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TAP - Q2 2012 Molson Coors Brewing Company Earnings Conference Call

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OVERVIEW:

Molson Coors announced 2Q12 underlying after-tax income of $250.1m and underlying EPS of $1.38.

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PRESENTATION

Operator

Good morning, ladies and gentlemen. My name is Martinna, and I will be your conference operator today. At this time, I would like to welcome everyone to the Molson Coors Brewing Company 2012 second-quarter earnings conference call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session.(Operator Instructions)

Before I begin, I will paraphrase the Company's Safe Harbor language. Some of the discussion today may include forward-looking statements. Actual results could differ materially from what the Company policy is today. So please refer to its most recent 10-K and 10-Q filings for a more complete description of factors that could affect these projections. The Company does not undertake to publicly update forward-looking statements, whether as a result of new information, future events, or otherwise. You should not place undue reliance on forward-looking statements, which speak only as of the date they are made.

Regarding any non-US GAAP measures that may be discussed during the call, and from time to time by Company executives in discussing the Company's performance, please visit the Company's website at www.molsoncoors.com, and click on the Financial Reporting tab of the Investor Relations page for a reconciliation of these measures to the nearest US GAAP results. Also, unless otherwise indicated, all financial results the Company discusses are versus the comparable prior-year period and in US dollars.

Now I would like to turn the call over to Peter Swinburn, President and CEO of Molson Coors.

Peter Swinburn - *Molson Coors Brewing Company - President, CEO*

Thank you, Martinna. Hello, and welcome, everybody, to the Molson Coors earnings call, and thanks for joining us today. So with me on the call this morning are Gavin Hattersley, Molson Coors CFO; Dave Perkins, the CEO of Molson Coors Canada; Tom Long, the CEO of MillerCoors; Mark Hunter, CEO of Molson Coors Central Europe; Stewart Glendinning, CEO of Molson Coors UK; Kandy Anand, CEO of Molson Coors International; Sam Walker, Molson Coors Chief Legal and People Officer; Zahir Ibrahim, Molson Coors Controller; and Dave Dunnewald, Molson Coors VP of

Investor Relations. On the earnings call today, Gavin and I will take you through highlights of our second-quarter results for Molson Coors Brewing Company, along with additional perspective regarding our acquisition of the StarBev business and our outlook for the balance of the year.

During the quarter, we financed and closed the acquisition of StarBev, which we now call Molson Coors Central Europe. In order to provide a comparable basis for understanding our new Central Europe business, this morning we provided historical US GAAP results for Central Europe on a pro forma basis, as if we had owned the operation since the beginning of 2011. In summary, we believe the EBITDA margins for this business are sustainable. Synergies will be delivered, and capital spend will be at the lower end of our original expectation.

Here are some of the financial details. We completed the acquisition on June 15, with a final purchase price of EUR2.7 billion, the equivalent of $3.4 billion. In pro forma US GAAP, the purchase price represents a multiple of 10.8 times 2011 underlying EBITDA. This is a reasonable multiple for a business with a good long-term growth profile, and we expect it will be earnings accretive in the first full year.

Poor February weather and local FX impacted first-half results, but the business delivered strong market share growth, and recent performance is in line with our expectations. For 2011, Central Europe pro forma results under US GAAP included net sales of $940 million and underlying pretax income of $182 million, the underlying EBITDA of $317 million. Gross margin as a percent of net sales was 44.2%. Underlying EBITDA margin was 33.8%, and underlying operating margin was 19.3%. These results confirm that the business has a solid margin structure on which to grow.

We financed the acquisition with $2.8 billion of new debt at very low interest rates, along with more than $600 million cash in hand. We are taking immediate steps to capture $50 million in annualized pretax operational synergies by 2015, and we expect the purchase of our new Central Europe business to drive positive returns for shareholders towards the early part of the three- to five-year range that we use to evaluate significant investments.

In terms of what Central Europe brings operationally to Molson Coors, this business sold 13.3 million hectoliters of beer last year and has the number-one brand in more than half of its markets, with strong positions in the rest. On a pro forma basis for 2011, Central Europe makes up 22.7% of our worldwide volume, 12.3% of net sales, including MillerCoors, and 16.2% of underlying operating profit. We now own the worldwide brand rights to Staropramen, which is growing strongly in many of the 30 countries where it is sold.

In a number of markets, we have licensing or distribution agreements with third parties for Staropramen and other brands, and we expect these to continue under the same conditions as prior to the transaction. We also see opportunity to increase our Central Europe market share through branding and packaging innovations, including introducing Molson Coors brands like Carling.

In summary, our first couple of months with this business confirm that this acquisition fits squarely into our strategy to increase our portfolio of premium brands and deepen our reach into growth markets around the world. The Central Europe beer market is attractive, with strong historical trends and upside potential. Our Central Europe business is a market leader in the region, and this acquisition provides Molson Coors with a great platform for growth.

Shifting gears now to our second-quarter financial results for Molson Coors, underlying after-tax income for the second quarter 2012 increased 8% to $250 million, driven by positive performance in our US business and the inclusion of two weeks of Central Europe results in 2012. Underlying earnings per share increased 12.2% to $1.38, which includes the benefits of two weeks of Central Europe results and fewer shares outstanding this year. Gross margin, including MillerCoors, declined from a year ago, while underlying operating margin increased.

Regionally, the US had a good quarter, but the UK and International businesses reported lower underlying earnings. In Canada, we grew earnings in local currency, but this was offset by negative foreign exchange in our reported US dollar results. Central Europe pro forma pretax earnings declined in the second quarter, but outperformed the industry. Based on the macroeconomic environment in Europe, we see some industry-related risk to our near-term performance, but we have encountered no negative surprises in the business, and current performance is in line with our expectations. Gavin will provide additional financial highlights in a minute.

In brands, second-quarter Coors Light sales to retail grew 4%, with solid volume and market-share growth in all of our regions. Molson Canadian trademark STRs in Canada grew in the quarter. Miller Lite declined low single-digits while showing incremental trend improvement versus the first quarter. The Carling brand declined in a weak UK economy that also suffered its wettest April-to-June period on record. Our Central Europe brands grew 1.4% on a pro forma basis.

In innovation, the launch of Coors Light Iced T in Canada has delivered strong consumer awareness and trial and is performing in line with our expectations. In the US, the Coors Light Aluminum Pint and Leinenkugel's Summer Shandy are consistently exceeding expectations. In a depressed UK beer market, the launch of Carling Zest has exceeded our expectations, with this new brand picking up listings in most of the major grocery chains.

With that as an overview, I'll turn it over to Gavin to give second-quarter financial highlights and a perspective on the second half of 2012. Gavin?

Gavin Hattersley - *Molson Coors Brewing Company - CFO*

Thank you, Peter, and hello, everybody. In second-quarter financial highlights, Molson Coors second-quarter underlying earnings increased 8% to $250.1 million, while earnings per share increased 12.2% to $1.38 per share. The addition of Central Europe results drove approximately 40% of the increase in underlying earnings per share. The Central Europe impact is made up of $19.7 million of underlying pretax income in the last two weeks of the quarter, partially offset by $5 million of acquisition-related interest expense in corporate.

Regionally, MillerCoors contributed a positive underlying profit performance in the quarter, with a 7.2% increase driven by continued solid pricing and cost reductions. In Canada positive volume, pricing, and cost reductions were offset by negative foreign currency in the quarter. The UK had a challenging quarter due to lower volumes, increased marketing and pension expense.

Now a note about how we are presenting our results following the Central Europe acquisition. In order to provide the most useful information, our discussion regarding Central Europe will center on pro forma results for both this year and the comparable prior-year period. A discussion of consolidated Canada, UK, International, and corporate results will be on the same basis as before StarBev.

So on a pro forma basis, Central Europe underlying pretax income in the second quarter declined 37%, driven by unfavorable foreign currency, channel and geographic mix, along with higher input costs and brand investments. Worldwide beer volume for Molson Coors increased 6.4% due to the addition of two weeks of Central Europe results. Excluding Central Europe, worldwide volume decreased 1%, driven by lower volume in the UK and US, partially offset by growth in International and Canada.

As we did last quarter, I will provide an overview of our results with MillerCoors presented as if it were proportionately consolidated. This is a non-GAAP approach, but we believe it provides a useful view of some key performance metrics for our business. On this basis, total Company net sales increased 5.7% in the second quarter, driven by the US, Canada, and International. Net sales per hectoliter decreased 0.8% in the quarter due to the addition of two weeks of Central Europe sales and lower NSR per hectoliter, which more than offset solid pricing in the US and Canada and the addition of NAB contract brewing revenue in Canada.

Cost of goods sold per hectoliter increased 0.4% due to input-cost inflation, higher pension expense, and the addition of contract brewing volume in Canada. Total Company gross margin was 41.5%, 70 basis points lower than a year ago, primarily due to the UK and International performance.

Marketing, general, and administrative expenses increased 8.2% due to the addition of two weeks of Central Europe results, including acquisition-related costs, higher pension expense, increased brand investments in Canada and International, slightly lower employee incentive costs in Canada last year. Underlying operating margin was 17.2%, up from 16.9% a year ago, due to margin growth in the US and the addition of two weeks of Central Europe operating income this year.

Please see the earnings release we distributed earlier this morning for a detailed review of our business unit financial results in the quarter, including for Central Europe on a comparable pro forma basis. It's important to note that our second-quarter underlying results exclude some special and other non-core gains, losses, and expenses that net to a $178.9 million pretax charge. These adjustments to our US GAAP results primarily relate to the Central Europe acquisition and financing and are described in detail in this morning's earnings release.

In the second quarter of 2012, our Resources for Growth cost-reduction program delivered $14 million in savings and a total of $150 million in savings since the program began over two years ago. As a result, we have achieved our three-year RFG2 program target of $150 million six months early. MillerCoors achieved cost savings of $32 million in the quarter, and we benefit from 42% of those cost savings.

Underlying free cash flow for the first half of this year was $335 million. This $213 million increase over last year was primarily driven by year over year changes in the timing of working capital. Our first-half cash generation was made up of the following. $397 million of operating cash flow, which includes $305 million from MillerCoors, plus $125 million of net add-backs for acquisition-related costs and purchases and sales of businesses and other assets. Cash outflows were $81 million of capital spending and $106 million of cash invested in MillerCoors.

Regarding cash uses, we did not repurchase shares during the second quarter, and as we mentioned when we announced our Central Europe acquisition in April, we do not expect further repurchases until our debt ratios are closer to pre-acquisition levels. Total debt at the end of the second quarter was $4.9 billion, and cash and cash equivalents totaled $516 million, resulting in net debt of $4.4 billion.

Looking forward, we are updating our 2012 guidance in a number of areas, principally because of the Central Europe acquisition. We now expect our 2012 MG&A expense in corporate to be approximately $135 million. This guidance includes about $35 million of acquisition-related fees and expenses, which we estimate will be less than $5 million in the second half of this year.

We now expect full-year 2012 underlying corporate interest expense to be approximately $150 million based on current foreign exchange rates and excluding underlying adjustments. The new debt used to help fund the Central Europe acquisition currently carries a weighted-average interest rate of about 3%.

Our 2012 capital spending outlook is approximately $240 million for the full year. This $40 million increase from previous guidance is driven by second-half capital spending in Central Europe. Note that this capital spending guidance excludes MillerCoors capital expenditure. We currently expect annual capital spending in Central Europe to be in the range of EUR80 million to EUR90 million for the next few years and moderately lower after that.

Over the medium term, we will be focusing on reducing our leverage. However, we remain committed to our existing capital allocation strategy and maintaining a strong dividend for our shareholders.

As far as our cost outlook is concerned, in Canada for 2012, we are now expecting our all-in cost of goods sold to increase at a high single-digit rate per hectoliter in local currency, up from mid-single-digits on our last earnings call. This increase in forecast is driven by a mix shift towards higher-cost packages and products, including Strongbow and Newcastle. In the US, we continue to expect MillerCoors cost of goods sold per hectoliter to increase at a low single-digit rate for the full year of 2012.

In Central Europe, we anticipate a low single-digit increase in pro forma cost of goods sold per hectoliter this year in local currency, driven by agricultural commodities, utilities, and fuel inflation. In the UK, we now expect our full-year cost of goods sold per hectoliter to grow at a high single-digit rate in local currency, driven by input inflation, sales mix, pension costs, and one-time expenses related to the UK brewery improvements this year. We expect additional pension expense this year of about $15 million in Canada and $10 million in the UK.

For the balance of the year, we are investing incrementally in our brands and innovation to drive growth in the years ahead. Marketing investments are planned to be higher in Canada, UK, and International. MillerCoors also plans incremental investments in the US for the balance of the year. In Central Europe, after a double-digit increase in marketing and sales spending behind our innovation agenda in the first half, we plan more moderate local currency increases in the second half of this year.

In other outlook, at current levels, we expect foreign exchange to have a negative impact on second-half 2012 profit of approximately $3 million in Canada, entirely driven by the third quarter, and approximately $25 million in Central Europe on a pro forma basis, primarily driven by the third quarter.

Also in Canada, in the third quarter, we expect a reversal of the second-quarter volume benefit from the timing of the Canada Day holiday. In the fourth quarter, we will cycle the 53rd week in our fiscal 2011 year, which provided approximately $12 million of additional pretax income in Canada last year. And in the UK in the third quarter, we will be cycling a reduction in employee incentive compensation expense last year. This will have a negative impact on our results in the third quarter of about $6 million.

At this point, I'll turn it back over to Peter for regional outlook, wrap-up, and a Q&A. Peter?

Peter Swinburn - *Molson Coors Brewing Company - President, CEO*

Thanks, Gavin. So in Canada, we continue to roll out Coors Light Iced T and have launched Aluminum Pints for Coors Light and Molson Canadian. We also acquired the license for Newcastle Brown Ale and the Strongbow Cider in Canada and managed the pricing-volume mix in the West to better balance our market-share performance.

In the US, we have strong marketing and sales programming behind our key brands this year in peak season, especially for Miller Lite, Coors Light and Miller 64. We are also introducing or testing a range of new brands, and we continue to leverage a full slate of innovative packaging, including the Miller Lite Punch Top Can, to help build on existing brands.

In Central Europe, our results were impacted by negative foreign exchange and up-front investment behind innovations and marketing efforts ahead of the peak season this year, from which we expect strong returns in the second half. These innovations include lemon and grapefruit extensions of some of our leading brands. These line extensions and new packages have been growing strongly this summer and are pulling volume from inside the beer category and from other types of beverages. Additionally, following expansion last year, Staropramen is growing strongly in Central Europe and in our export markets. As a result, we are optimistic that our Central Europe trends in local currency will improve in the second half.

In the UK, we plan to invest in marketing and in our Sharp's Brewery to increase capacity in order to support the strong growth of Doom Bar, which has been the fastest growing cask ale in the UK for the past three years. The 2012 investment in our International business will be moderately higher than last year.

Finally, the following are the most recent volume trends for each of our businesses early in the third quarter. In Canada, our sales to retail for the first four weeks of the quarter declined at a mid-single-digit range versus 2011, and this was related to the year over year shift of the Canada Day holiday. In the US, for the four weeks ended July 28, STRs were in line with the prior year.

In Central Europe, our sales volumes increased to the high single-digit rate for the first month of the quarter. And in the first four weeks of the quarter, our UK STRs decreased at a mid-single-digit rate. In the first four weeks, our International STRs have increased at a low double-digit rate.

As always, please keep in mind that these numbers represent only a portion of the current quarter, and trends could change in the weeks ahead.

So to summarize our discussions today, we have completed an important acquisition that we expect to strengthen our Company, enhance our growth profile, and increase shareholder value in a relatively short time frame. Increased net sales and NSR per hectoliter on an apples-to-apples basis on solid pricing, and we sustained moderate gross margin compression, which we are addressing. We also continued to invest in our key brands and innovation across the business, and most important, on an underlying basis, we grew operating margins, earning per share, and free cash flow in the quarter.

The markets in which we operate remain tough, but we are taking, and will continue to take, aggressive steps to drive long-term value for our shareholders. Now, before we start the Q&A portion of the call, a quick comment.

Our prepared remarks will be on our website for your reference within a couple of hours this afternoon. And also as usual, at 2.00 p.m. Eastern Time today, Dave Dunnewald will host a follow-up conference call, which is an opportunity for you to ask additional questions regarding our quarterly results. That call will also be available for you to hear via webcast on our website. So at this point, Martinna, we would like to open it up for questions, please.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Judy Hong, Goldman Sachs.

Judy Hong - *Goldman Sachs - Analyst*

First, on the Central Europe, because obviously, it's the first time we're seeing the pro forma results here. If I just look at the profit weakness in 2Q, it sounds like it really came a lot from the COGS inflation being much higher. Can you just walk us through in terms of how much of that was industry-wide issue?

And based on your comment, it sounds like you are expecting the cost per hectoliter to improve in the back half. Why are you expecting that to happen? And then some of the negative geographic and channel mix that you've talked about in 2Q, if you can just go through that in a little bit more details?

Peter Swinburn - *Molson Coors Brewing Company - President, CEO*

Yes, I'll let Mark take you through the detail, Judy, but I think really, as far as our perspective on the business that we've acquired and what we've seen of it, everything that's happened is either due to strategic business decisions, which we support, which will give us a good solid foundation for the second half of the year, and/or just stuff that's happening in the market regarding weather, which has been quite difficult, but that was in the first quarter. Mark, do you want to take us through a bit more detail?

Mark Hunter - *Molson Coors Central Europe - President, CEO*

Sure. Hi, Judy. Let me give you a little bit of context and then talk about the specific on COGS. I think what we've seen in the business has been very impressive and very much in line with our expectations around the quality of the people, the brands, the focus and execution, and the discipline and leanness of the business. Certainly in the first half of the year, following a very, very soft February driven by very poor weather across Central Europe, the business took a decision to invest aggressively ahead of the peak selling season. So we've seen a significant increase in sales and marketing investment, significant increase in innovation, and we've invested more heavily in customer relationships and customer trading.

That's certainly helped drive momentum in the business. As you heard Peter and Gavin mention, we've seen a high single-digit volume growth through July and see those now in our peak selling season. So, I think those decisions have been well placed.

As we've got to the end of the first half, seen our volume run ahead of the market, our share's up. Our pricing is up. For the first half, pricing is up about 5%, and that's more than compensating for any mix or discount activity in the marketplace.

And then to your final point, COGS clearly have moved along a high single-digit level in the first half. And to be fair, none of that is MCCE specific. Most of it is industry-wide challenges around input-cost inflation on things like malt, energy, and fuel. So I don't think we're seeing anything unusual in our COGS numbers.

As we look towards the second half, we will be lapping some one-off costs associated with packaging changes and bottle changes in the second half of last year, and that will have a dampening effect on COGS as we move through the second half of the year. So that's why we're confident that a high single-digit number will certainly come back through the second half of the year.

Judy Hong - *Goldman Sachs - Analyst*

Just following up on that, Mark, maybe can you give us some comfort around why you think that the strategic investment step-up that you saw in 2Q was really just a one-quarter situation. That we're not going to continue to see higher investment needed to drive better sales growth going forward.

And then, it sounds like your comment about the business or the acquisition being accretive in the first year. So if you could just help us quantify how much accretion you're assuming for 2013? And what are some of the assumptions that you have in your forecast to get to that accretion number?

Mark Hunter - *Molson Coors Central Europe - President, CEO*

I can certainly pick up the first part of the question, and I'll ask Gavin or Peter to pick up the second part. With regard to the investments in the business, I mean the industry in Central Europe in the first quarter was down over 3% in volume terms. And I think the leadership team here took a decision, which was do we either start trimming back on investment to deal with that volume softness or do we pull some of our investment from the second half towards the first half.

That's the decision that was made, and I believe it to be the right decision. So it's been very much a change in phasing of investment from second half to first half across sales and marketing and innovation. And that's starting to pay dividends a la the volume trends improvement that we've seen through July. I think we said at the time of acquisition, we do see opportunities over the medium term to move the sales and marketing investment up, but that will be done very much in the context of ensuring that the bottom line of our P&L moves in the right direction.

So there are clearly opportunities on a market-by-market basis to further strengthen our position, and we'll be taking those. But we'll do that in the normal course of business. So I think you can look on the sales and marketing investment this year very much as a rephasing of that spend for the right reasons.

With regard to the accretion, Gavin or Peter, do you want to pick that up?

Peter Swinburn - *Molson Coors Brewing Company - President, CEO*

Yes, that's fine. Thanks, Mark. Hi, Judy. Look, we're not going to give earnings per share guidance or accretion numbers. What we have given you is our pro forma numbers, and we've tried to give you some flavor around what's impacting those pro forma numbers going back and going forward. So that's as far as we can go on that question, Judy.

Judy Hong - *Goldman Sachs - Analyst*

Okay, and then my last question. Just on Canada, so you had a pretty big step-up in terms of marketing spending in the quarter. It sounds like the share is still down a bit on a year-over-year. Then I don't know if the industry numbers also weakened in the July, but July being down mid-single-digits, in terms of sales to retailers, growth for Canada just also seems a little bit weaker.

So Dave, maybe you can tell us what you're seeing from a competitive environment. And why don't you -- do you think that some of the investment that you're making is actually driving better share performance?

Dave Perkins - *Molson Coors Canada - President, CEO*

Yes, thanks, Judy. Let me take you through the shape of our share results and in Q2. Let me start by brand. First of all, Coors Light trademark was up double-digits. We had really strong trial on Iced T.

And the interesting thing is despite the strong trial, we saw the Coors Light brand itself up mid-single-digits.

So didn't seem to be any cannibalization on the surface there. If anything, there was a bit of a halo for the brand. So really pleased with what we saw in the Coors Light trademark. Obviously, the Iced T is at a premium price, as you know. So it would have had a premiumization effect for us.

Canadian was up low single-digits, and our above-premium brands were strong for us through the quarter. Crafts were up double-digit. Our domestic above-premium, which would largely be Rickard's, was up mid-single-digit, and the imports were up low single-digit.

Innovation in total, and remember that the step-up in our marketing investment would come into play here, was between 3 and 3.5 points. And again, with a premiumization effect from Iced T and from the growth of Molson Canadian 67.

What we saw in the quarter was something similar to Q1. Our share challenge was in Western Canada. That's where we lost share. What we did see in the quarter is better trends on our core brands, so Canadian and Coors Light, but we saw worsening trends in the value segment. I think when you look at the mix of what's happened, that helps you understand why we had a very positive NSR result for the quarter. So where we were feeling the pain was really at the bottom end of the market, and premium and above doing very well for us.

In terms of the competitive environment, I'd say very competitive market across the country, both in terms of price and innovation. So we saw an awful lot of activity in the market. There was more beer that would have been sold on promotion than in prior quarters. I'd characterize the West as the most active market, but I think there was a step up in Quebec, as well, that we saw.

Despite that, we're really pleased with what we saw in our NSR per hectoliter, where we're up about 3.3%. We're not blindly chasing volume or share. We're making the right decisions, I think, to get the balance between value and volume. That help?

Judy Hong - *Goldman Sachs - Analyst*

Yes, that's helpful. Thank you.

Operator

Kaumil Gajrawala, UBS.

Kaumil Gajrawala - *UBS - Analyst*

I want to follow up a little bit on the profit declines at StarBev. There was only, I guess, two weeks in your reported numbers. It sounds like some of the marketing decisions were tactical decisions, but that was a short period of time for what sounds like a big swing in the strategy. So, can you help maybe give some context on how big of an impact each one of these things had on the decline in profitability?

Peter Swinburn - *Molson Coors Brewing Company - President, CEO*

For clarity, the decline in profitability that we're talking about on a pro forma basis is for the first six months, not just for the two weeks. We only had the business for two weeks, and during that period of time the business has performed absolutely in line with our expectations. So we can -- the main drivers by far are the ones that Mark has talked to. There's FX in there.

There was a very poor weather in February, where literally accounts were closed and they couldn't deliver beer, which significantly affected the profits in that particular month, and also the strategic decisions that the team made locally to put money behind the brands in advance of the peak season. And that's really been a, if you like, a movement of funding from the second half of the year into the first half of the year. But over the full year, the marketing expenditure will be much in line with what we expected. I don't know if that [helped].

Kaumil Gajrawala - *UBS - Analyst*

Okay. Got it. And if maybe we could talk about Romania a little bit. I believe that's your largest market of all the new countries, and it's been a market where the market share over the last couple of years has declined quite a bit. Is the marketing step-up getting allocated to a particular division? And how do you see your share trends progressing in Romania?

Peter Swinburn - *Molson Coors Brewing Company - President, CEO*

Again, I'll let Mark talk specifically about Romania. It's not our biggest market, either in volume or in profit terms. But Mark, do you want to pick it up?

Mark Hunter - *Molson Coors Central Europe - President, CEO*

Yes, so just to be clear, if you look at total industry volume, then Romania clearly leads the pack across Central Europe. We have a number-three position there, and my sense is as we've conducted our current planning process, that we are growing in confidence about our ability to move that business forward. And it won't be in 12 months, but I believe over the next 36 months we can, with the strength of our brand portfolio, expect to see an appropriate level of increased marketing spend, a broader commercial spend, to be fair, and an improvement in both our share trends and our bottom-line performance.

If you look back over the last three to five years, this was a far more profitable and a larger market for the Central European business. My view is that we can regain a material proportion of that over the course of the next three years, but clearly, beyond that, I'm not going to offer any detail at this stage.

Kaumil Gajrawala - *UBS - Analyst*

Okay. And if I could ask one financial question. You alluded to the focus on paying down debt. What would be the target ratios that you want to hit before it would be appropriate to begin considering a buyback again?

Gavin Hattersley - *Molson Coors Brewing Company - CFO*

Thanks, Kaumil, what we're trying to do -- it's Gavin here -- what we're trying to do is get back to our pre-acquisition ratios that we had in place. And as we said at the time of the acquisition, we would expect that to be in the next two to three years, top.

Kaumil Gajrawala - *UBS - Analyst*

Okay, got it. Thank you.

Operator

Mark Swartzberg, Stifel Nicolaus.

Mark Swartzberg - *Stifel Nicolaus - Analyst*

On -- I guess, Mark or Malcolm, it actually sounds like on a local-currency basis, this is also on StarBev, you expect things to actually improve quite a bit here in the second half. You've got pricing that has been positive. You've got volumes accelerating. Sounds like cost of sales per hectoliter decelerating. You said marketing spend is shifting from 2h, or has shifted from 2h into 1h.

Are you -- I guess, is that a fair understanding? And it sounds like it actually translates into an expectation of EBITDA growth, local currency, for StarBev in the second half.

Peter Swinburn - *Molson Coors Brewing Company - President, CEO*

Yes, Mark, I think you picked up all the data points accurately.

Mark Hunter - *Molson Coors Central Europe - President, CEO*

Yes. Yes; no, I think that's a very fair summary.

Mark Swartzberg - *Stifel Nicolaus - Analyst*

Okay. And when you said pricing up 5% for StarBev in the first half, was that inclusive of mix? I think it was local currency, but can you speak to net sales per hectoliter inclusive of mix?

Mark Hunter - *Molson Coors Central Europe - President, CEO*

Yes, in the second quarter, unit pricing was up 5%, and then mix and discount activity took about 3% out of that. So it gave us a net position of about 2% growth in second quarter, and that's pretty similar for the first half in total.

Mark Swartzberg - *Stifel Nicolaus - Analyst*

Got it. Okay, similar. Okay, okay. Great. And then finally, if we try to tease out FX in the first half, can you give us some sense of what EBITDA did in terms of rate of decline, or maybe gross profit? Some metric, if we're trying to tease out the underlying business performance in the first half.

Gavin Hattersley - *Molson Coors Brewing Company - CFO*

Mark, this is Gavin here. From a second-quarter point of view in Central Europe, about one-third of the decline was related to FX, a little over $9 million.

Mark Swartzberg - *Stifel Nicolaus - Analyst*

Got it. And that's at the EBITDA line?

Gavin Hattersley - *Molson Coors Brewing Company - CFO*

Yes.

Mark Swartzberg - *Stifel Nicolaus - Analyst*

Okay, great. Thank you, guys.

Mark Hunter - *Molson Coors Central Europe - President, CEO*

Mark, just to clarify, that $9 million is at the operating income level. The FX impact on EBITDA is actually more significant than that.

Mark Swartzberg - *Stifel Nicolaus - Analyst*

Okay. Can you give us some magnitude difference?

Mark Hunter - *Molson Coors Central Europe - President, CEO*

Yes, so it's probably about $15 million impact at the EBITDA line and about $9 million at the operating income line.

Mark Swartzberg - *Stifel Nicolaus - Analyst*

Got it. And both those numbers are translation?

Mark Hunter - *Molson Coors Central Europe - President, CEO*

Yes, that's correct.

Mark Swartzberg - *Stifel Nicolaus - Analyst*

Okay, great. Thank you, guys.

Dave Dunnewald - *Molson Coors Brewing Company - VP IR*

Mark, this is Dave Dunnewald. For clarification, or just looking at the relative size of the -- going from operating to EBITDA. If you look at the size of the depreciation and amortization, you'll see the kind of ratio that Mark just alluded to when he gave you those numbers.

Mark Swartzberg - *Stifel Nicolaus - Analyst*

Got it. Got it. Great. Okay, thank you.

Operator

Bryan Spillane, Bank of America.

Bryan Spillane - *BofA Merrill Lynch - Analyst*

Just a follow-up on Mark's question. In terms of FX, what was the effect on -- I guess first, in terms of the outlook you gave, the $25 million impact in the second half, is that on operating income or on EBITDA?

Gavin Hattersley - *Molson Coors Brewing Company - CFO*

It's on pre-tax, Bryan.

Bryan Spillane - *BofA Merrill Lynch - Analyst*

Pre-tax profit?

Gavin Hattersley - *Molson Coors Brewing Company - CFO*

Yes.

Bryan Spillane - *BofA Merrill Lynch - Analyst*

Okay. And then what was the effect in the first quarter?

Gavin Hattersley - *Molson Coors Brewing Company - CFO*

It was pretty flat at a pre-tax level.

Bryan Spillane - *BofA Merrill Lynch - Analyst*

Okay, okay. Then in terms of your outlook for the year, just on FX, there's no -- is that a fixed -- have you done anything to hedge foreign currency at all? Or is there a chance that that number would float around with exchange rates?

Gavin Hattersley - *Molson Coors Brewing Company - CFO*

Yes, the number that we gave you was based on current exchange rates, Bryan. So if anything happens to the exchange rates going forward, it would obviously impact that outlook.

Bryan Spillane - *BofA Merrill Lynch - Analyst*

Okay. Then I guess, when you look at, I think, some of the reaction today to the pro forma, I suspect that there is still some lingering question about the ongoing margins and whether or not they're sustainable. And I think part of it is foreign exchange has had a pretty significant negative effect on the translated number. So I think that's one thing.

The second is, and I'd like to get your insight into this, how much -- is there any purchase accounting or any other accounting adjustments that have been made that would be negatively affecting it? Then finally, just in terms of where we stand today on margins, just why you think that this is a good base, and a base to grow off of?

Gavin Hattersley - *Molson Coors Brewing Company - CFO*

Maybe I'll take the purchase accounting question quickly, Brian. The purchase accounting had a very minimal impact on our EBITDAR and our EBITDA pre-tax numbers. In fact, the numbers that were announced at the time of the deal and the numbers that we're showing in the pro forma are very similar. There's very little difference between the two.

Peter Swinburn - *Molson Coors Brewing Company - President, CEO*

And Bryan, as I highlighted in the script, we've had chance to look at this business. We can see the structure of the business, both in terms of the top line, in terms of the pricing, and the margins that are being driven out there, plus the cost structure and any likely increased costs that we might have in terms of owning the business, plus the capital structure that we think we're need going forward. And really, as I said in the script, we are very confident that the EBITDAR margins of local currency are sustainable.

We also believe that the initial draw that we made on the business in terms of what we thought we would have to spend in capital was over-lagged. So our capital expenditure going forward is less than we expected, and we also expected to drive up the synergies. So we're very confident on all of those three points.

And on a much broader basis, I have to say we're very pleased with the business that we bought. And we're very confident that we'll hit the sort of return rates that we talked about at the very early part of the three to five years that we've always outlined.

Bryan Spillane - *BofA Merrill Lynch - Analyst*

Okay. Then if I could follow up, it sounds like February had a pretty negative effect on the first quarter. Can you just talk about how volatile, or how this business is affected by weather? Is it any more weather-sensitive, I guess, relative to your core businesses? Or was the weather just so extreme that it had that type of effect?

Peter Swinburn - *Molson Coors Brewing Company - President, CEO*

Yes, the weather was so extreme that the business closed down. And even with the rain in the UK, we never got to that level. So it was just a -- I won't say it's a one-off, but it was very extreme weather.

Bryan Spillane - *BofA Merrill Lynch - Analyst*

Okay, great. And then just one final question. There was a -- in the quarter, you had some write-downs in China. Could you just talk a little bit more about what drove that and if there's anything we'd anticipate going forward in that regard?

Kandy Anand - *Molson Coors International - President*

This is Kandy, Bryan. Overall our International business, as you know, has been growing strong top line, putting 30% on the quarter.

Specifically on the China JV, our performance has been below expectations since the inception of the JV, led with challenges by joint venture partner. As a result, we did the testing and wrote off the entire goodwill related to the joint venture in this quarter.

We have an agreement to buy out the minority interest of our joint venture partner this quarter. However, due to developments, we think closing of that agreement is challenged, and therefore we are at this point in time looking at all the alternatives for that investment.

Bryan Spillane - *BofA Merrill Lynch - Analyst*

So you'd -- meaning a different partner there?

Kandy Anand - *Molson Coors International - President*

We are looking at all the alternatives at this time, Bryan. We have (multiple speakers)--

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Bryan Spillane - *BofA Merrill Lynch - Analyst*

Okay, thank you.

Operator

John Faucher, JPMorgan. James Watson, HSBC.

James Watson - *HSBC - Analyst*

First question, just wanted to go on StarBev. On the marketing that you were pulling forward, I was just curious why or what you were so confident in, in the first half, having just been able to take over this business that you wanted to pull forward, if there were certain great opportunities that you saw or certain things that you felt were just so obvious, certain brands, or things that you wanted to pull that forward, as opposed to waiting to own the business a little longer before phasing in the marketing that way?

Peter Swinburn - *Molson Coors Brewing Company - President, CEO*

James, we probably need to make this a bit clearer. We didn't make those decisions. Those decisions were made by the previous management, so we reflect it -- and they are reflected in the pro forma results. We, as you rightly point out, have only had the business for a couple of weeks. So, we did not make those decisions. They were made previously.

James Watson - *HSBC - Analyst*

Okay. Then I'll just go further. In terms of your marketing, do you see any big opportunities when you look at certain brands, certain regions, that perhaps having done more due diligence since our last conversation, that you'd like to talk about?

Peter Swinburn - *Molson Coors Brewing Company - President, CEO*

Well, yes. I think that the -- as we said, we've got very strong positions in most of the markets. The team there has done a very good job on innovation in terms of line extensions, maybe to flavors, and a lot of the investment that went on in the first half of the year was behind that innovation. And as Mark said, that's really, excuse the pun, that's bearing fruit now.

The other part of it would be that Staropramen was extended into most of the markets last year and early this year. Investment's gone behind that brand, and that brand is performing exceptionally well. That's a mix play, because it indexes at around about 110, 115 compared to most of our core brands. That's growing at strong double-digits, so we're pleased about that.

Looking forward, we're currently examining [for the year] and researching the possibility of expanding the Carling brand into some of the markets, but we haven't yet matched the product, nor do we have the consumer research back yet, but they would be the three main areas I'd highlight.

James Watson - *HSBC - Analyst*

Okay. Staropramen in that 110 or 115, I was wondering how big of a premium segment do a lot of these markets have built out? And if you were to bring Carling in, would that be squarely within an international premium segment?

Peter Swinburn - *Molson Coors Brewing Company - President, CEO*

Yes, the premium, or the above-premium, whichever sector we are talking about, the above-mainstream category in all of these markets is pretty limited. So that's an opportunity going forward, and as GDP grows in these markets, then we would expect that sector to, or that category, sorry, to increase as a percentage of the overall business.

Carling will be -- again, we haven't done the consumer research, so we can't tell you exactly what the index would be, but it would certainly be above the average.

James Watson - *HSBC - Analyst*

Okay. Then just quickly on Canada, looking at your main competitor there, they also seemed to lose share in the second quarter, so I was just wondering where the competitive pressure is. Is this coming from in-Canada, and if it's coming from smaller brewers or from retailers pushing pricing? How long that can last, if that's going to spill over to the mainstream from the value brands?

Peter Swinburn - *Molson Coors Brewing Company - President, CEO*

Okay, I'll let Dave go into detail, but you've got it right. It is the smaller brewers in the value sector that -- they are the ones who are picking up the share in general. But Dave, do you have any more specifics?

Dave Perkins - *Molson Coors Canada - President, CEO*

No, I mean it's a longstanding trend where we've seen the smaller national and regional brewers playing hard in the value segment and picking up share there. It's the reason that we've done things like the introduction of Keystone a couple years ago and working hard on our position within the value segment.

It's a very, very fragmented segment. The competitive set is different in each region, and so it takes some finesse to compete in that segment and that's the work we have going on. But it is an ongoing trend that we see.

James Watson - *HSBC - Analyst*

Did the pricing pressure from within value spill over to mainstream at all? Is the gap between value and mainstream staying where you want it to stay?

Dave Perkins - *Molson Coors Canada - President, CEO*

Yes, the gap is larger in the West, frankly, than where I'd like to see it. You have some provinces where value index is as low as a 53. But generally in the major markets across the country, the gap is manageable. But you will get the exception in a couple of the Western markets where the gaps are large enough that it certainly spills into the mainstream.

James Watson - *HSBC - Analyst*

Great. Thank you very much.

Operator

Mark Swartzberg, Stifel Nicolaus.

Mark Swartzberg - *Stifel Nicolaus - Analyst*

Yes, hi again, Mark. I wanted to try to understand a little bit better what's going on with the mix in StarBev and how you think about stickiness of volume as you move into next year. On the mix side you're getting -- you're netting out positive on net sales per hectoliter. Are these incremental products you're putting more emphasis on, are they gross margin enhancing or are they gross margin degrading?

And then how do you think about the stickiness of this volume lift? I really don't understand what's driving it in terms of products or channels. You're spending -- or prior management decided to up spending in the second quarter. But I'm not sure where that money is going against and whether it's sustained volume lift.

Mark Hunter - *Molson Coors Central Europe - President, CEO*

Okay, there's a number of different questions in there, Mark, so let me try and pick my way through them. The orientation of the business is really from a portfolio perspective to drive everything we can at core, which is our mainstream brands or above. And everything we're doing from an innovation perspective should be margin enhancing versus our average margin, so that really is the focus of the commercial team.

And the bulk of the incremental investment in sales and marketing in the first half or really the second quarter has gone principally behind the innovation agenda and our core brands.

You've got to remember we've currently got the number-one brand in four markets, and we're a strong number two or three in the other three markets. So investing in our core brand, not dissimilar to Coors Light investment in the US, or Canadian and Coors Light investment in Canada, or Carling in the UK, remains absolutely central to our thinking.

We're looking to continue to strengthen the backbone of our business through marketing and orientate the business to top-line and value growth on the back of premiumizing the portfolio, with a big chunk of that being driven by our innovation agenda.

The mix that we refer to is a combination of things. It's a shift in some of the dynamic in our customer mix, so we're seeing shifts from traditional trade to what's called key accounts here. You'd recognize it as the grocery channel.

And a little bit of mix on packaging types as well as we move from some returnable bottles into more non-returnable packaging, things like PET in some of the markets. So below the top line, there's a combination of different factors going on, and our job is, obviously, to manage that holistically and make sure that the total number moves in the right direction, and that's what the team generally have been doing and continue to do.

Mark Swartzberg - *Stifel Nicolaus - Analyst*

So, it sounds like the objective is mix enhancement, but because of the channel mix and because of the package mix, there's been a little bit of a mix degrade. Is that a fair assumption?

And how do you think about lapping these volume benefits? I know it's very early days, but how do you think about that?

Mark Hunter - *Molson Coors Central Europe - President, CEO*

I would probably characterize the challenge much more as more general top-line growth, so a combination of both pricing, volume, and mix all being managed effectively. And the good news is that if you look at overall industry trends, the likelihood of stronger industry growth than we have seen in other markets is higher, because of the economic growth that we have seen here from a GDP perspective.

And even against the broader euro zone, we expect GDP growth to be at least twice that that we'll see across the broader euro zone, and correlation between GDP growth and beer volume growth is very strong. So I have a relatively high degree of confidence, as long as the economic situation doesn't take a dramatic turn for the worst, that the volume growth should come through in the business. And if we can continue to manage pricing and mix as the team has been doing and drive the innovation agenda, maintaining and developing the margins in a local currency level should be well within our capabilities.

Mark Swartzberg - *Stifel Nicolaus - Analyst*

Great. That's great. Thank you, Mark.

Operator

(Operator Instructions) Brett Cooper, Consumer Edge Research.

Brett Cooper - *Consumer Edge Research - Analyst*

A couple of questions. It would be helpful if we could get the 8% increase in SG&A in the Central and Eastern European business. How much of that was a pull-forward, I guess, versus just underlying growth in the quarter?

And then the second one would be on Canada, how much did the shift of Canada Day impact volumes?

Dave Perkins - *Molson Coors Canada - President, CEO*

Do you want me to take Canada first? Probably simpler. Our estimate for the quarter is that it was about a 2% impact on volume.

Brett Cooper - *Consumer Edge Research - Analyst*

Thanks.

Mark Hunter - *Molson Coors Central Europe - President, CEO*

Sorry, yes, can you just repeat the 8% referring to?

Dave Perkins - *Molson Coors Canada - President, CEO*

So, I think you said in local currency, MG&A was up 8% in Central and Eastern Europe. And we've obviously talked a lot about that being pulled forward, or I guess marketing expenses being pulled forward from the second half. And I just was trying to understand what the, if you will, the underlying, or ex- that pull forward increase was, just so that we could understand what the underlying growth in MG&A would have been or might be as we think about this going forward.

Mark Hunter - *Molson Coors Central Europe - President, CEO*

Let me talk specifically about sales and marketing. On a full-year basis, we would expect our sales and marketing to be relatively flat year-on-year. That's probably the best indication I can give you of the difference in phasing that's taken place in our investment.

On a total-year basis, we're currently projecting sales and marketing investment to be generally flat, so you'll need to work back from there. Much of that flowed through as incremental in the first half. I don't have that specific number in front of me.

Brett Cooper - *Consumer Edge Research - Analyst*

Okay, thanks.

Dave Perkins - *Molson Coors Canada - President, CEO*

Brett, to be sure, that's in local currency that Mark is talking about.

Brett Cooper - *Consumer Edge Research - Analyst*

Yes.

Operator

We have no further questions at this time. I turn the call back to the presenters.

Peter Swinburn - *Molson Coors Brewing Company - President, CEO*

Okay, thank you, Martinna. Thank you, everybody, for taking part this morning/this afternoon. We welcome your interest and look forward to speaking to you at the next quarter's announcements. Thank you.

Operator

This concludes today's conference call. You may now disconnect.