THE ANALYST

Campari Group: The Perfect Serve
BUY @ €6.96

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Campari – View All Notes and Models

Recommendation: **Buy (Initiation of Coverage)**

Price: **€6.96**	2-Year Price Target: **€11.59**	Forecast Return: **~66%**
3m Average Daily Volume: **$54.6m**	Market Cap: **€7.8bn**	Ticker: **CPR IM**
Valuation Metric: **FY'23e P/E**	Current Multiple: **18.2x**	Target Multiple: **30x**

Investment Thesis

- **Family-owned Italian gem managed with a multi-decade view. Combines unique, global growth products with pricing power, high margins, and structural demand.**
- **Mid-single-digit group revenue growth can accelerate as consumption of key product Aperol continues to explode around the world.**
- **Growth is highly accretive to group profitability due to Aperol's higher gross margins.**
- **Other brands in the portfolio provide exposure to key spirits categories, offering both further growth optionality and potential margin upside thanks to structural demand trends, brand internationalisation, and premiumisation.**
- **30x FY'23e EPS and adding two years of dividends gives a target price of €11.59, representing ~66% upside.**

Campari Group has been on our wish list for a long time. Today, it moves to our buy list. We initiate with a Buy recommendation and a €11.59 target price, representing ~66% upside.

We met the company in Italy in the past and looked again in mid-2018. Each time, at much lower share prices than today, we concluded that valuation was prohibitive for us to add the stock to our buy list. However, with the passage of time, we have come to understand that fundamentals and growth consistently outweigh valuation and the best companies rarely get 'cheap'. Clients may still push back on valuation concerns, but the broader environment remains one of extremely low interest rates, whilst Campari has great long-term earnings and growth visibility.

We argue Campari is one of the best companies in Europe, delivering unique products with global growth runway, pricing power, high margins, and structural demand. Campari's 'secret sauce' relies on a business model focused on brand-building and a long-term planning strategy backed by very patient shareholders.

The key elements of our thesis are:

- Aperol has a long runway of high growth ahead as the brand has barely scratched the surface of its huge global potential. This is underpinned by product uniqueness, structural demand, and a significant 'share of throat' gain available. We estimate Aperol sales growth at ~21% CAGR 2019-23e, reaching €720m by FY'23e. Growth is highly accretive to profitability as Aperol is higher gross margin than the group and it is accelerating its market penetration in higher-margin countries.

- Other brands in the portfolio such as Campari, Wild Turkey, and Appleton Estate offer exposure to growing spirits categories and are set to benefit from shrewd bottom-up marketing, brand internationalisation, and premiumisation positioning. We see both growth optionality and margin upside which we think are currently overlooked by the market.

- Overall, we estimate the group revenue growth will accelerate after FY'20 to low-double-digit with gross margin increasing from 60.9% in FY'19 to 62.5% in FY'23e.

- We estimate that the business can generate cumulative free cash flows (after earn-outs) of ~€590m by FY'22e. We expect additional capital returns to shareholders after the announced €350m share buyback in FY'20. However, M&A represents additional optionality as the group has been a canny acquirer in the past.

Campari Group has a lot of the characteristics of a great business which can compound and create value for investors over decades. The stock is down ~25% since its pre-COVID-19 high. The current uncertainty offers a good opportunity to build up a position for the long term in one of the best-run business in Europe.

Aperol: Still a Long Runway of Explosive Growth Ahead

Three-Stage Sustainable Growth Model at the Heart of the Brand-Building Strategy

When it comes to market penetration and brand building, the company's strategy relies on a three-phase product roll-out plan spanning 15+ years. Along the way, the group controls the pace of the roll-out thanks to its direct distribution approach and maintains strict control of the brand image. Local management teams spend a lot of time understanding the consumer, training barmen, and tweaking their marketing approach. Once the bottom-up marketing model kicks off, the brand starts growing rapidly.

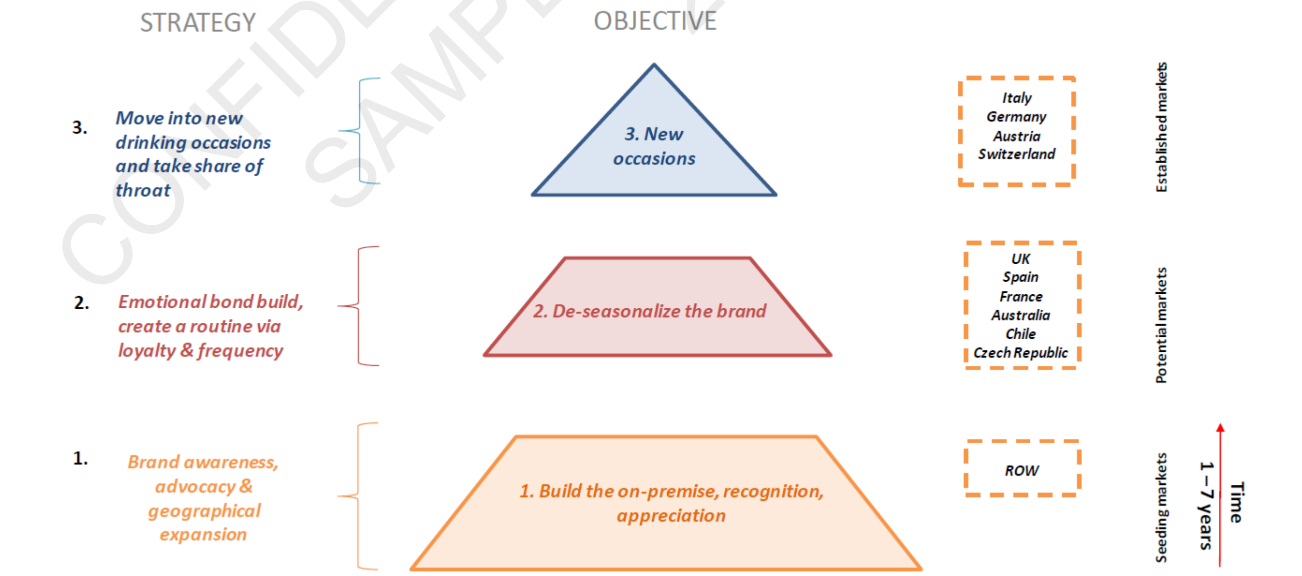
Phase 1 (Year 1-7): The company targets specific cities/bars focusing on educating the market and training bartenders on the perfect serve. In the early stage, sales are mainly on-trade and the gross margin is fully reinvested in advertising and promotion. The brand building is driven by experimental marketing such as social events organised by Campari's employees and the product is slowly released off-premise (90% on-trade/10% off-trade).

Once the market is educated on how to use Aperol and brand awareness grows, the company starts to grow off-trade and continues investing in education, but now start to grow EBIT margin.

Phase 2 (Year 8-13): During this second phase, the strategy is to de-seasonalise Aperol into the winter and build consumption frequency beyond the summer, more similar to beer consumption. The brand-building continues through winter events (e.g. winter sports, après-ski parties). At this stage, the product is fully released off-premise as consumers are more familiar with the brand.

Phase 3 (Year 14+): The focus is on increasing consumption outside of pre-dinner aperitifs with food pairing (e.g. pizza, burgers) at lunchtime and/or dinner. The intent is to take further 'share of throat' from beer and wine.

Exhibit 1: Three-Stage Approach to Campari's Brand-Building Growth Strategy



Source: Campari Group Presentation 2017 (Accessed April 2020)

Sourcing Volume from Beer and Wine

Despite incredible growth over the last 15 years (+19.6% volume CAGR 2003-18), we do not think that Aperol will reach saturation anytime soon and believe **the brand has barely scratched the surface of its huge global growth potential.**

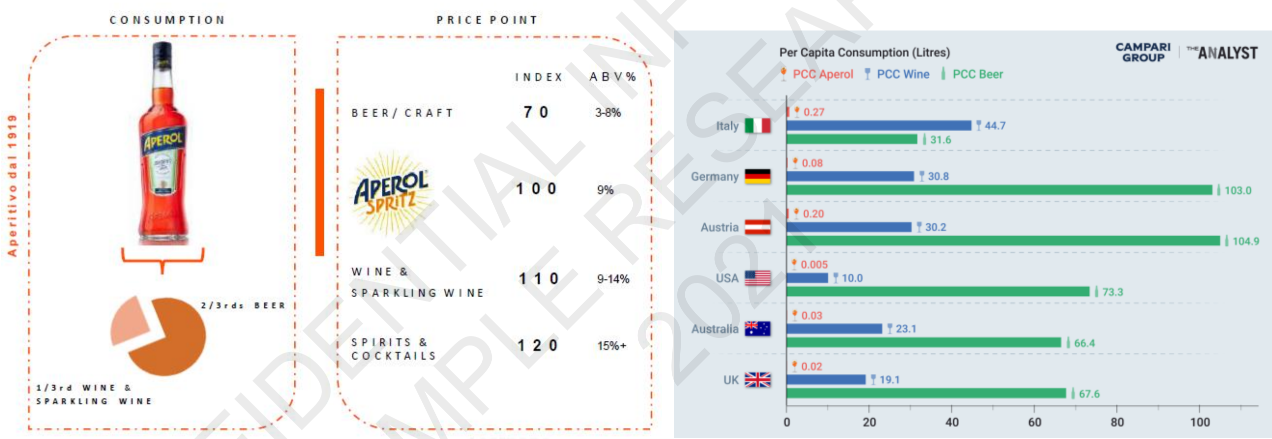
Aperol Spritz competes mainly with beer and wine which makes the addressable market very large. As per the company, ~67% of the growth comes from beer and the rest from wine. **Aperol possesses several attributes underpinning further market penetration and 'share of throat' gain.**

1. Aperol is a classic Italian bitter aperitif, a sub-category which has been surging in popularity, driven by consumers' disaffection for sweet cocktails underpinned by growing trends of health and wellness. Aperol Spritz's notes of herbaceous bitterness, eye-popping shade, and aspirational image make it stand out against beer and wine.

2. Aperol's lower level of alcohol by volume (ABV) than wine and spirits/cocktails also fits a trend towards moderation which is partly fuelled by young people wanting to stay more in control and having a keen awareness of their social media image.

3. The price point of Aperol Spritz is 10-20% lower than wine and spirits/cocktails as it typically contains less alcohol. This is advantageous for young adults who still want to drink and socialise but often live in large cities where the cost of living is continuously rising and may have less disposable income to spend on social drinking.

Exhibit 2: Capturing 'Share of Throat' from Beer and Wine



Source: Campari Group Presentations (Accessed April 2020)

Local Approach Fueling Global Expansion

We estimate that ~52m litres of Aperol were sold in 2019, generating €337m of sales. The company could continue to grow volume at ~18% p.a. over the next five years as the brand is still in the early innings of activation in large seeding and high potential markets such as the US, France, the UK, and Russia (fourth-largest market in value), and with per-capita consumption (PCC) at a fraction of established markets.

In the US, Aperol has grown at an average ~50% in value over the last three years. It is now Aperol's third biggest market by value and the fifth largest by volume with per capita consumption of only ~0.005L. After a seeding and activation phase in large East & West Coasts cities (NYC, LA, SF, Miami), the brand is beginning to penetrate both the on and off-premise, while initial activations in the mid-west (Chicago) took place in 2019.

We see the US market reaching ~9m litres by 2023 (~40% CAGR). This means per capita consumption would be ~0.03L, a level close to where markets such as France and Australia are today but still a fraction of Italy and Austria.

Seeding markets such as Scandinavia, Central and Eastern Europe, and LatAm (Brazil in particular) will fuel the volume growth engine at high-double digit rate, although from a low base. In five years, most of these markets will still display double-digit growth rates as they move from the seeding stage to high-potential markets.

The company is also looking to engage in exploratory initiatives in China (initially planned in 2020) after some very successful first-time activations in Shanghai in the summer of 2019. This is potentially an enormous opportunity for the next decade. A per capita consumption level of 0.005L (today's US level) by 2023 would bring ~8m litres or +17% on current group level of 52m litres.

In the meantime, we expect **established markets** (Italy, Germany, Austria) to continue growing at low- to mid-single digits, driven by higher frequency consumption through de-seasonalisation and extension of usage occasions. These markets have increased volumes at 8.9% p.a. from 2015 to 2018 with Italy still growing sales at mid-double digit (+15% in 2018; +13% in 2019).

We see Aperol volume growth as being of better quality as it becomes less dependent on a few established markets. In 2018, 68% of volumes came from established markets, 20% from high-potential markets, and 12% from seeding markets. This compares to 90%, 6%, and 2% respectively in 2013.

The potential addressable market for Aperol is huge but a scattergun approach is highly unlikely. We expect management to stick to its patient model, taking time to understand the local consumers and tweaking its marketing approach along the way.

Exhibit 3: Aperol Has Barely Scratched the Surface of Its Huge Global Growth Potential

Country	Market stage	Liter per capita (2018)	Volume (m litres, 2018)	*Per Capita Consumption CAGR* 2012-18	2016-18	2018-23e	Liter per capita (2023e)	Volume (m litres, 2023e)	Volume CAGR 18-23e
Italy	Core Established	0.27	16.4	5%	8%	3%	0.31	19.0	3%
Germany	Core Established	0.08	6.6	4%	(11%)	3%	0.09	8.1	4%
Austria	Core Established	0.20	1.8	15%	-	2%	0.22	2.0	3%
US	High Potential	0.005	1.6	33%	58%	39%	0.03	8.8	40%
Australia	High Potential	0.03	0.7	48%	22%	23%	0.09	2.3	25%
France	High Potential	0.03	2.3	na	29%	25%	0.10	6.9	25%
UK	High Potential	0.02	1.3	70%	41%	24%	0.06	4.0	25%
Others	Seeding / High potential		13.3					48.8	30%
Volume (m litres)			**44.0**					**99.8**	**18%**
Estimated average price (€/litre)			*€ 6.3*					*€ 7.2*	*3%*
Revenue (€m)			**279**					**720**	**21%**
Gross margin (est.)			*72%*					*74%*	
Gross profit (€m)			**201**					**533**	**22%**

Source: Campari Group Presentations (Accessed April 2020), The Analyst Estimates (Completed April 2020)

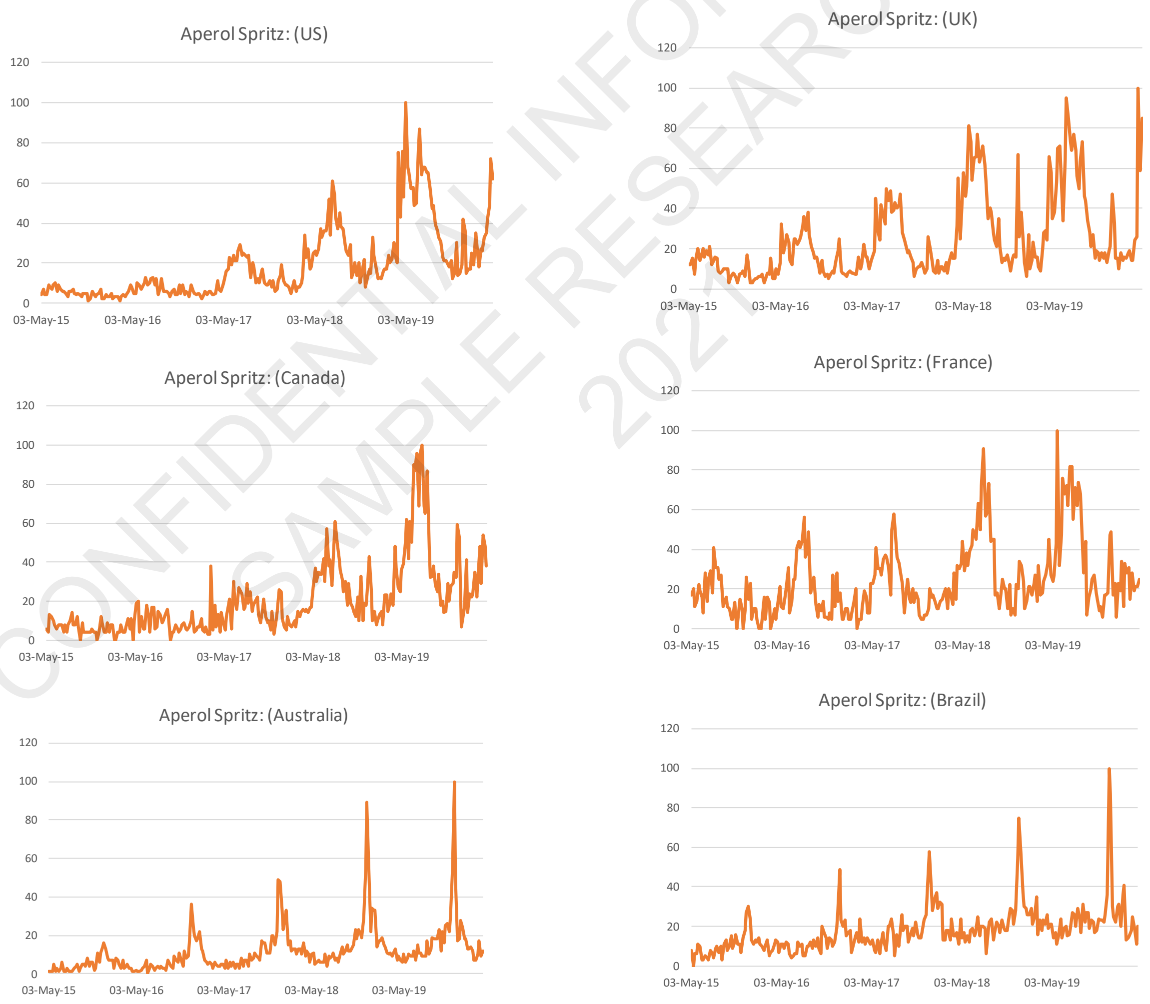
On a 10-year view, Aperol global volume could be ~4x higher than today, reaching close to 200m litres; this is potentially a ~€1.7bn sales brand generating ~75% gross margin by the end of the decade, adding ~€1bn of profit.

Exhibit 4: Longer-Term, Aperol Could Add ~€1bn of Profit to the Group

Country	Est. 10 year volume growth	Volume CAGR 23-28e	Liter per capita (2028e)	Volume (m litres, 2028e)
Italy	3%	3%	0.36	22
Germany	3%	2%	0.10	9
Austria	3%	3%	0.24	2
US	25%	12%	0.04	15
Australia	20%	15%	0.16	5
France	20%	15%	0.20	14
UK	20%	15%	0.11	8
Others	25%	21%	-	124
Total	**16%**	**15%**		**199**
Estimated average price (€/litre)				*€ 8.5*
Revenue (€m)				**1,694**
Gross margin (est.)				*75%*
Gross profit (€m)				**1,271**

Source: The Analyst Estimates (Completed April 2020)

Exhibit 5: Google Searches for Aperol Spritz in Key High Potential and Seeding Markets



Source: Google Trends (Accessed April 2020)

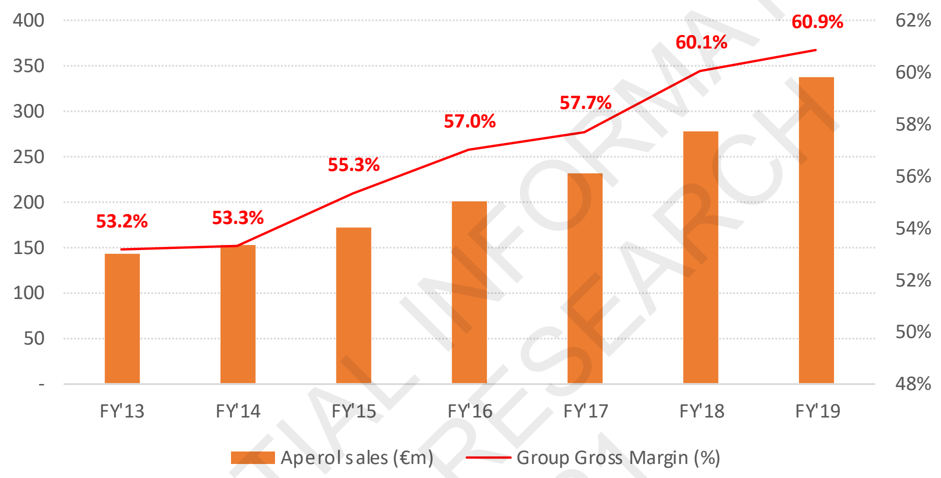
Growth Is Highly Accretive to Profitability

Based on our previous conversations with the company, we understand that Aperol gross margins are above 70%, which is higher than group gross margins of 60.9%. US gross margins are >80% (US retail price is 2-3x that of Italy). Australia and UK prices are higher than in Italy, whilst South America is cheaper. Italy, France, Spain, and Germany are broadly priced in line. This is important as the explosive growth in new markets drives higher pricing and gross margins.

Aperol is 18% of group sales FY'19 with an estimated gross profit contribution of ~22%. We estimate that the brand will represent 30% of group sales by FY'23e contributing ~35% of total gross profit.

In addition, we see the premiumisation of the some of the other high-growth Global Priority brands (e.g. Wild Turkey, Jamaican Rums) as another potential driver of gross margin accretion (see below).

Exhibit 6: Aperol Growth Is Highly Accretive to Group Gross Margin



Source: Campari Group Annual Reports (Accessed April 2020)

Other Brands: A Balanced Cocktail of Future Growth Optionality

While the performance of other brands has been a bit of a mixed bag, a lot of the portfolio alignment has already been implemented and we see some of the brand-building efforts starting to pay off. We think the growth optionality embedded in some of these brands is potentially overlooked by the market.

We expect the overall growth of the Global Priorities portfolio (~40% of group sales ex-Aperol) to accelerate driven by 1) a continuation of supporting underlying trends in core markets (e.g. classic cocktails revival, premiumisation) and 2) internationalisation opportunities. Additionally, we expect some positive effect on gross margins driven by the increasing premiumisation positioning of high-growth key brands such as Wild Turkey and Appleton Estate.

- Campari's organic sales growth has averaged 9.1% over the last 5 years (2/3 volumes, 1/3 price) although, growth has decelerated to ~5% in the last two years, due to volume decline in Argentina (a large market for the brand) and destocking effect in Japan ahead of a change to route to market (FY'19). Nevertheless, the brand continues benefitting from a very solid underlying global trend of classic cocktails. In the US (second largest market in value), the brand's organic sales growth has averaged 16% over the last three years supported by the revival of Campari-based classic cocktails and speakeasy-style mixology (in particular the Negroni, Americano, and Boulevardier). Also, the company indicates that off-trade consumption is increasing. We have the Campari brand growing at ~4% CAGR 2019-23e.

- SKYY Vodka has been a drag on the company's growth due to significant decline in the US (~73% of sales value) driven by unfavourable trends in the core vodka segment where consumers taste is shifting from sweet-favoured products to handmade and botanical vodkas. The decline has decelerated, helped by the company's marketing efforts to keep the brand premium and relevant among millennial consumers. The end of the destocking cycle in the US should support some level of stabilisation while it remains to be seen if international can gather further momentum. We have conservatively modelled sales CAGR of -1.1% in FY'19-'23e.

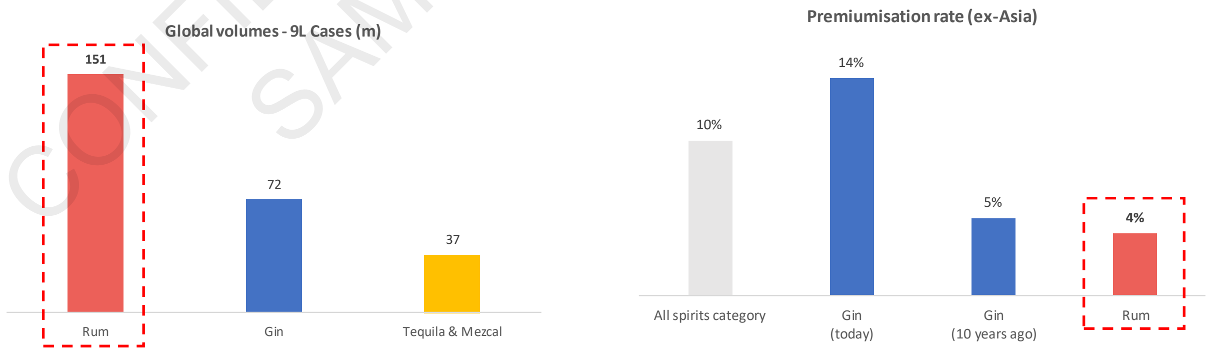
- Wild Turkey, a higher margin product, has steady mid-single-digit organic sales growth. The brand growth should continue to be driven by the premium extensions of the Wild Turkey portfolio (Longbranch Bourbon, Russell's Reserve), leveraging on the brand heritage and celebrity endorsements. Growth in premium product offerings also provides some level of margin accretion at the group level, although the US-centric positioning of the product could limit a significant global expansion.

- Grand Marnier, acquired in 2016, has so far, displayed some mixed performance. The brand is being repositioned with a focus on cocktails and mixologists for its core product and a push into the premium/super-premium segments leveraging on the brand heritage. While it has gathered some tractions in the US (largest market in value), in Europe, the brand still needs to be transformed from being a gastronomy brand (i.e. used for cakes) into a cocktail brand. We estimate that the brand can grow at low-to-mid-single-digit in the next 3-5 years.

- The Jamaican Rums portfolio has delivered solid organic growth thanks to its key brands Wray and Nephew Overproof and Appleton Estate.
  - Wray and Nephew Overproof, a white rum, has been growing at 12-15% p.a. over the last three years as it continues to be one of mixologists' favourite. In the UK, the brand is benefiting from consumers upgrading to more expensive rums. As per IWSR, in the UK, premium-and-above rum segments have seen volumes soar by more than 140% in just five years and these higher-end rums now make up just shy of 10% of the market.
  - With Appleton Estate, the group is building a portfolio of premium and aged dark rums and is set to leverage the upcoming premiumisation trend of rums. In the latest Bacardi 2020 Cocktail Trends Report, 43% of bartenders globally voted dark rum as the top spirit to premiumise.

- In July 2019, the group acquired three French premium rum brands providing access to a growing rum market (IWSR reports that premium plus rums are gaining share in France with volume increasing 28% in 2019) and adding critical mass to a strategic market for Aperol and Campari.

Exhibit 7: Rum Premiumisation Offers Significant Growth Potential for Campari's Rum Portfolio



Source: IWSR, Inside the Cask (Accessed April 2020)

The Regional Priority Brands portfolio is growing at ~4% and is lower gross margin.

- Espolon has been fast-growing with an average organic growth of ~38% over the last five years. As a high-end tequila brand, it has been benefitting from an explosion of the category in the US driven by a switch from cheaper mixed varieties to 100% pure agave Mexican products. However, the boom has spurred continuous inflation in agave prices which has negatively impacted gross margin at the group level (30bps in FY'19; ~€6m).

- The brand's premium positioning provides some expansion potential beyond the US market on the back of the global cocktail trends. Seeding markets such as Australia, Canada and Italy have shown positive momentum. We think the brand has the potential to reach ~€140m in sales by FY'23e versus ~€70m today (FY'19).

Local Priorities and the rest of the portfolio are growing at low to mid-single-digit rate and are lower gross margins. They include RTDs, liquors, and sparkling wines which Campari plans to keep as these provide access into local markets such as Russia and Brazil.

Exhibit 8: Campari Group Provides Premium Spirits for Each of the Top 10 Cocktails in the World

Brands portfolio	% of Group sales (FY'19)	Organic growth FY'15	FY'16	FY'17	FY'18	FY'19	Average Last 5 years	Last 3 years	Last 2 years
Aperol	*18%*	*12%*	*19%*	*20%*	*28%*	*21%*	*20%*	*23%*	*24%*
Campari	*10%*	*6%*	*9%*	*10%*	*5%*	*5%*	*7%*	*7%*	*5%*
SKYY Vodka	*8%*	*3%*	*(1%)*	*(4%)*	*(8%)*	*(4%)*	*(3%)*	*(5%)*	*(6%)*
Wild Turkey	*8%*	*9%*	*1%*	*6%*	*7%*	*3%*	*5%*	*5%*	*5%*
Jamaican Rums	*6%*	*16%*	*2%*	*6%*	*8%*	*8%*	*8%*	*7%*	*8%*
Grand Marnier	*7%*	*-*	*-*	*nm*	*5%*	*(1%)*	*nm*	*nm*	*2%*
Global Priorities	**57%**	**8%**	**6%**	**8%**	**9%**	**7%**	**8%**	**8%**	**8%**
Regional Priorities	17%	(8%)	9%	13%	3%	4%	4%	7%	4%
Local Priorities	12%	2%	(1%)	1%	(2%)	2%	1%	1%	0%
Rest of Portfolio	15%	3%	2%	2%	2%	6%	3%	3%	4%
Group	**100%**	**3%**	**5%**	**6%**	**5%**	**6%**	**5%**	**6%**	**6%**

Source: Campari Group Annual Reports, Campari Group Presentation 2018 (Accessed April 2020)

COVID-19 Crisis Impact

Campari Group is certainly not immune from the impact of current COVID-19 crisis, given its brands' bias towards on-trade, the aperitifs segment, and social gatherings. The share price is already down ~25% since its pre-crisis peak.

The group limited exposure to Asia (7% of group sales but 2.2% excluding Australia) and the global retail travel channel (1.6% of group sales) should mitigate the impact on Q1'20 sales, but the first quarter is generally only ~20% of total sales.

We expect Q2'20 (~25% of total sales) to be much more impacted as most of Europe and the Americas entered some form of lockdown in mid-/end-March. As the world slowly comes out of the lockdown, Q3 and Q4 FY'20 (~25% and ~30% of total sales, respectively) to be somewhat less impacted with possibly some catch-up in Q4.

Overall, we estimate revenue to decline by ~5% and adj. EBIT by ~8% in FY'20e with A&P flexibility acting as potential mitigating factors to negative operating leverage. EPS increases by 3% in FY'20 supported by the announced share buyback.

On 27 March 2020, the company has confirmed that the dividend payment of €63m and €350m will be returned to shareholders in 2020 through a share buyback programme. As a result, we see leverage going from 1.6x in FY'19 to 2.0x in FY'20e.

Campari Group has €581m of bond maturing on 30 September 2020. As of 31 December 2019, the group had cash equivalents of €704m as well as existing undrawn credit lines of €500m. It has recently announced a new €750m term debt facility. The Group confirms the absence of any financial covenant on the outstanding debt.

Valuation

We estimate group revenue growth at ~6.6% CAGR 2019-23e driven by ~21% at Aperol and ~3.5% for the rest of the portfolio. Gross margin increases from 60.9% in FY'19 to 62.5% in FY'23e. The gross margin accretion of 165bps is relatively modest as we expect a 90bps gross margin impact on FY'20e. From FY'21e to FY'23e, we forecast 75-100 bps margin accretion per annum (the company guides to 100-120 bps).

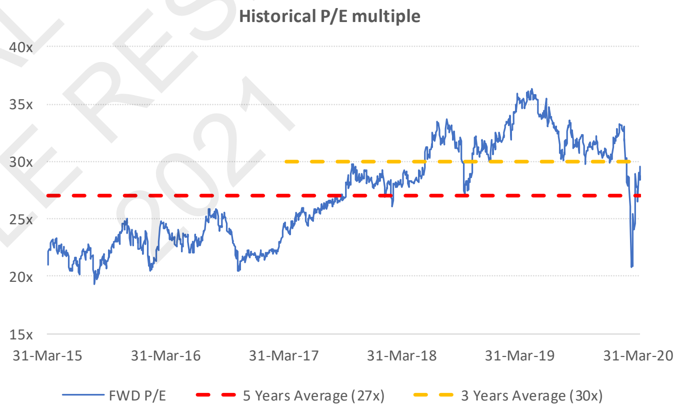
We estimate adjusted EBIT to reach ~€575m by FY'23e, with margins increasing from 22.1% in FY'19 to 24.2% in FY'23e. We have assumed a moderate operating leverage effect on fixed costs with A&P increasing in line with the top line at 6.1% CAGR 19-23e and overhead at 5.2% CAGR 19-23e.

We expect Campari Group to generate ~€0.6bn of free cash flow after earn-outs in 2020-22e. We have not factored in any M&A, although we note the current negotiations to acquire 80% of the owner of the champagne brand Lallier. At this stage, we have assumed an additional €350m share buyback in FY'22e with the company maintaining a ND/EBITDA of 1.9x.

As a result, adj. EPS is expected to grow at ~14% CAGR from FY'19 to FY'23e. We value Campari Group on 30x forward P/E FY'23e, in line with the last three years' average (five-year average at 27x). Adding two years of dividends provides a target price of €11.6, implying a total return of ~66%.

Exhibit 9: Campari Valuation and Historical P/E Multiples

EPS FY'23e	**€ 0.38**
CAGR 19-23e	*14%*
YoY growth FY'23e	*18%*
P/E multiple	30.0x
Implied share price FY'22e	**€ 11.5**
Plus: 2 years of dividends	€ 0.1
Implied share price FY'22e	**€ 11.6**
Upside to current	*66%*
2-year IRR	*21%*



Source: The Analyst Estimates (Completed April 2020), Bloomberg (Accessed April 2020)

Conclusion

Campari Group combines a lot of the characteristics of a great business. Growth can accelerate as Aperol has only scratched the surface of its global potential and the other key brands in the portfolio have some significant growth optionality. The stock is down ~25% since its pre-COVID-19 peak and the current uncertainty offers a good opportunity to build up a position for the long-term in one of the best-run business in Europe. Therefore, we initiate with a Buy recommendation and a €11.59 target price, offering ~66% upside.

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