away from drinking at pubs and restaurants (where the company's products are sold at higher margins) towards drinking at home, has also adversely impacted profitability.

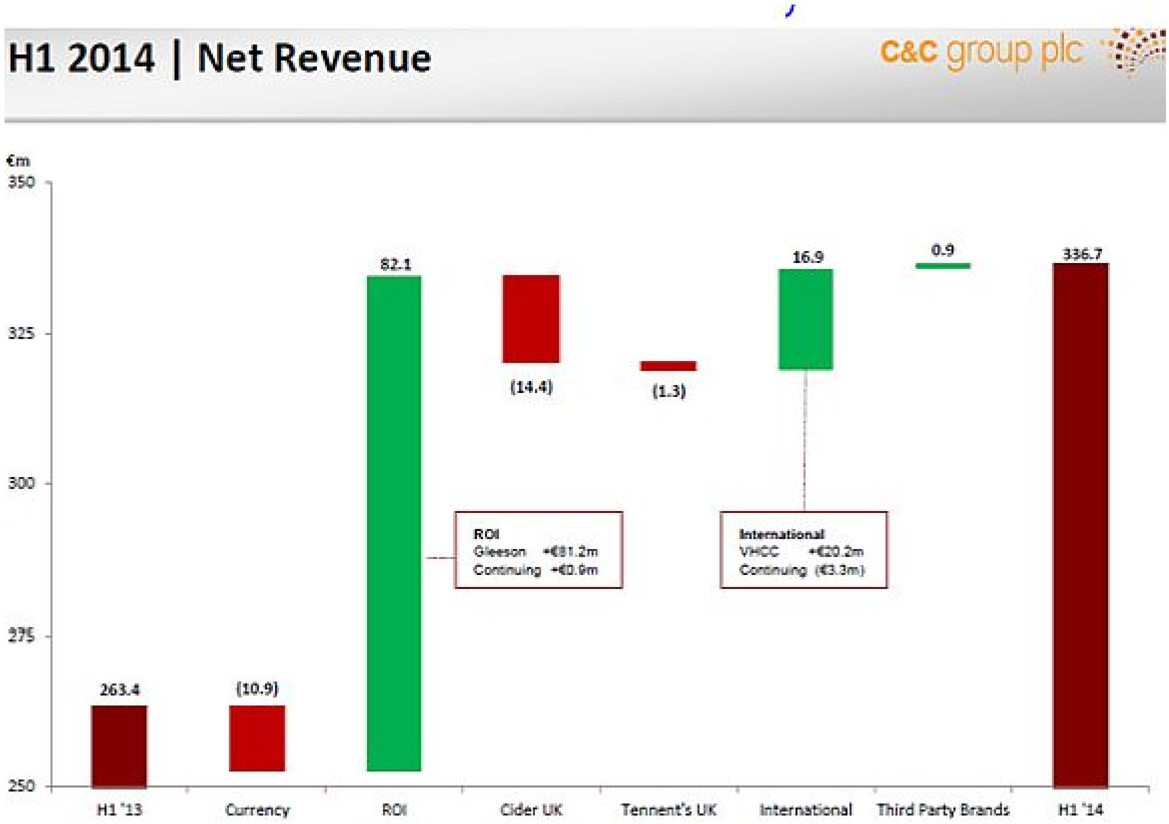
The lean times necessitated a bearing down on costs and, with sales now growing again, C&C is well placed to see earnings rebound in our view.

The regional diversity of C&C's earnings has also increased in the wake of the GFC as management sought to diversify out of Ireland by adding Scottish beer brand Tennents and US cider offering Woodchuck. Before the GFC the company generated around 70 percent of earnings in Ireland, compared to around a third now.

The tide certainly appears to have turned for C&C, particularly in Ireland, as evidenced by recent results for the six months to 31 August 2013.

The company reported that interim operating profit rose by 7.9 percent on a year ago to 71.1 million euros. Encouragingly, management also painted a very upbeat picture for the full year.

C&C unveiled overall net revenues of €336.7 million which represented growth of 27.8 percent on the previous year.

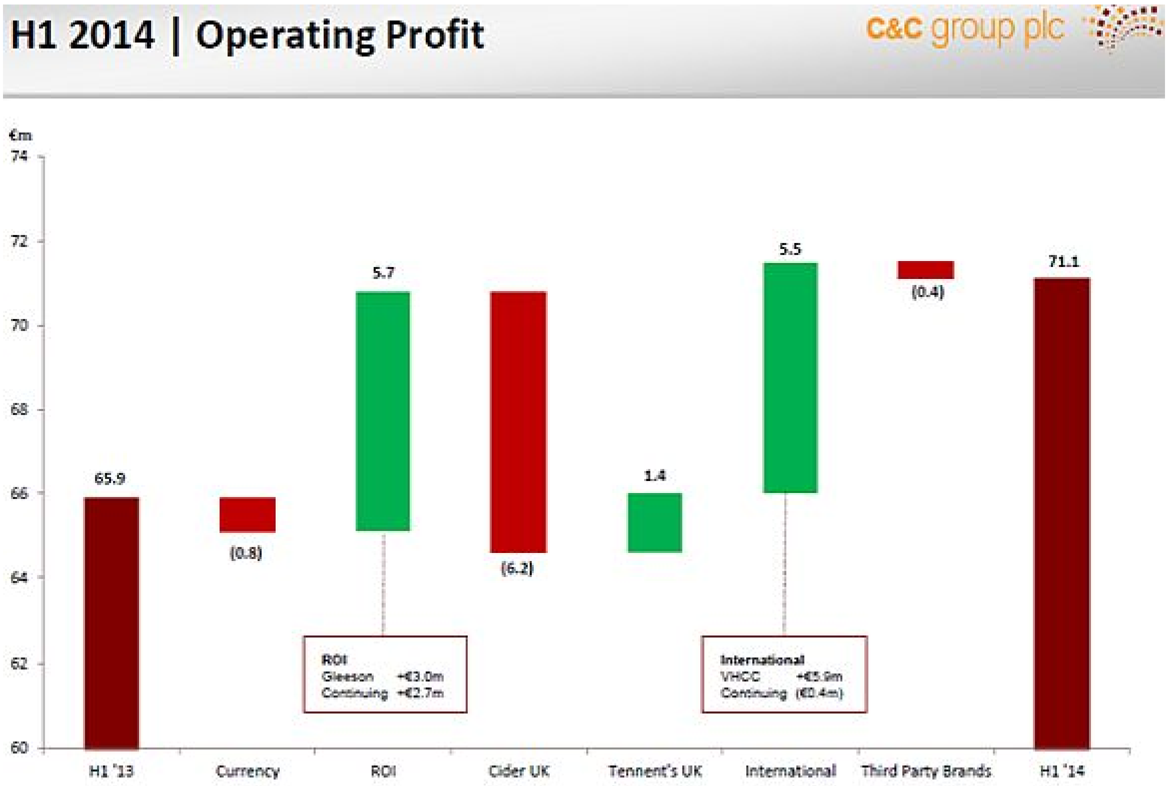


Source: Company Presentation

The interim results were though somewhat flattered by acquisitions. Stripping these out, net revenues declined 10.7% to €235.3 million, and operating profits were off 5.6% to €62.2 million.

However the underlying trend in margins suggests that the business is well positioned as volumes recover, which appears to be happening.

Management's tight control over costs saw comparable operating margins grow 1.4 percentage points from 25.0% to 26.4%.



Source: Company Presentation

C&C also signs of improvement and changing consumption patterns in the still core Irish market. Volume and revenue grew in Ireland during the period with volumes here up 18 percent in the second quarter as Bulmers outperformed rivals. Signs that the Irish pub market has turned the corner were also evident as sales volumes to bars outperformed off-licences for the first time in seven years.

C&C also reported that brands in some other countries were performing well, with the Scottish based Tennents particularly robust. With the group's strong experience in brand integration it is also no surprise to hear that the absorption of the Gleeson business is also on track with 'meaningful' synergies expected over the coming years.

ROI (incl Gleeson)	H12014	Change Const Curr.
Net revenue	€133.4m	+160%
Operating profit	€28.2m	+25.3%
Operating margin	*21.1%*	*(22.8 ppts)*
Volumes kHL (ex Gleeson)	347	+2.7%

UK: Cider	H12014	Change Const Curr.
Net revenue	€63.7m	(18.4%)
Operating profit	€13.7m	(31.2%)
Operating margin	*21.5%*	*(4.0ppts)*
Volumes kHL	608	(14.0%)

UK: Tennent's	H12014	Change Const Curr.
Net revenue	€52.7m	(2.4%)
Operating profit	€16.6m	+9.2%
Operating margin	*31.5%*	*+3.4ppts*
Volumes kHL	646	(5.8%)

International (incl VHCC)	H12014	Change Const Curr.
Net revenue	€40.0m	+73.2%
Operating profit	€9.7m	+131%
Operating margin	*24.3%*	*+6.1 ppts*
Volumes kHL	281	+76.7%

Source: Company Presentation

It has not been all beer and skittles for C&C though, with the UK business somewhat the laggard. UK cider volumes declined 14 percent as Magners ceded market share while Tennents UK also weakened. Management remain committed to turning this around with further investment (over €3m this year) in sales, marketing capacity and brand awareness.

Whilst there is no quick fix in this market, be believe the company is right to continuing the focus on Magners which remains the number one cider in the UK by volume and value.

The company's US business also suffered due to changes in distribution arrangements for the Woodchuck and Magners cider brands. However, management reports significant progress in re-positioning the US cider business, and expects volumes here to improve from next year as the new structure beds down.

This will boost the international division's profitability which was (excluding Vermont Hard Cider) down 10 percent to €3.8m.

Outlook

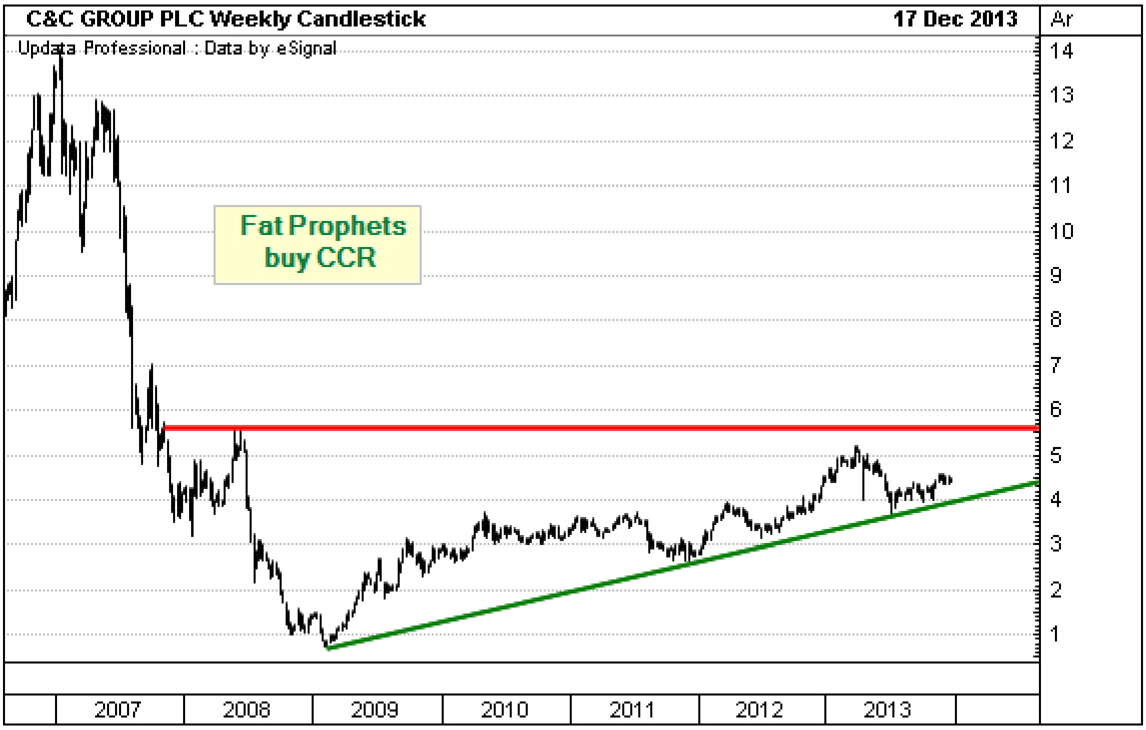
Whilst not all businesses are firing on all cylinders it was encouraging that management produced a fairly upbeat assessment for the coming 6 months. **The company reaffirmed guidance for full year growth of between 10 and 16 percent with forecast operating profit of between** €125 million to €132 million.

We believe there is every reason to share management's optimism about future earnings. The core Irish business appears to be back on the up as an improving economy underpins volumes and margins. A relatively weak UK market has been factored in but marketing investment should start to turn the performance around.

We expect sentiment towards the shares to continue to improve in line with progress on each of these fronts.

The international business adds diversity to earnings has has significant growth potential as C&C continues to invest in operations. One example is a new €23 million in a new cidery in Vermont which should open in April.

The consolidation of the company's distributors in this market by year end will add further stability and a foundation for growth. This is as beer sales generally are falling whilst cider consumption is on the up, albeit from a lower base.



Cash flows and Balance Sheet

C&C has an extremely robust cash flow profile with free cash flow coming in at €59.7 million in the first six months of the year and the correlation with earnings has been solid. Management reports a healthy 72% conversion ratio (of free cash flow to underlying EBITDA) and expects this to remain within a range of 60% to 70% in the year ahead.

With strong cash generating ability it is perhaps no surprise that the company's balance sheet is equally firm. **Management forecasts that the ratio of net debt to underlying earnings will be less than 1 times by year end with gearing relatively modest at 18 percent.**

Strong cash flows and earnings are being passed on to shareholders with management adopting a progressive dividend policy. At the half year the interim dividend was increased 7.5% to 4.3 cents per share or around 26% of underlying earnings.

Valuation

C&C trades on forward price earnings multiple of 13.8 times which we regard as undemanding given the scope for earnings upgrades as the core Irish market gathers momentum. The prospect of a recovery in the UK business gives further upside while strategic positioning in the US provides long-term growth potential.

C&C's valuation is also attractive when compared to larger more established rivals with the company's peer group trading on almost 18 times forward earnings.

The stock also holds the appeal of a 2.5% prospective yield which will rise in line with a progressive dividend policy.

Summary

Overall, we regard C&C as a solid play on the ongoing resurgence of the consumer in the core Irish market as the Irish economy rebounds. Added recovery spice comes from the UK and the International business gives the group long-term potential. We expect sentiment towards the stock continue to improve as C&C see progress on these fronts.

Accordingly we recommend C&C Group as a buy to all Members around current prices.

Snapshot C&C

C&C Group

Dublin based C&C group manufactures, markets and distributes a range of cider and beer, with company's flagship offerings being cider brands Blackthorn, Bulmers, Magners, Gaymers and Shepton Mallet Cider Mill and beer under the badge of Tennent's. The company also owns Woodchuck and Hornsby's, two of the leading craft cider brands in the United States.

Market Capitalisation:£1,258m

	FY1	FY2
Price to Earnings	13.8	13.1
Dividend Yield (%)	2.5	2.5
Price to Book	1.67	1.65
Return on Equity (%)	5.3	11.1
EV/EBITDA	11.86	11.9