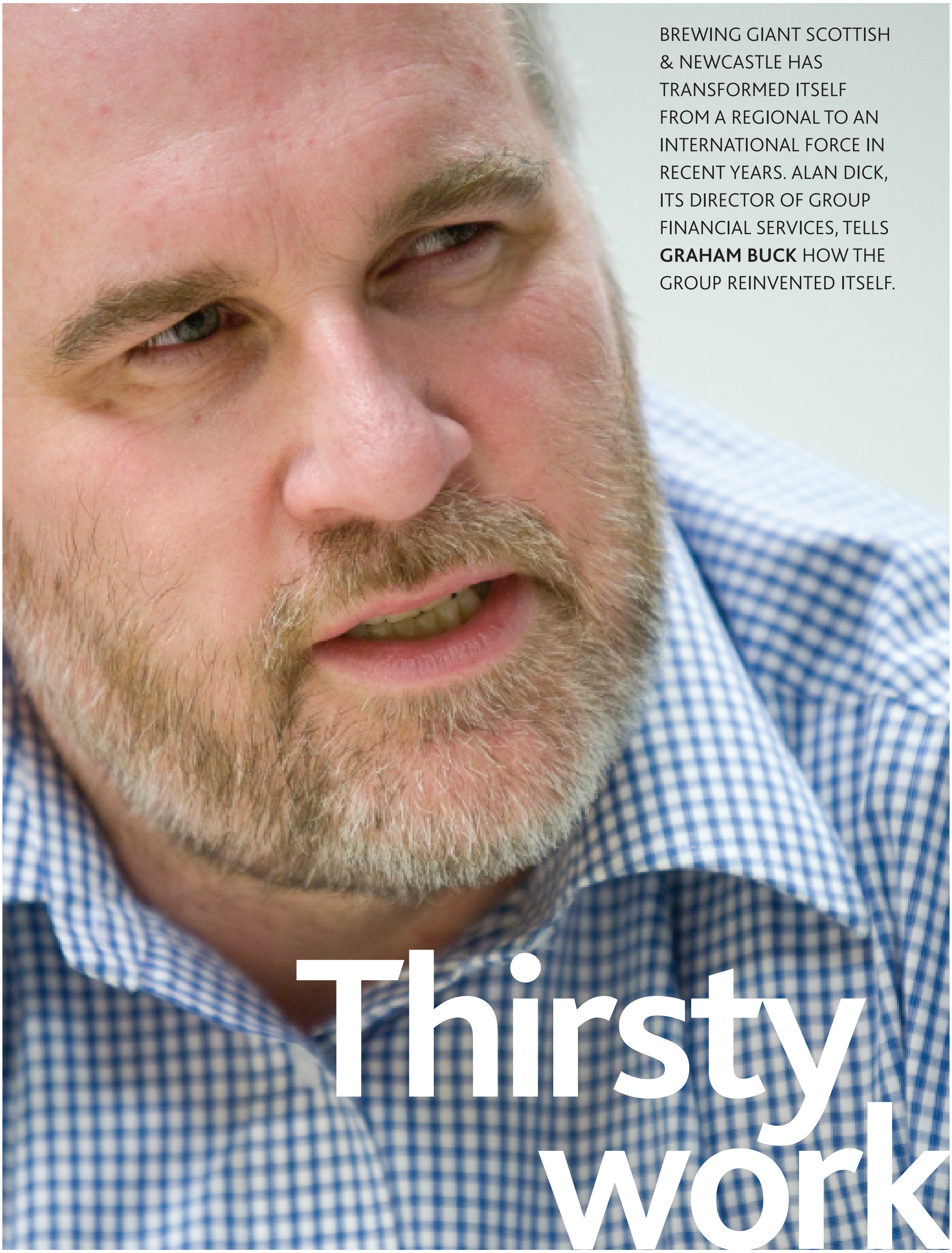

Thirsty work

BREWING GIANT SCOTTISH & NEWCASTLE HAS TRANSFORMED ITSELF FROM A REGIONAL TO AN INTERNATIONAL FORCE IN RECENT YEARS. ALAN DICK, ITS DIRECTOR OF GROUP FINANCIAL SERVICES, TELLS **GRAHAM BUCK** HOW THE GROUP REINVENTED ITSELF.

PHOTOGRAPHER: ROGER HARRIS

He hasn't been whistling *Que sera sera* but the sentiment is one Alan Dick might be expected to share given the period of uncertainty that he and his team have recently had to contend with.

The Director of Group Financial Services at brewing giant Scottish & Newcastle admits that conditions have been difficult, since the news of a bid approach for the group from rivals Heineken and Carlsberg was first leaked to the press last October, despite all efforts to keep the negotiations private.

The final deal, which took several months to hammer out, saw the offer improved in stages from an initial 720p per share to 800p, which was the figure that the group was holding out for. The increase was enough to turn around S&N's initial rejection to acceptance of the offer in January.

If S&N's treasury department is broken up once the new owners take over, it will end Dick's lengthy relationship with the group which, with one interruption, has lasted the best part of two decades.

Before joining S&N, Dick trained as a Chartered Accountant for three years with the firm of Coopers & Lybrand after graduating from the University of Edinburgh in 1985.

This was followed by a two-year stint as Development Accountant at ICI Films, at that time the film division of the chemicals group. But as Dick observes, the late 1980s saw the UK film industry "going into one of its periodic downturns".

GROWTH OF A BUSINESS In 1990, he moved to S&N for what proved to be his first period with the group. The late 1980s had proved eventful for the group. In 1988 it fended off a hostile bid from Australian brewing giant Elders and the following year established a major presence in the leisure market by acquiring majority stakes in holiday businesses Center Parcs and Pontins.

However, S&N's long-established treasury department offered only limited opportunity for promotion, with the Group Treasurer having been in the post since the mid-1970s.

After four years, Dick took up the job offer of Treasury Manager from the venerable Scotch whisky producer William Grant. The company had been through some radical changes, which included the construction of a state-of-the-art purpose-built bottling plant. "They needed someone for functions such as treasury, insurance and tax," Dick recalls.

However, he had been there only a short time when his old boss at S&N departed and he was tempted back to the group in 1995, this time as Deputy Treasurer.

It proved to be another notable year for S&N, which then had a 12% share of the UK brewing market, a portfolio of 1,200 pubs, the Chef & Brewer chain (bought two years earlier from Grand Metropolitan for £629m) and the leisure division.

Its £430m acquisition of Courage doubled the size of its beer business and added the well-known brands Foster's, Kronenbourg and John Smith's to its portfolio. Scottish Courage, formed in August 1995 following the deal, became the UK's biggest brewer.

The Courage deal began the transformation of S&N from a regional brewer to an international brand manager. It was more than four years until the next major deal, but the December 1999 acquisition of Greenalls for £1.1bn was another headline-grabber that expanded S&N's pubs estate and added the Premier Lodge chain.

During this period, Dick's work as Deputy Treasurer involved negotiating the financing of the deals, managing the balance sheet and achieving tax efficiencies.

"My role, which was very treasury-focused, steadily expanded to encompass new areas," he says.

Despite this growth, the treasury team has remained relatively small, with just six individuals handling property, five dealing with treasury matters, two on pensions and two on insurance.

"S&N has a strong corporate governance structure," Dick adds. "The treasury team reports monthly on matters such as the group's debt and derivatives position. Once a quarter it reports to the treasury committee, which reviews issues coming up on the horizon, the group's debt facilities and other matters."

FOCUSING ON THE BEER At the end of the 1990s, S&N's credit rating stood at A. A further series of major deals in the new decade and the debt incurred gradually reduced it to BBB. Prior to the recent takeover approach, one of the group's top priorities was to improve its rating again.

Most of the acquisitions of the past few years have seen the group put debt facilities in place and using the medium-term note market via listed bonds.

At the same time, the group has made several major divestitures. In 2000, the leisure businesses were disposed of, with Center Parcs sold to French group Pierre et Vacances for £670m and three years later the pubs portfolio was picked up by Spirit, now part of Punch Taverns, in a £2.6bn deal.

"Both were partly made necessary by the string of acquisitions, that had taken our debt to more than £4bn and resulted in high gearing," says Dick. "However, management also decided that we should focus on the core business of brewing, which, it was agreed, represented our main strength. Pubs are undoubtedly an asset, but they do swallow up a lot of capital."

The first post-millennium deal for S&N came in March 2000, when a partnership with France's Groupe Danone strengthened its position in Europe and gave it progressive ownership of Kronenbourg. In 2002, it spent £1.2bn on Finland's leading brewing group, Hartwall, and gained access to Russia and the Baltic market through Hartwall's 50% stake in Baltic Beverage Holdings.

Indeed, it was the Baltic Beverage stake that helped to make S&N a tempting target for Carlsberg, which holds the other 50%.

Refinancing round

One of the big issues for Dick in the last few months has been whether to bring forward the date of the group's refinancing, which falls due in 2010. Dick says that since the credit crunch hit with a vengeance last summer, there has been some lessening of the execution risk, although the pricing has risen.

"This new environment isn't going to go away quickly," he predicts, adding that banks have got to carry out a lot of repairs to their balance sheets and have also lost some important sources of income.

"So while the situation may not deteriorate any further, it's also very likely that it won't improve for some time. Risk was obviously priced incorrectly this time last year, although the better risks should still be able to achieve a good pricing."

Dick feels some sympathy for the woes of pub group Mitchells & Butlers, which recently reported a £274m post-tax loss from its hedging investments, describing it as "a case of unfortunate timing".

"We don't have quite the same exposure as M&B to a powerful shareholder such as Robert Tcheguiz," he says. "The Hartwall family has a 10% stake and is represented on the board by non-executives, while our largest institutional investor holds no more than 4%."

For the Hartwall acquisition, and again in 2003 when S&N acquired the cider maker Bulmer, the group offered shareholders shares as an option to cash and in both cases enjoyed a high take-up, says Dick.

PARTNERSHIP VALUES In recent years, the group's horizons have been spreading rather wider. While western Europe's drinks markets are either flat or in decline, eastern Europe and Asia are both growing strongly. Although both deals were relatively modest, S&N formed a strategic partnership at the start of 2002 with United Breweries, India's largest brewer, and in 2004 acquired a stake of nearly 20% in China's Chongqing Beer Group.

"Had we remained independent, the group would undoubtedly have pursued more ventures in Asia, which has massive potential," he says. "In another 10 years, India is likely to represent a major market, whereas in 2003 its total consumption was probably no more than Scotland's, despite the vast difference in their respective populations."

S&N has also enjoyed success with its distribution business in the US, where Newcastle Brown has established itself as a top 10 brand and sales surpass those of the UK. Dick attributes Newcastle Brown's popularity to "Americans' liking of variety, which has encouraged the development of the microbreweries".

LAST ORDERS In contrast to the growth opportunities beyond Europe, at home there is a general surplus of brewing capacity. Four years ago the group took a controversial decision to close its breweries in Edinburgh and Newcastle upon Tyne and recently announced that its Reading plant – the last word in high-tech brewing when it opened nearly 30 years ago – will close in 2010 at a cost of £22m, while a further £15m will be invested to increase production at other sites.

Dick's own remit has also broadened. In 2003, he was promoted to Group Treasurer and, two years later, took over his current position as Director of Group Financial Services, a role thatencompasses insurance, property and pension asset investment as well as treasury.

S&N still offers a final salary pension scheme to existing employees, although it moved from being non-contributory to 6% of earnings. "People were encouraged – and new starts have no choice – to be on career average," he says. "It still gives a guaranteed pension, but is really based on starting salary uplifted for inflation."

The pension fund's deficit, gross of tax, stood at around £100m at the end of the year and while the recent downturn in the equity markets has had some impact it is "not huge as we have quite a diversified portfolio of investments".

What would be S&N's last major deal as an independent came in April 2006, when the group furthered its international portfolio by acquiring the Foster's brand in Europe, Russia and the Commonwealth of Independent States from its Australian parent.

"While there were no specific acquisition plans in the pipeline for 2008 and 2009, there has long been an interest in expanding the business by strategic partnerships, which will now of course no longer take place," says Dick.

Working with partners in the Chinese and Indian ventures has proved fairly straightforward, but the Baltic Beverage joint venture takes up "a considerable amount of time", he adds. Most of the work is carried out in Moscow and St Petersburg, despite the joint venture's presence in the CIS and Baltic countries.

HARD TIMES "The last few months have been very difficult," he admits. "In different circumstances, we would have spent the last few months looking at a possible refinancing of our debt and perhaps considering a share buyback of the Russian business."

Like many other groups dealing with rising commodity prices, S&N has also had to contend with sharp hikes in the cost of its raw materials. In February, it warned that price rises were in the pipeline to offset a projected 8.5% increase in costs this year, although long-term procurement contracts, which the group uses rather than hedging, has helped avoid an even steeper rise.

However, S&N's team have had to cope with months of uncertainty, which by now may have largely been resolved. Dick was due to meet with Heineken early last month to decide how the Carlsberg-Heineken consortium will run the business.

Barring any 11th hour intervention from a rival bidder, shareholders were scheduled to vote on the offer at the end of March. And while the future was not his to see a few weeks ago, he may well have his next move decided by the time that S&N's suitors move in and the group takes its final bow in the FTSE 100.

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Alan Dick is Chairman of the first day of the ACT Annual Conference, held in Edinburgh, 28-30 April.