



MINERVA
Investment Management
Society

June 21, 2018

CAMPARI SpA

Our View:

We suggest a HOLD recommendation on Campari SpA, assessing a €6,58 final target price by the beginning of June (considering 18th June closing price).

Key Points:

Now, Campari SpA has positive and increasing cash flows. During its 158-year story, Campari was able to become one of the most important players worldwide.

Campari's investment in distribution and new brand are strategic because those investment allow Campari to penetrate in North America and new markets.

This year results will also be affected by some events not showing their full impact yet such as the sale of the Lemonsoda business, the acquisition of Bisquit Cognac and the termination of the agreement to distribute Brown Forman products in Italy.

However, one must be aware that instable macroeconomic scenario in emerging countries and high marginality in developed markets will affect the whole result of this year.

Valuation:

Our valuation is the combination of a two-stage DCF analysis (6 years of business plan and one terminal value) and a multiple valuation based on three multiples (calculated choosing four comparable). The final result is obtained as an average of the two prices found with the two different procedures.

Riccardo Bellucci
(Equity Research Analyst)

Antonio Cantatore
(Equity Research Analyst)

Manuel Carta
(Equity Research Analyst)

Angelo Zanella
(Equity Research Analyst)

HOLD

Target Price: € 6,58

Listed on: Piazza Affari

SCENARIO ANALYSIS



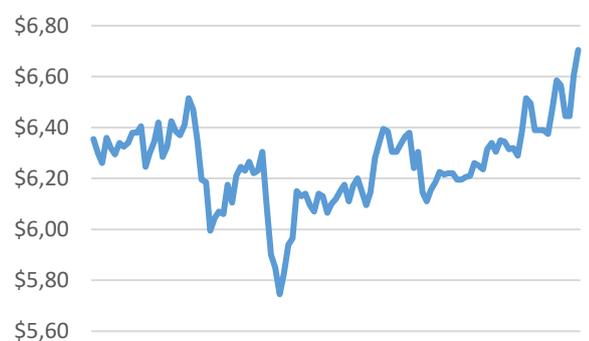
KEY STATISTICS

52-Week Range	€ 5,67 - € 6,95
Average Volume	1'820'274
Shares Out. (mm)	1B
Market Cap. (mm)	7,81 B €

FINANCIAL KEYS

	Y2017	2018E	2019E	2020E
E (mm)	356,3	237,68	264,49	292,71
EPS	0,20	0,213	0,239	0,264
DPS	0,05	0,048	0,053	0,06
CPS	-	0,3	0,325	0,348
FCFO		363,18	389,38	419,53
FCFE		219,63	235,51	254,81

Campari's closing price during 2018



SPIRITS IN THE WORLD

The spirits market consists of the sale of brandy, liqueurs, rum, specialty spirits, vodka, whisky, Tequila & Mezcal, and Gin & Genever.

Looking at the global market between 2011 and 2016, spirits increased their share of total alcoholic drinks consumption. The principal reason of this increase is a weak performance of the biggest categories in this market: beer for China and USA and wine for Western European markets. Along with this, there was a healthy growth in spirits (mainly in Asia Pacific).

However, in the same period, the sales saw a CAGR of 1% in volume terms, but were static in constant value terms. This is especially since most of the volume growth came from low value local spirits in the emerging markets. Even where there were high value ones, consumers traded down because of the crackdown on gift giving and corporate entertaining.

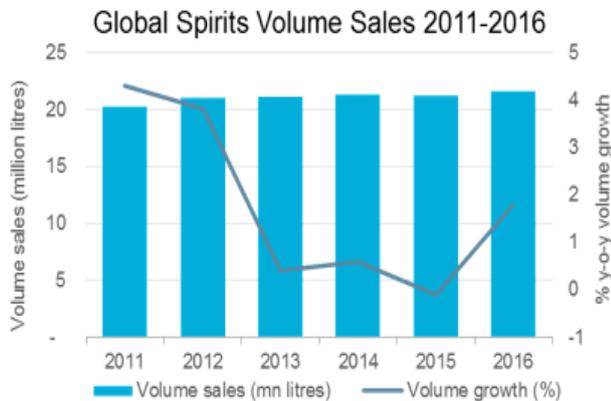
Nonetheless, this trend didn't show up in developed markets, where consumers have continued to trade up to higher value products. This is the reason why there has been a switch from local spirits products to international ones, such as blended Scotch, but also within categories. All in all, this compensated the plunge registered in the emerging markets and led the growth to be close to zero.

Moving on and analysing the single areas in more detail, Emerging markets on the one hand will continue to be the key growth drivers for spirits, as growing wealth in these markets makes products more affordable. Sales in developed markets are growing by 730,000 litres between 2011 and 2021 (expected) while emerging markets will grow by 2.7 billion litres.

Among them, it is found that the Asia Pacific share of global spirits sales rose from 55% to 60% over 2011-2016 thanks to the region seeing volumes rise over twice the speed of the 7% total global volume growth over the period.

Nevertheless, the Middle East and Africa remains the most underdeveloped region in terms of spirits consumption. In 2016, consumers in the region drank only 659,000 litres in total; 20% of which was just in South Africa.

However, on the other hand, the mature markets and especially the US still offer good opportunities. With reference to the last one, there the company Diageo leads in both volume and value, thanks to the strong performances of brands like Bulleit and Ciroc, but its greater historic emphasis on lower value brands and categories, such as Smirnoff vodka and Captain Morgan rum, pulled it down.



All in all, the main trends and drivers of growth in the spirits market can be summed up in the following points:

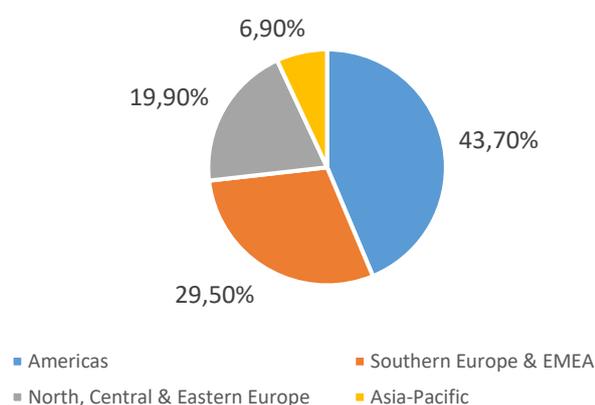
- Consumers are heading to the off-trade, especially in North America
- Premiumisation drives spirits growth, with consumers continuing to trade up to higher value products
- Rise of craft (that can be considered as a niche of premium products), especially in mature markets
- Emerging markets will be the key growth driver
- Growth rate estimated at 8% between 2017 and 2021
- M&A-driven growth, with also acquisitions of “craft brands”

SPIRITS IN ITALY AND EUROPE

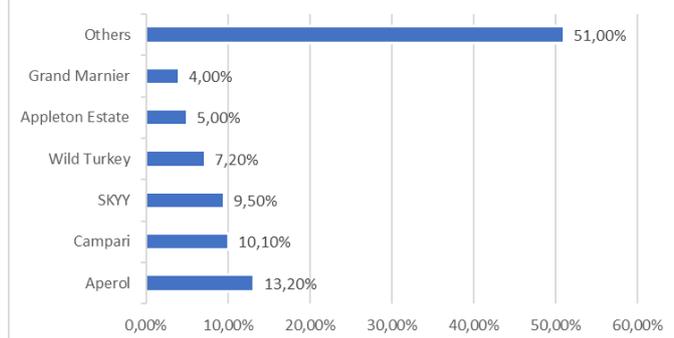
Italian spirits market had a normal growth in recent years and it is expected to continue with this trend until the end of 2020. It generated total revenues of \$8,979.5m in 2015, representing a CAGR of 1.0% between 2011 and 2015. In comparison, the French and German markets grew with CAGRs of 2.4% and 1.5% respectively, over the same period, to reach respective values of \$21,395.0m and \$22,934.7m in 2015. Market consumption volume increased with a CAGR of 0.6% between 2011 and 2015, to reach a total of 169.9 million litres in 2015. The market's volume is expected to rise to 176.2 million litres by the end of 2020, representing a CAGR of 0.7% for the 2015-2020 period.

Rank	Company	2016 % volume share
1	Diageo	9,8%
2	Pernod Ricard	4,8%
3	Hite Jinro	3,0%
4	Thai Beverage	2,7%
5	Suntory	2,0%
6	Beijing S. A.	1,4%
7	Alliance Global	1,4%
8	Bacardi	1,4%
9	Lotte	1,3%
10	San Miguel	1,0%
...		
14	Campari	0,9%

Percentage of sales by Region in 2017



Net sales share by Brand in 2017



CAMPARI OVERVIEW

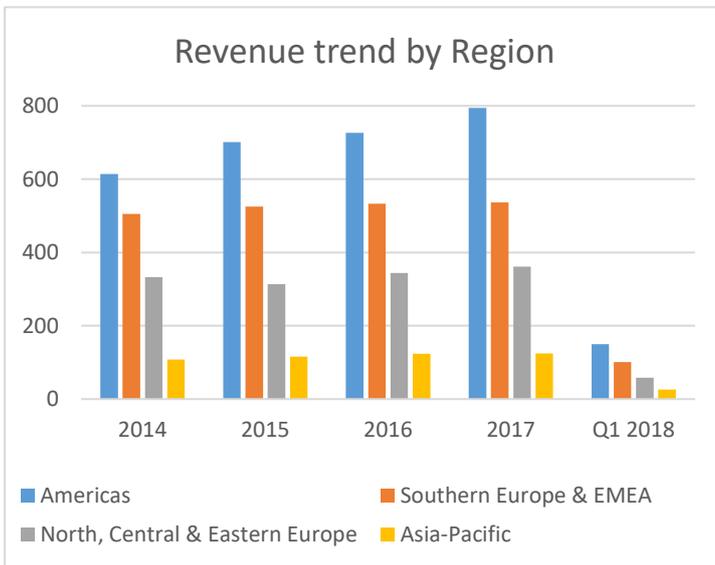
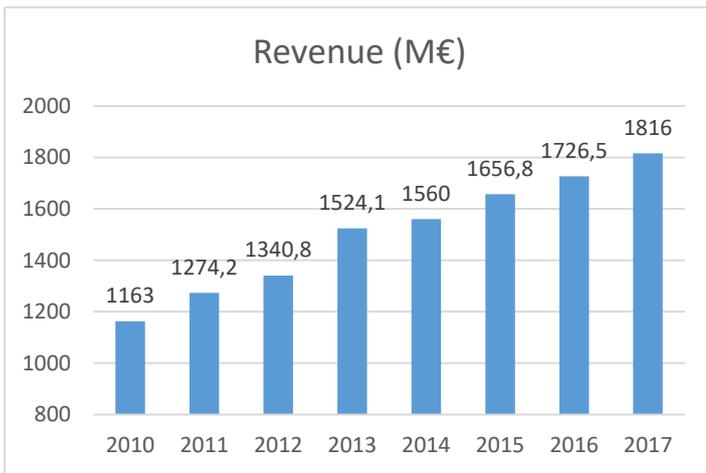
Campari SpA is an Italian company, listed on Piazza Affari since 2001, operating in the beverage industry, and whose core business is Spirits. It was founded in 1860 and, during its 158-year story, it managed to become one of the most important players worldwide. In Italy it can be considered by far one of the top player of the market. However, despite this great results in its home country, much more can be done on a global basis, where it still was the 14th player in 2016.

Over the last decade, Campari's performance has been driven by its long-term strategy consisting of keeping on investing in distribution and new brands. The M&A strategy is based on strict criteria, prioritising the penetration of North America and new markets. This strategy has led to a continuous growth of the company, which can be immediately seen by looking at its revenue's trend of the last years.

Accordingly, if we split the sales by region, almost half of them comes from Americas, whilst few of them come from emerging markets despite Campari already trying to expand also on some of these regions. This can be surely considered a weakness of the company, especially considering the importance that these markets (as reported above) will have in terms of growth over the next years. However, Campari is perfectly aware of it and, in its business plan, one of the main aims is to develop the Group's presence in emerging markets by also building new distribution platforms.

As far as the brands are concerned, 49% of net sales are represented by the six Global Priority brands, namely Aperol, Campari, SKYY Vodka, Wild Turkey, Appleton Estate and Grand Marnier (acquired in 2016). These brands are forecast to overperform even this year, as already happened during the first quarter, whose results are good (organic growth of 2,2%, according to the 2018 first quarter financial report; actually, the overall performance is slightly negative, due to the negative exchange rate variations) but still mainly driven by developed markets, given the present macroeconomic uncertainty characterising some emerging markets (above all, Russia).

This year results will also be affected by some events not showing their full impact yet, and the sale of the Lemonsoda business (considered non-core), the acquisition of Bisquit Cognac and the termination of



the agreement to distribute Brown Forman products in Italy.

Overall, we can expect that trends characterising the first quarter

of 2018, i.e. overperformance of Global Priority brands (but also of some Regional priority brands), instable macroeconomic scenario in emerging countries and high marginality in developed markets, will affect the whole result of this year.

However, Campari's growth strategy, based on empowering its already owned brands, developing its presence in high-potential markets (included emerging markets, whose contribution will be important as soon as their economies will become more stable), acquiring new brands and maintaining its financial discipline, will probably further boost Campari's performance and allow it to (at least) maintain its strong market position.

VALUATION - DCF

In our valuation we perform a two-stage DCF: the first stage is a six years business plan for the years between 2018 and 2023, instead the second stage is a perpetual growth starting from 2024. The analysis is concentrated on the equity side using Free Cash Flow to Equity.

Income statement forecasts

	FY15	FY16	FY17	FY18 E	FY19 E	FY20 E	FY21 E	FY22 E	FY23 E
REVENUES	1.657	1.727	1.816	1895,542	1978,568	2065,231	2157,857	2254,637	2355,757
COST OF GOODS SOLD	739,80	741,90	741,1	757,3304	773,9162	790,8652	808,1855	825,8851	843,9722
GROSS INCOME	917,2	984,60	1.075	1138,212	1204,652	1274,366	1349,671	1428,752	1511,785
OPERATING EXPENSE	584,3	612,5	632,1	651,063	670,5949	690,7127	711,4341	732,7771	754,7605
EBITDA	332,9	372,1	442,9	487,1488	534,0573	583,6531	638,2371	695,9744	757,0243
DEPRECIATION & AMORTIZATION	47,40	52,70	57,70	62,893	68,55337	74,72317	81,44826	88,7786	96,76868
EBIT	285,5	319,4	385,2	424,2558	465,5039	508,93	556,7889	607,1958	660,2557
INTEREST EXPENSE	60,00	58,60	58,60	58,6	58,6	58,6	58,6	58,6	58,6
PRE-TAX PROFIT	225,5	260,8	326,6	365,6558	406,9039	450,33	498,1889	548,5958	601,6557
TAX PROVISION	73,40	70,50	-29,7	127,9795	142,4164	157,6155	174,3661	192,0085	210,5795
NET INCOME	152,1	190,3	356,3	237,6763	264,4875	292,7145	323,8228	356,5873	391,0762

The main assumption made on these forecasts regards the growth of revenues. We assigned a total growth of 4,38% between years 2018 and 2020 and a total growth of 4,49% for the remaining years. These results are calculated with a weighted average considering Campari's sales by geographical region as weights and according to Euromonitor International's CAGR forecasts for the period. Our decision to split the growth in two different rates is due to the conviction that Campari will change the percentage of sales in the future, moving towards to more profitable regions.

Geographical areas	%Campari's sales	CAGR	2018-20 CAGR	2021-23 CAGR
EMEA	49,42%	4,30%		
America	43,73%	5%		
Asia and Pacific	6,85%	1%		
Total	100%		4,38%	4,49%

Other assumptions are:

- Cost of goods sold will increase by half of revenue's growth
- According to historical trend Operating expense will increase by 3% and Depreciation & Amortization by 9%
- Interest expense is fixed at 58,6
- Tax rate is fixed at 35%

FCFE forecasts

	2018	2019	2020	2021	2022	2023	TV
NET INCOME	237,6763	264,4875	292,7145	323,8228	356,5873	391,0762	
EBIT Taxes	42,42558	46,55039	50,893	52,89494	57,6836	62,72429	
Capex	56,86626	59,35705	61,95693	64,7357	67,6391	70,67271	
NET WORKING CAPITAL	224,80	230,80	239,67	248,8809	258,4458	268,3782	
FCFO	363,1844	389,3801	419,5345	455,073	489,7103	526,0574	
Taxes	85,55395	95,86597	106,7225	121,4712	134,3249	147,8552	
Change in Net Debt	0,6	0,6	0,6	0,6	0,6	0,6	
Interest expense	58,6	58,6	58,6	58,6	58,6	58,6	
FCFE	219,6305	235,5141	254,8121	275,6018	297,3854	320,2022	328,8509
year	1	2	3	4	5	6	6
Discounted FCFE	206,1416	235,5141	254,8121	275,6018	297,3854	320,2022	5850,901

The perpetual FCFE of 2024 is derived by previous year FCFE multiplied by (1+2,70%). This rate is calculated through a weighted average using IMF's forecasts of Real GDP growth and Campari's sales by geographical region as weights (EMEA, America and Asia & Pacific). In that way we connected the future development of Campari to the development of the countries in which is business is mainly based.

The cost of equity used in the discounted model is given by CAPM model:

Ke	Rf	Beta	ERP
6,54%	2,62%	0,77	5,08%

We used as risk free the 10Y Italy Treasury Bond which includes the Country Risk Premium that the market assigns to Italy. This operation allowed us to exclude the CRP in the Equity Risk Premium; the latter is equal to 5,08% according to Damodaran's forecasts. Instead the estimation of beta derives from a Bottom-up approach. The first step started with the raw beta of comparable companies (source: Thomson Reuters). The second one regarded the deleveraging of the raw beta through the formula $\beta_{unlevered} = \frac{\beta_{raw}}{1+(1-tc)*D/E}$ (where tc=24% and D/E is Net Debt/Market Cap). Then, we calculated the unlevered beta for Campari as the arithmetic average of the four unlevered betas of the comparable companies. Finally, we found the β levered of Campari using its D/E ratio target.

raw beta	Net Debt/mkt cap	beta unlevered	beta levered	Comparable companies
0,97	15,72%	0,866480		Diageo
0,8	23,44%	0,679034		Pernod
0,54	6,83%	0,513353		Remy
0,83	9,83%	0,772303		Brown
	12,00%	0,707792	0,772343	Campari

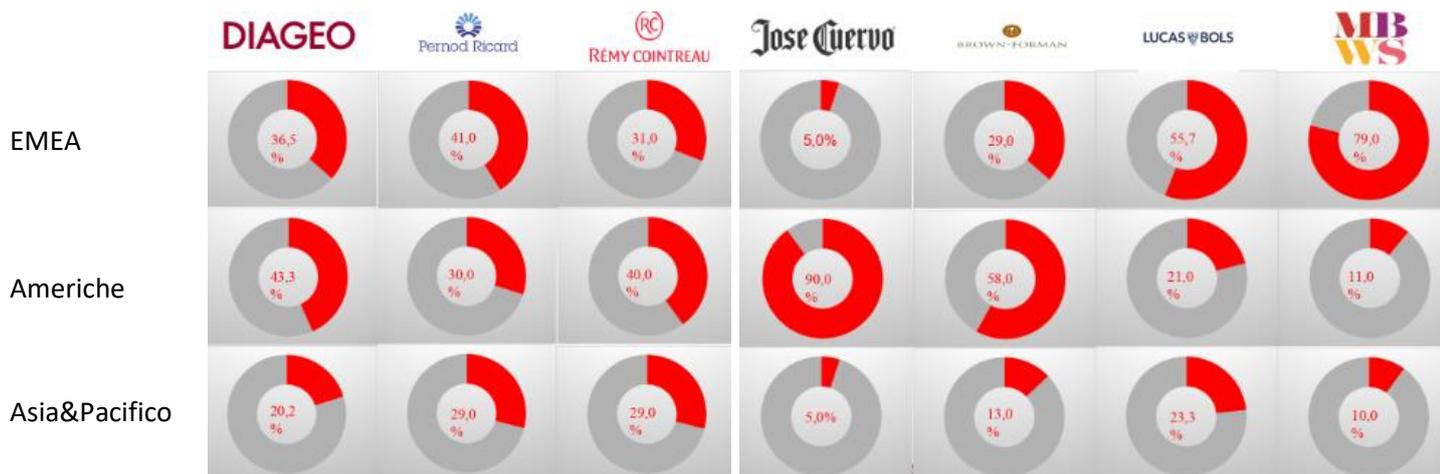
The sum of the Discounted FCFE leads to an Equity value of 7440,56 million of euros. Dividing this amount for the number of shares (1153, source: Thomson Reuters) we obtained a price of 6,45.

				ΔKe		
		-0,50%	-0,25%	0	0,25%	0,50%
	-0,50%	6,57	6,19	5,85	5,54	5,27
	-0,25%	6,94	6,51	6,13	5,80	5,50
Δg	0	7,38	6,88	6,45	6,08	5,74
	0,25%	7,88	7,31	6,82	6,39	6,02
	0,50%	8,47	7,80	7,24	6,76	6,34

Sensitivity Analysis
Best scenario: 8,47 (+31,32%)
Worst scenario: 5,27 (-18.30%)

VALUATION – MULTIPLES

This analysis has been conducted considering four comparable companies chosen following business model, geographical sales and financial structure criteria. Firstly, we selected a sample formed by 7 companies whose revenues come at least for 75% from spirits. Secondly, among these companies, we analysed the geographical sales share. We removed from the sample three companies (i.e. José Cuervo, Lucas Bols and MBWS) whose geographical target is too different from the Campari's one.



	CAMPARI	Pernod Ricard	Remy Cointreau	DIAGEO	Brown-Forman
Net Debt/Equity	14,46%	23,44%	6,83%	15,72%	9,18%
EBITDA/Sales	23,81%	29,42%	22,83%	34,26%	35,64%

Finally, the last step was to compare the financial structure of Campari and the remaining four possible comparable. No big differences were found; therefore, the final sample is formed by the same four companies, namely Diageo, Pernod Ricard, Remy Cointreau and Brown Forman.

We then selected two multiples, all asset side: EV/EBITDA and EV/SALES. The reason under the first multiple is simple: it's the best choice for the comparison between light capital-intensive companies. Furthermore, it is used as a benchmark in many M&A transactions. We included in the analysis also EV/SALES because the market share is fundamental in Spirits market. Final Campari's multiples are the average of the four comparable companies' multiples. We selected three multiples, all asset side: EV/EBITDA, EV/EBIT and EV/SALES. The reason under the first two multiple are simple: they are the best choice for comparison between industrial companies. Furthermore, they are used as benchmark in many M&A transactions. We included in the analysis also EV/SALES because the market share is fundamental in Spirits market. Final Campari's multiples are the average of the four comparable companies' multiples.

Company Name	EV/EBITDA (FY 0)	EV/SALES (FY 0)	EV/EBIT (FY 0)	Net Debt	shares
Pernod Ricard SA	17,64984	4,329419	16,18592		
Diageo PLC	19,33017	5,546828	18,38264		
Remy Cointreau SA	26,40551	5,389801	27,22683		
Brown-Forman Corp	26,55314	9,010094	28,1663		
Campari	22,48466	6,069035	22,49042	938,7	1153

	Enterprise Value	Price
EV/EBITDA (FY 0)	8617,281	6,659654
EV/EBIT (FY 0)	7337,775	5,549935
EV/SALES (FY 0)	10082,67	7,930588
Mean	9349,975	6,713393

$$P = \frac{EV - Net\ Debt}{n^{\circ}\ shares}$$

VALUATION - CONCLUSION

The final step of the valuation is the recommendation that comes from the union of the results given by the two different procedures.

DCF Price	MM Price	Final Price	Recommendation
6,45	6,71	6,58	HOLD

On one hand we have a more conservative price given by the DCF analysis, on the other hand MM approach shows a more generous result (especially if we don't consider EV/EBIT). The final valuation price is the average of the two and comparing it with 50 days MA (6,32) we suggest a hold recommendation. To rise its value, Campari's main future focuses must be the increase of the market share in emerging markets and the exploitation of the economies of scale.