C&C Group 13/12/2018 **FAT-UK-762**

CCR EUR €2.94 Special MED. S

Shutting off the beer tap

C&C Group (LSE.CCR) released interim results showing that it has benefitted from literal tailwinds, with the weather boosting up sales of its offerings while the timing of the World Cup also helped. However, it seems that there are issues cropping up, with input costs rising and pressuring margins. While the touted Matthew Clark and Bibendum acquisition is looking to be an expensive 'fixer upper'. In light of the looming Brexit, we believe the risks are too great and opt to 'shut off the bar tap' and cut our losses with a SELL rating on the shares.

What's New?

In our last coverage of the group back in September (FAT-UK-751), we took a look at its AGM trading update which provided some hints on the direction of the group for FY19. It seems that the group has benefitted from the World Cup, as well as good weather being literally tailwinds.

We also provided a recap on the **Matthew Clark and Bibendum** (MCB) acquisition, which was snapped up by the group from the ailing Conviviality, which is now in administration. MCB is the leading independent drink distributor in the UK pub sector, supplying over 4,000 products covering beers, wines, spirits, cider and soft drinks, supplying these to over 23,000 pubs, hotels and restaurants.

The deal was said to be "**significantly accretive to earnings** and **provide attractive returns on capital** in the first full year of ownership," and with the group releasing the interim FY19 (1H19) results, we can now put a measuring stick behind it.

Brief results review – 1H19 (in € unless otherwise noted)

Looking at the top line, **Total Revenues for the group in the 1H19 amounted to €838.7 million**, a significant boost compared to last year's €292.8 million with most of the increase coming from the MCB acquisition and contributed €529.5 million (-11% yoy) over a 5-month period. Organic growth (adjusting out MCB) shows that net revenues were up 6.4%, helped largely by a 'contract revenue adjustment' and favourable terms for its US operations, offsetting unfavourable currency fluctuations.

On the volume side, and adjusting out MCB, the group sold 2.321 million HL (hectolitres) up 5.1% year-on-year (yoy), with increased sales of core brands (4% yoy) and craft beers (+23%), which were more than enough to offset weaknesses in other owned brands (-15%) and international (-20%).

H1’19 Financial highlights

€m except per share items	Existing C&C Group	5mths MCW and Bibendum	Total C&C Group	Organic growth %
Net revenue	309.2	529.5	838.7	+6.4%
Adjusted EBITDA	58.9	7.3	66.2	+2.6%
Operating profit	52.3	6.1	58.4	+4.0%
Operating margin	*16.9%*	*1.2%*	*7.0%*	*(40bps)*
				Reported growth %
Basic EPS (cent)			14.6	+15.0%
Adjusted diluted EPS (cent)			15.4	+19.4%
Dividend per share (cent)			5.33	+2.3%
Free cash flow (excl. exceptionals)			97.9	+29.8%
Free cash flow /Adjusted EBITDA (% conversion)			147.9%	+170bps
Net debt			278.9	

Source: 25 October 2018 Group Filing

Statutory Operating Profit was up 15.6% year-on-year to €58.4 million with most of the increases (~77.2%) coming from the MCB contribution of €6.1 million. Looking at organic growth though, operating profit was only up 4% which implies that there were some costs that ticked up to lower margins.

In fact, organic operating margins declined 40 basis points due to higher input prices and pension costs that dragged on the Irish operations significantly (~130 bps). Looking at the margin impact of the MCB though, and we see that this reduced group level margins from 17.2% last year to circa 7%. This is mainly due to the MCB business, as it is a high volume and low margin business (wholesaler).

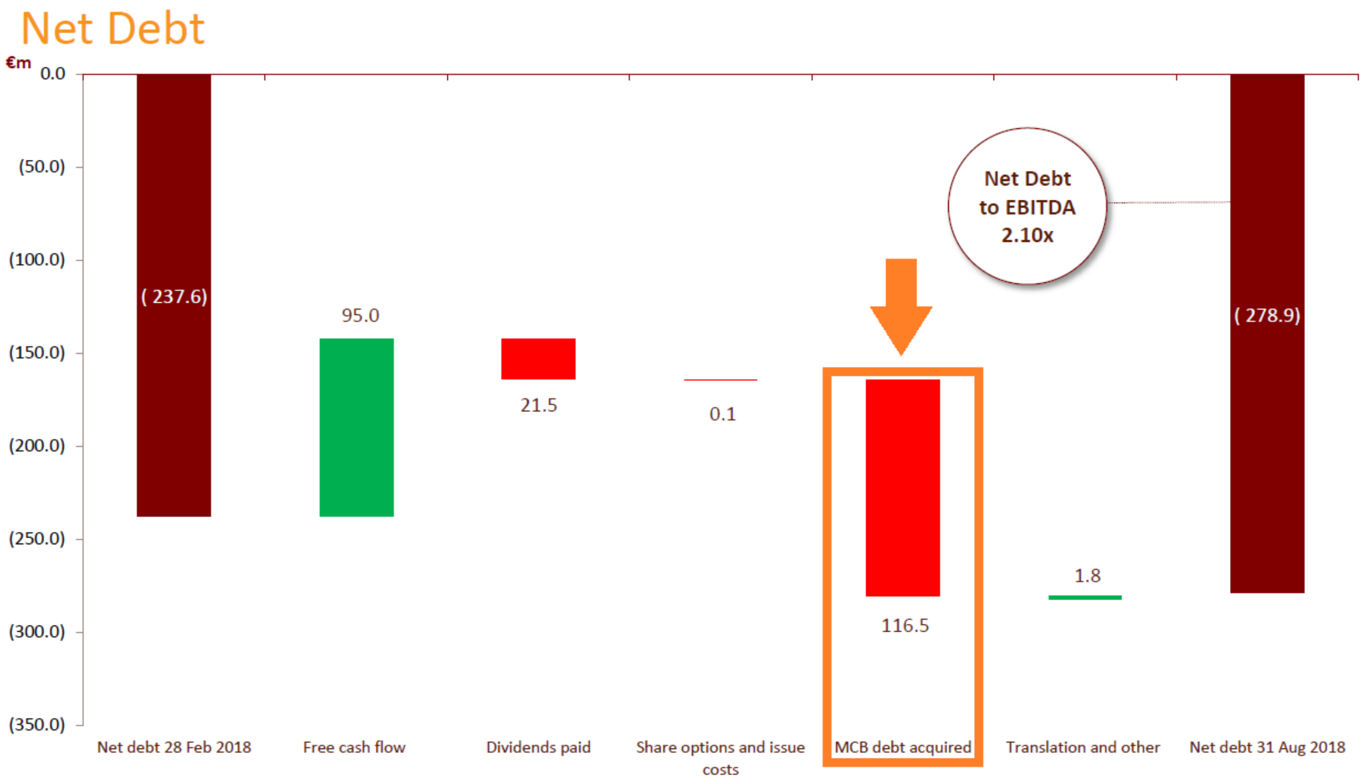
Before moving on to the bottomline, we take a deeper look at the MCB impact. Management earlier noted that this was mainly a strategic acquisition and would bolster the group’s distribution network, with MCB’s 18 depots across the UK enough to service circa 23,000 business customers. This factor was also seen as “**significantly accretive to earnings** and **provide attractive returns on capital** in the first full year of ownership.”

So far, MCB has generated some €6.1 million in operating profit from €529.5 million in revenues, implying an operating margin of 1.2%. <u>This is well below management’s expected ‘normalised’ operating margins of between 2% and 2.5%</u>.

Additionally, EBITDA margins for MCB are at 1.4% which is substantially lower to its historical EBITDA margin of circa 4.3%, which C&C Group touted prior to the acquisition. Though to be fair, the business was acquired in a distressed state which means that initial profitability shouldn’t be an issue as there are numerous matters to address.

So far, the group has made significant strides in ‘fixing up’ the business and repaying suppliers (and regained trust for MCB), to paying back overdue tax balances as well as fixed stock availability of the top 400 SKUs to 96% (On acquisition: ~42%). The group has also recovered some £146 million from overdue balances owed by customers.

Progress has been so far solid; however, we do want to note if the acquisition was ultimately worth it. According to the filing, it was mainly for a cash consideration of £1, however, the true cost of the acquisition includes taking on MCB's liabilities which in-short has resulted in an additional debt burden of €116.5 million.



Source: 25 October 2018 Group Presentation

Management also notes that some of MCB's (specifically Bibendum) are losing money, this makes the MCB acquisition very costly, as it only converts 1.2% of revenues to operating profits; making it walk a very narrow tight rope to stay afloat. So much for 'attractive returns' that management claims.

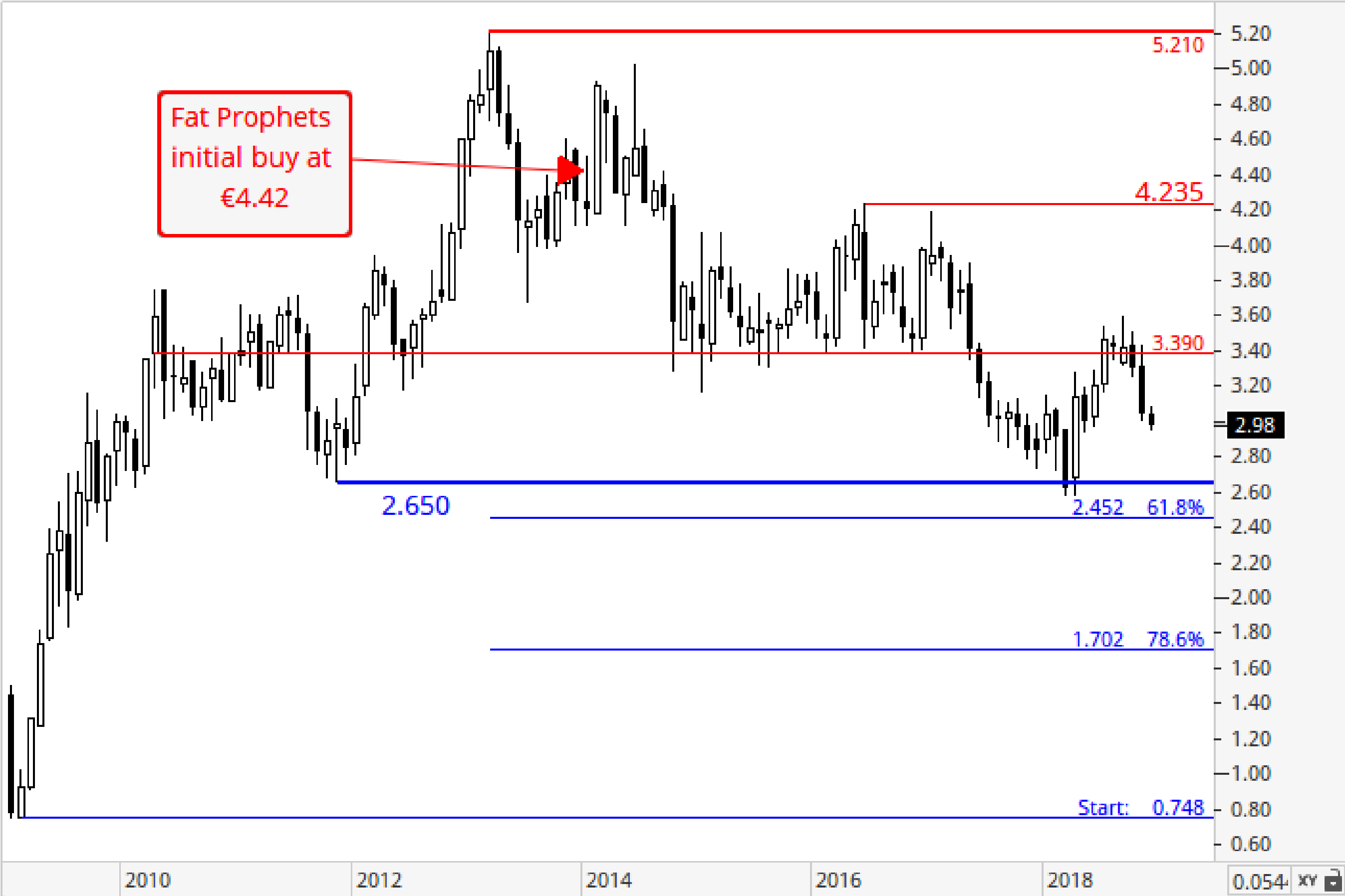
We also find it concerning that the company has levered itself up substantially now. Though management reports that Net Debt to EBITDA is at 2.1x but this is an adjusted number and doesn't include the MCB debt.

In fact, **the real Net Debt to EBITDA is at 4.21x** which is getting up there, note that 4x to 5x should already set alarm bells. Whereas looking at MCB alone, with its debt, puts its **Net Debt to EBITDA at a massive 15.96x** which implies that the operation alone has 'debt over its eyeballs' and with a tight margin range of 1.2% in a what management calls a 'challenging environment', **we believe this is way too much risk on the table**.

Also, an apt quote from Warren Buffett captures this scenario quite well "when a management with a reputation for brilliance tackles a business with a reputation for bad economics, it is the reputation of the business that remains intact."

Ultimately, we see MCB as too much of a "fixer upper," and management seems to have quite an uphill battle left. Furthermore, this ties up valuable resource and management attention especially with looming Brexit which is already a sizeable management problem to deal with. **Thus, we believe it's 'time to shut off the bar tap' and cut our losses.**

C&C Group Plc - CCR (LSE) - 1 Month CandleStick Chart - GBP



Summary

C&C Group's interim results show that it has benefitted from literal tailwinds, with the weather boosting up sales of its offerings. While the timing of the World Cup also helped. However, it seems that there are issues cropping up, with input costs rising and pressuring margins. While the touted Matthew Clark and Bibendum acquisition is looking to be an expensive 'fixer upper.'.

In light of the looming Brexit, we believe the risks are too great and opt to 'shut off the bar tap' and cut our losses.

Accordingly, we recommend Members SELL their holdings in C&C Group (LSE.CCR), and coverage of the stock will cease immediately.

Snapshot CCR

C&C Group

Latest Closing Price: €2.94

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:€913.61m

	FY1	FY2
Price to Earnings	13.4	10.8
Dividend Yield (%)	1.8	5.3
Price to Book	1.7	-
Return on Equity (%)	12.4	14.8
EV/EBITDA	11.6	9.4