Britvic PLC

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Will Pepsi buy out Britvic?

Despite the current economic situation in the country, the sales of well known soft drinks brands seem to hold up somewhat well. This benefits Chelmsford-based Britvic PLC (listed in London under BVIC, capitalised at £681m). The figures in the company's interim half yearly results ending 12th April '09 look encouraging – revenue, earnings and dividends are all up on the last reporting period. What is of medium-term interest to most investors, though, is to consider how far Britvic can still go in this fairly low-margin, mature business. Will it be bought out by Pepsi as some investors hope, or will it go on to build a large European business with a portfolio of well-known brands as other, more ambitious investors predict?

The company is currently the second largest soft drinks manufacturer and distributor in the UK (Coca Cola Enterprises holds the top spot). Britvic has a large and diversified customer base supplying drinks to over 200,000 outlets nationwide including Tesco, Sainsbury, Asda and WM Morrison. With the acquisition in 2007 of C&C Group in the Republic of Ireland for £170m, Britvic now has a sizeable and potentially strong business there. Other international operations are fairly immaterial (£9m revenue in half year to12th April '09).

The company's main revenue drivers are such seemingly recession-resilient brands as Pepsi, 7UP, Gatorade, Tango, Robinsons, Fruit Shoot and J2O. Britvic's most significant commercial partner by a large margin is Pepsi Co; this partnership has so far worked out well and Britvic has several long-term committed bottling and distribution agreements with Pepsi Co in the UK and Ireland for such brands as Pepsi, Gatorade and 7UP (UK agreement is due for renewal in 2023 and Ireland agreement runs until 2015).

Britvic in its most recent history has been a highly geared company with almost no equity and all capital requirements being met by debt. The company currently has £443m worth of debt capital (£11.6m of this being current, in unsecured bank loans); pre-tax cost of this debt is 6.10%. The interest cover ratio is 3.4.

Current Assets have generated £483.2m worth of revenue in six months ending 12th April 09, an uplift of 6.3% over previous reporting period. And although the gross margin has slipped 2 percentage points compared to last reporting period we still end up with EPS of 6.7p, an increase of 11.7% over EPS in previous reporting period. This was achieved by well controlled selling and admin costs and reduced finance costs. The net income margin Britvic generated was 5.7% of revenue (adjusted annual basis), well below the industry average of 11%. This type of income margin allows us a Return on Capital of 12.5% (before exceptionals); compare this to the company's cost of capital of 6.10% and you have a fairly profitable business. Had the net income margin been the industry average we would be looking at ROC of 24% - this would make for a lot more excitement.

Price: 949

Market Cap: £2.52 billion

1 Year Share Price Graph

Share Information

Code:		BVIC
Listing:		LSE
52 week	**High**	**Low**
	1079	**782.5**
Sector:		**Food & drink**
Website:		**www.britvic.com**

Company Synopsis:

Britvic is a United Kingdom-based manufacturer and distributor of soft drinks. The Company's portfolio of brands includes names, such as 7UP, Ame, Britvic 55, J20, drench, Gatorade, Idris, Pennine Spring, Pepsi, Purdey's, Red Devil, Shandy Bass, Tango and Lime Grove.

action@proactiveinvestors.com

Britvic's total assets stand at £836m (£786.4m last reporting period), mainly due to increase in currency swaps. With total liabilities being £836.5m we have a negative number for total assets. Current Ratio also points to balance sheet weakness; it equals 0.84, as current assets do not cover current commitments. Cash is at a pretty lowly £3m (£15.2m in last reporting period).

Another point of interest on the Balance Sheet is the company's £42.3m pension reserve deficit, an increase over the last reporting period of £28.1m. The company has now committed to paying down £10m annually, on 31st December of '09 and '10 to eliminate this gap.

Net cash-flow from operating activities for 6 months to 12th April 09 came in at £14.1m, down by 21.7% on last reporting period. The cash flow was greatly affected by a £12m restructuring charge invested in the Irish business. The increase in Capital Expenditures is attributable to the same cause.

The declared dividend in the reporting period was set at £19m or 8.7 pence a share, yielding just over 4% on an annual adjusted basis.

So, given all of the above, does the market price Britvic fairly? It seems so; given the company's pay out ratio of 87% the dividend discount model gives us an intrinsic value for Britvic's stock in the range of 350-360 pence a share. Evidently, there is a small upside to the current stock price of 322 pence a share.

The firm value could potentially increase if management achieves sizeable improvement in net profit margins and increases its growth. So far the revenue has been increasing at a pedestrian 5.5% a year over the last five years, while income has been dropping by 8.7% a year with a resulting steady decrease in dividends.

The key to sustainable value creating in Britvic's business is brand innovation and successful brand marketing (last year's advertising budget stood at 7% of revenue, likely to be maintained going forward). The company is innovating, in the last six months Britvic launched two new products: "Drench" - adult juice drink on the go and "Robinsons Be Natural" - brand extension. Other launches will concentrate on new pack architecture, such as "Tango with Added Tango". "Lipton Ice Tea" has also recently been added as extension of Britvic's relationship with Pepsi Co (Pepsi now owns around 5% of Britvic).

Elsewhere Britvic are at work improving efficiencies, restructuring their Irish business to the tune of £12.8m last year and reducing head count there by 145 (Cork factory has now been shut and investments in Dublin factory will enable it to produce the popular Robinsons drinks locally). Potential synergies with Britvic UK should add up to around EUR27m by 2011.

Will Pepsi buy out Britvic? It may do, the company is highly dependant on good working relationship with Pepsi Co, which places Pepsi in good negotiating position, assuming the economics of the deal could be worked out. Can Britvic develop a larger European business? Danone and Nestle will without a doubt be in the way, but Britvic has the necessary market expertise to venture, although their distribution capabilities in Europe a less certain.

What seems clear is that the status quo presents no meaningful upside so come the general economic recovery, where next for the company?