CCH – Q3 2016 Trading Update
Conference call Q&A transcript – 3 November 2016

CORPORATE PARTICIPANTS

Dimitris Lois - Coca-Cola HBC AG – CEO

Michalis Imellos - Coca-Cola HBC AG – CFO

QUESTIONS FROM

Sanjeet Aujla, Credit Suisse

Stamatios Draziotis, Eurobank Equities

Kate Kalashnikova, Citigroup

Richard Felton, Morgan Stanley

Tristan van Strien, Deutsche Bank

Chris MacDonald, Redburn

Komal Dhillon, JP Morgan

Nikita Goloshchekov, O1 Group

QUESTIONS AND ANSWERS

Telephone Operator
Thank you. Our first question comes from the line of Sanjeet Aujla. Please go ahead you are now unmuted and can deliver your question.

Sanjeet Aujla, Credit Suisse
Hi, just a couple of questions please Dimitris and Michalis firstly on price mix. Can you just give us a sense of how much of that might have been distorted by the category mix with Water being down so much and how you see that playing out for the rest of the year and going into next year? And that also how that ties in with your margin expectations please for the full year?

Dimitris Lois, Chief Executive Officer
Sanjeet, let me take you through the different segments because I think that will give a bit more clarity. I will start with Emerging and here the main driver is pricing and you have seen also our packaging mix being positive. Now going to the other two segments, I will start with Developing, and in Developing we have seen a great swing in Water between Q3 last year and Q3 this year. I will remind you that last year we had, in some of the countries, and I'm referring to Poland, a 30 plus percent increase, so obviously that is effecting the overall revenue per case.

So what we have seen this year, the 3.5% is definitely driven to a great extent by Water. There is an underlying improvement in pricing. So I would say approximately one percentage point would be attributed to Water.

Now moving to Established, here as you've heard we have two elements that have been negative for the quarter. One has been the channel mix. And the second overall promotional pressures and that's why we see in Q3 a marginal decline of 0.3%.

Now going forward we reiterate what we said back in February, that this year we're going to see a substantial improvement in the FX neutral revenue per case. And if we see Q4 ahead of us we are working to have - going back to positive in Established, versus the minus 0.3 in Q3. Obviously in Developing markets we will not have the Water effect, so we will not have the 3.5, it's going to be lower than that. And in Emerging overall we said that we are taking pricing, we will continue to take pricing so we expect something better than what we have seen so far.

Sanjeet Aujla, Credit Suisse
That's very helpful. Just a follow up on Nigeria, another quarter of solid growth there; how do you see the consumer environment playing out there since the devaluation and some of the pricing that you're putting through?

Dimitris Lois, Chief Executive Officer
What we have seen, and that is a general trend, not only reflecting in Nigeria, is first we see the negative macros and there is some time between the negative macros and or the positive macros reflecting to the consumer and to the consumption. So what we have seen is a very solid growth in Q3, double digit, 11%. And that has been driven by Sparkling and Juices. We have been taking pricing and we will continue to take pricing across Q4.

And our expectation, or what we see ahead is that as these macros and the teens inflation will gradually start filtering through to consumers that we will see that reflecting next year overall in our volumes. So we do expect, as we originally said, a good year this year, a year that we're going to grow mid to high single digits and eventually the overall external environment being far more evident as we transition into 2017.

Sanjeet Aujla, Credit Suisse
Got it, thanks.

Telephone Operator
Our next question comes from the line of Stam Draziotis. Please go ahead Stam you're now unmuted.

Stamatios Draziotis, Eurobank Equities
Hi there, good morning everyone and thank you very much for taking my questions, three if I may please. The first one would be a follow up on FX neutral net revenue per unit case, could you please tell us what the year on year change would have been in Q3 excluding Russia and Nigeria please?

The second question would be on profitability, after the half year results you had expressed confidence that operating profit margins would remain on an upward trajectory and expand in H2. As far as I can tell, you are basically reiterating this expectation following the Q3 trading. Just wondering whether you also anticipate that this EBIT margin expansion will also translate into year on year growth on an absolute basis please?

And lastly, during past conference calls you have referred to the potential of using the balance sheet for bolt-on acquisitions to, as far as I can tell, potentially fill in gaps in the portfolio. My question is whether you'd also consider a more sizable acquisition that would enable you to increase your geographic footprint, but which would gear up significantly the balance sheet? Thank you.

Dimitris Lois, Chief Executive Officer
Stam let me take the last part and here our policy is not to comment or speculate about potential M&A transactions. And you should not read anything into that. Let me pass to Michalis for your profitability question.

Michalis Imellos, Chief Financial Officer
Hi Stam, let me start with the margins. So in quarter 3 things have developed in line with our expectations. We said that volumes held up very well considering last year's half comparatives. Still the impact is negative because of the decline to the margin. However, revenue per case on a currency neutral basis accelerated significantly, so that has a strong leverage effect, positive leverage effect to the margins.

We did point out to an input cost environment that would deteriorate gradually in the second half compared to the first half and this is indeed happening in line with our expectations. So everything is developing exactly in line with what we shared with you back in August.

Looking at quarter 4, volume leverage should improve, supported by the one extra selling day. Revenue per case will continue to contribute positively to the bottom line. We talked about overall in the full year an acceleration of the revenue per case currency neutral growth compared to the first half. Input costs will become a stronger headwind, mainly in the emerging markets, so that they close the year overall with a marginal increase as we said back in August. So all in all nothing has changed compared to what we were quoting back in August.

Now on your very first question, I'm not sure if it makes a lot of sense to take out Russia and Nigeria, but if you want really an indication one should look at Established and Developing market trends. And then if you, within Emerging, which is the major driver of the revenue per case currency neutral growth because of the pricing developments in Russia and now in Nigeria, I would say that the rest of the territories are following pretty much the trends that we see in Established and Developing markets.

Stamatios Draziotis, Eurobank Equities
That's very clear. And just a follow up on the last question, we saw - you basically commented on the reversal of this negative trend in Developing markets which was, as you said partly due to the Water effect, but there is some element of underlying improvement. Do you think this is sustainable, either these deflationary pressures which were evident in past quarters will improve, or will moderate?

Michalis Imellos, Chief Financial Officer
This is one Dimitris talked about - the exceptional positive impact that we had in quarter 3 because we are cycling strong Water growth from last year. So this year quarter 3, the category mix is exceptionally good because of this cycling. This is not going to continue obviously in quarter 4 as we get back to more normalised cycling in terms of categories. Still category mix is expected to be positive in quarter 4. Pack mix continues to be

positive, it's the result of all the OBPPC initiatives that we have taken and it's positive both in Sparkling and in Water.

Now, channel mix across our segments, and of course more in Developing is negative. And it's Poland there that is primarily driving this. Now on price it's not the biggest element in the Developing segment, it's more or less stable, but as the deflationary pressure are abating and we see evidence of that in Developing markets, we do expect that gradually and slowly pricing will also be a little bit better. But it's not the major element within the Developing markets, it's pack and category mix that is driving the growth there.

Stamatios Draziotis, Eurobank Equities
That's very useful, thank you.

Telephone Operator
Our next question comes from the line of Kate Kalashnikova. Please go ahead Kate you are now unmuted.

Kate Kalashnikova, Citigroup
So my first question is a follow up on Nigeria. You've taken some pricing in Nigeria, most recently in mid-September I believe, have your competitors followed this? And how are you addressing affordability concerns in Nigeria?

And secondly, can you talk a little bit about the opportunity for cost savings in Nigeria to mitigate some of the headwinds next year?

Dimitris Lois, Chief Executive Officer
Yes, so first of all we have been taking pricing starting, I would say, in the last part of May / beginning of June and as we've said we gradually continue to take pricing within Q3 and we will continue with Q4. So it is not only one month, but it is the gradual pricing across the months and will continue.

We are absolutely focusing and affordability is at the core of our initiatives. And here we have referred to a couple of initiatives, starting with different packages that we have been introducing and this will continue across and it will also continue next year. The second is that we see the different regions, so we have a segmented approach per region. And then obviously along with the different packages it is the mix of our product portfolio. So affordability will always be at the centre, being addressed by package and focusing behind price points.

Now, going to the last part of your question with regards to cost savings; we have been referring to a couple of initiatives and these start with optimising our footprint. There are two areas there, the first area has to do with the overall manufacturing footprint, reducing the number of sites, and then additionally we have been taking out slow lines and replacing with faster lines that allow us to have better flexibility and efficiency. And that filters through to the overall logistics, the number of distribution centres is being optimised and there is a lot of work for this year and for next year behind the overall optimisation of our cost structure in Nigeria.

Kate Kalashnikova, Citigroup
Very helpful, thank you.

Telephone Operator
Our next question comes from the line of Richard Felton. Please go ahead Richard you're now unmuted.

Richard Felton, Morgan Stanley
Morning, thank you for taking my questions, two for me please. So firstly on Nigeria, we've been hearing from some companies that despite the floating rate they're still struggling to secure enough dollars to operate, I was wondering if you've been having any similar issues?

And then secondly, please can you give us an update on FX guidance, at the half year results you guided for an adverse impact of €115m at EBIT level, are there any updates there? Thank you.

Michalis Imellos, Chief Financial Officer
Hi Richard, starting with your second question on the FX guidance, back in August we guided you to an FX hit for the full year of €115m, since then the rouble has improved, at the time the spot price was at around 72.5, now we see it in the region of 68 to 70, we saw some volatility in the last few days.

Having said that, it is an improvement, and at the same time we see that there is some hit coming from Nigeria and it's not so much on the official rate, but it is more on the rate that we experience that gets embedded into our transactional exposures when we negotiate locally with suppliers for purchases of raw materials. Therefore the positive effect from the rouble gets partially offset by the negative impact from Nigeria. So overall I would say that we see a small improvement to this €115m in the ballpark of €5m. So around about €110m for the full year.

In terms of the situation with the hard currency liquidity in Nigeria, it is challenging, it does remain challenging. The naira devalued by nearly 40% since the Central Bank's decision in June to float the currency from 199 to around 320 at the moment. We have seen the Central Bank performing some hard currency injections in the form of special auctions to decrease the outstanding backlog of hard currency in the market. These are still not particularly significant I would say compared to the needs.

We are working with our suppliers, with the Coca-Cola Company, we execute pre-buys and in many respects we try to mitigate the overall impact. However, because we purchase a lot of our raw materials in local currency liquidity is not an issue, it's more a question of what the embedded rate that suppliers build into those raw materials is. And that is what is driving some of the negative impact that I mentioned earlier.

Richard Felton, Morgan Stanley
Great, thank you that's very helpful.

Telephone Operator
Our next question comes from the line of Tristen van Strien. Please go ahead Tristen you're now unmuted.

Tristan van Strien, Deutsche Bank
Good morning, three questions if I may. Sorry, another follow up on Nigeria, apologies for that. Just to be clear here you say affordability is core, does that mean you expect your price and probably more importantly your mix will lag the high inflation that you're seeing there currently of 18 to 20%.

The second question, and Michalis just to follow up on your input cost, did you hedge your sugar pricing in around September / October like you did last year, you might give a bit of insight and colour on that?

Then lastly, you've now launched your One Brand campaign, so if you could maybe give a bit of colour on the impact particularly on Coke Zero because you didn't call that out and how consumers have received it or if there has been any backlash on your packaging change around that?

Dimitris Lois, Chief Executive Officer
Hi Tristen I'll take the first and the last one and Michalis will help you with the second one. Starting with the affordability being at the core, you will recall in high inflationary environments what we have been sharing is that it usually takes between two to two and a half years to really cover - and especially when we see such abrupt moves to high teens, which is where CPI is currently in Nigeria.

So that's why we are going gradually with our pricing because we believe that is the right, sustainable move, otherwise you have the risk of being completely disconnected from consumers. And that is exactly what we are following and we will be following in Nigeria. So gradually taking pricing and eventually it takes some time to cover the high inflationary environment.

Second, with regards to the One Brand this is a key strategic initiative for us. This is something that we will start implementing January 1st next year across all of our countries. At this point of time we don't have an exact figure behind Zero, but one thing is clear that the overall positioning of Zero and Light will be expanded starting from the permanent beverage section and then obviously this will extend to overall displays and so on and so forth. So we do see an acceleration of overall MyCoke with a key driver being Light and Zero. And let me pass now to Michalis for your third question.

Michalis Imellos, Chief Financial Officer
Hi Tristan, so on sugar in Nigeria, first of all I would say that there are two elements here, there is the dollar price and there is the naira price because we buy sugar in Nigeria locally in naira. On the dollar price of the sugar we are more than 50% hedged already and clearly because of the development in the price very recently, but it has gone significantly up, we have not been extremely active on hedging dollar price recently. So we are in a good place in terms of the 55% primarily coming from hedges earlier in the year.

When it comes to the naira price, as long as the situation with the challenging liquidity remains there is an element of volatility there because it depends very much on the local negotiations of what the naira to dollar embedded rate is in the local price. So I hope this gives you some colour in terms of where we stand with the Nigerian sugar.

Tristan van Strien, Deutsche Bank
That was very clear. If I can just follow up on the One Brand strategy, you call out the success of Coca-Cola Life in some of your markets, but at the same time it seems like the Coca-Cola Company is, I'm not saying withdrawing support, but less focused on that extension, so what's the importance of Life in your portfolio going forwards?

Dimitris Lois, Chief Executive Officer
Well, Tristen as we've shared Life and the role of Life is not to be a huge volume driver. Life is a choice that we give to consumers and as we said in a couple of our calls at 2% its contribution to MyCoke is our first target, we're a bit below that, but we have seen the overall MyCoke being - I would use the word rejuvenated in the countries that we have introduced it.

The second element is that we are selective also with the choice of packages, which has contributed overall to the revenue per case. And then there's a third element and the third element has to do with the overall evolution of the formula. You will recall that up to now we have a formula which is 36% less calories. So we are looking forward to the next step and that's part of the overall work that the Coca-Cola Company is doing with reformulation, going up to 50%. So 50% with the same or even better taste profile we believe that that's going to be another positive element in the overall MyCoke portfolio.

Tristan van Strien, Deutsche Bank
Great, very clear, thank you.

Telephone Operator
Our next question comes from the line of Chris MacDonald. Please go ahead Chris you're now unmuted.

Chris MacDonald, Redburn
Good morning and thanks for the questions, most of my questions have been asked already. But just quickly in terms of M&A I understand that you can't comment and I assume that you're in the running for CCBA, but were you to miss out on the acquisition on my estimates your balance sheet falls below the 1.5 times net debt to EBITDA guided range this year. I mean can we assume a special dividend and what sort of amount would you be looking to return to shareholders?

And just in terms of Russia looking out to 2017, are you able to comment on whether or not you think the market should be back in growth, what sort of growth is a reasonable expectation? And I know it's still only Q3, but that would be helpful. Thank you.

Dimitris Lois, Chief Executive Officer
Chris, let me take the question on Russia, first of all I will reiterate what we said in February this year that obviously starting with '16, '16 is going to be a better year than '15, decelerating the rate of decline. And we do see as we have been sharing with you that '17 is going to be the year where we will see a turnaround. Here the turnaround is marginal, at this point of time the market is expected to be flattish overall non-alcoholic ready to drink market flattish to a bit negative. We do believe that as we transition to '17, we will see even a bit more positive trajectory for the market. And as you know we consistently outperform the market. So that is what we have at this point of time and always have in mind that in that market also we go for value.

Now let me give the floor to Michalis for your first question.

Michalis Imellos, Chief Financial Officer
Hi Chris, so our position on the balance sheet hasn't really changed. Indeed as you say we closed 2015 with a net debt to comparable EBITDA of 1.5 and this is going to be somewhere lower at the end of 2016. We believe that in view of the ongoing volatility in the markets it's not a bad place to be and it does allow a lot of flexibility in our decision making.

Clearly we have talked a lot about bolt-on acquisitions, Water and Juice, locally relevant brands in our territories and we are active in looking for such opportunities. If, after considering all this, we find ourselves that we need to optimise the gearing then clearly we wouldn't rule out the possibility of a special dividend. But the timing and the size of it is really the decision of the Board and we'll come to it as and when the situation arises.

Chris MacDonald, Redburn
Perfect, thank you very much.

Telephone Operator
Our next question comes from the line of Komal Dhillon. Please go ahead Komal, you're now unmuted.

Komal Dhillon, JP Morgan
Hi good morning. Sorry to press on with the issue but I've just got another few questions on Nigeria. Can I just confirm you said volume increased by 11% in Q3 which is high single digit in H1 and you're guiding to mid to high single digit growth for the full year so you expect material pressure in Q4?

And then should we be thinking about volume decline in Nigeria, I mean it's probably a little bit early but in 2017 based on what you're seeing in terms of the underlying consumer but also your pricing strategy?

And so you've said that you're going to offset the devaluation in about two, two and a half years. Is that correct?

And then lastly what is the margin trajectory in the country in - what should we be expecting in 2017? So given obviously deteriorating volumes but also the cost savings that you mentioned?

And then finally sorry on input costs. Thank you for the update on Nigerian sugar but can you give us some more colour on how your input costs are developing as we move into '17 based on current hedges? Thank you.

Dimitris Lois, Chief Executive Officer
Komal let me take the first part of your questions and then Michalis will contribute to the last part. So we are absolutely happy with Q3, with all our segments improving now in Nigeria. And Q4 is going to be another good quarter. Don't forget that we have also in Nigeria the one additional day so that is a tailwind. Overall going to mid to high single digit for the year as we have originally shared.

Now it's far too early to make a call for next year and we will definitely share that in our February call but obviously both the external environment filtering through to consumers as well as our gradual pricing will have an effect on the volume, but at this point in time it's far too early to comment on what the volume would be in Nigeria. Let me pass the floor to Michalis.

Michalis Imellos, Chief Financial Officer
Yes hi Komal. Let me start with the input costs for 2016. First of all we said that we reiterate the marginal increase overall on a per case basis currency neutral. Looking at 2017 we are in a good place for some of the commodities, a little bit too early for some others. We are working right now on our assumptions and our plans. However let me say that for EU sugar we are already 100% contracted in for 2017 and the price is very similar to that of 2016. In Russia we are also 100% contracted in. And as I said earlier in Nigeria

more than 50%, but Nigeria is a little bit of a wild card because there is some transactional FX element which is uncertain at the moment.

In terms of resin we are around 25% hedged right now through pre-buys effectively, not derivatives, and there will be an increase in 2017 because of the phasing of the oil price developments versus 2016. And in Aluminium and Juices we are around two thirds hedged right now and we expect a small increase. We will put all this together and we will come with a guidance in February as to what it means, but overall we are looking for next year at an increase, we have to see whether it will be a mid single or a low single or see how everything comes together.

In terms of your question on the margins in Nigeria, typically when there is a significant currency devaluation, and back to Dimitris' point it takes some time for pricing and other initiatives to catch up with abrupt currency moves, clearly the margins take a hit to start with. And as pricing is catching up and hopefully currencies normalise then at the back end of this two to three years we see margins recovering very fast. This is the experience from Russia and from other countries where we have seen abrupt currency moves. So indeed margins in Nigeria will take a hit as a result of the severe devaluation of the currency to recover gradually afterwards through the catch up in the pricing and the cost initiatives that Dimitris mentioned.

Komal Dhillon, JP Morgan
Okay that's very clear, thank you very much.

Telephone Operator
Ladies and gentlemen this is just a reminder. If you would like to ask a question please press *1 on your telephone keypad.

Moving onto our next question it comes from the line of Nikita Goloshchekov. Please go ahead, you are now unmuted.

Nikita Goloshchekov, O1 Group
Good morning everyone. Actually three questions from us which I would like to ask you, to ask one by one. Could you please update us with your capex guidance for 2017? Should we expect this to remain in the range of 6% to 7% of the revenue?

Michalis Imellos, Chief Financial Officer
I am not sure which guidance you are referring to 6% to 7% sorry?

Nikita Goloshchekov, O1 Group
In terms of capex for 2017, maybe you could just give us your guidance?

Michalis Imellos, Chief Financial Officer
Okay the capex guidance is in the range of 5.5% to 6.5% of revenue and we maintain this also for 2017.

Nikita Goloshchekov, O1 Group
Okay. And how much of this capex actually will be related to coolers and refrigerators?

Michalis Imellos, Chief Financial Officer
Generally speaking we call them revenue generating initiatives which is coolers and any new production infrastructure and that is typically around 70% to 75% of the spend overall.

Nikita Goloshchekov, O1 Group
Okay thank you. We've heard a Frigoglass one of the largest suppliers of refrigerators is experiencing real problems with your high debt burden. Currently Frigoglass is a sole supplier of the equipment for you?

Dimitris Lois, Chief Executive Officer
No we have a wide range of suppliers. Frigoglass is one of the suppliers.

Nikita Goloshchekov, O1 Group
How much of coolers, refrigerators do they supply to you?

Dimitris Lois, Chief Executive Officer
We'll let the IR come back to you. I don't know the exact numbers on that so IR will come back to you and give you the details on that.

Nikita Goloshchekov, O1 Group
Okay so you think that there is alternative suppliers that can cover any supply disruption from Frigoglass right?

Dimitris Lois, Chief Executive Officer
Correct.

Nikita Goloshchekov, O1 Group
Okay thank you.

Telephone Operator
We have no more questions in the queue so at this point I would like to turn the conference back to your host for any concluding remarks.

Dimitris Lois, Chief Executive Officer
Thank you operator. I want to thank you for joining us today and for all your questions that facilitated a good discussion around our third quarter performance. At our investor day in June we shared with your our roadmap for top line growth and margin expansion as well as the strategic initiatives that will get us there. We have been implementing these initiatives and we will continue to drive the business forward and deliver on our promise for the benefit of our stakeholders. We look forward to sharing the results with you in the coming periods. Thank you very much and have a great day.

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