The Charter Quest Institute

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Strategic Report for AB InBev

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EXECUTIVE SUMMARY

Terms of Reference: Anheuser-Busch (AB InBev) is a Belgian-Brazilian transnational beverage and brewing company headquartered in Belgium. AB InBev has engaged Bluewater Consulting to prioritize, evaluate and recommend solutions to various urgent issues currently faced by AB InBev.

PRIORITIZATION & FOCUS

Issue/Scenario	Urgency	Financial Impact	Issue Complexity	Score	Priority
Africa Direct-Entry via Nigeria	5	5	5	5	**1**
B2B and downstream supply chain strategy	3	3	3	3	**4**
Integration, Synergies and Execution Risk	4	2	4	3.4	**2**
Environmental Hazard in China	5	3	1	3.2	**3**
Deal Funding Strategy & Financial Performance	2	3	3	2.6	**5**
Weighting	*40%*	*30%*	*30%*	*Out of 5*	

LEGEND: *1 = lowest, 5 = highest*

KEY RECOMMENDATIONS

Bluewater Consulting Group has made a number of recommendations to AB InBev by taking into consideration the macroeconomic environment, business ethics, shareholder returns, financial impacts and the company's strategic direction. Key recommendations, listed in order of priority can be found below:

1. Continue with the acquisition of SABMiller.
2. Focus on developing and growing AB InBev's presence in Asia through SABMiller's distribution channels.
3. Speak to contactor about concern and determine alternative waste disposal methods in China.
4. Venture into direct retailing to customers in order to significantly increase revenues.
5. Finance the acquisition with a mixture of debt and equity.

SITUATION ANALYSIS

STRENGTHS	OPPORTUNITIES

• AB InBev have past experience and proven success with large-scale acquisitions
• Global industry leaders, operate in 25 countries in 6 defined geographical zones
• Diversification in multiple segments within the alcoholic beverage industry
• AB InBev has a centralized operating model to cut process costs
• Proven ability to increase effectiveness and profitability within acquired companies
• Ability to adapt to core markets upon entering
	• SABMiller acquiring
	  ○ Results in about 30% worldwide market share if successful
	• Exposure to new untapped markets in Africa
	  ○ African countries have among highest growing populations in the world
	• Forming Newco could save costs by way of synergies through combined distribution operations

WEAKNESSES	**THREATS**
• Company growth is dependent on acquisitions • Little revenue diversification • Poor environmental response strategies in place • AB InBev's working capital has been very inconsistent and has been negative most years • Lack of application for sustainable strategy to promote "a better world," anchored in three pillars: a growing world, a cleaner world, a healthier world • Insufficient staff and procedures in place to ensure the deal with SABMiller closes	• Profit focus could impact quality of products • Potential for significant loss if the merger does not progress • Slow growth rate projected for AB InBev from 2014 - 2020 • Must obtain necessary regulatory approvals from African government before closing SABMiller deal • Synergies may not be realized within merger • Decreased company goodwill if insufficient strategy is implemented to solve environmental issues within China

AFRICA DIRECT ENTRY VIA NIGERIA

Situation: AB InBev is currently in the process of acquiring SABMiller. The acquisition process has started but obtaining the necessary regulatory clearances and approval from AB InBev shareholders, among other factors, may prevent the acquisition from closing successfully. An alternative path for AB InBev is to enter into the African market is through a Foreign Direct Investment (FDI) in Nigeria.

Objectives

- ✓ Enter the African market in order to diversify AB InBev selling countries.
- ✓ Maintain AB InBev's growth through acquisitions.
- ✓ Overcome barriers including government regulations and shareholder approval to complete SABMiller acquisition, if pursued.

Analysis

AB InBev past performance

Throughout AB-InBev history, the organization has built success by relying on key strengths, also known as core competencies. One such competency is AB InBev's ability to grow through acquisition of other brands, and is something that has allowed the organization to grow and attain immediate success in new markets. Whether it be Anheuser-Busch's merger with Belgian-based Interbrew, or acquisition of Mexican-based Grupo Modelo, AB-InBev has consistently demonstrated an ability to use mergers & acquisitions to successfully grow into new markets.

AB InBev current financial position

From a financial perspective, AB InBev must look carefully to determine if they want to continue with the SABMiller acquisition. Currently, AB InBev do not have the capital to make this acquisition deal possible and would require additional debt and equity financing in order to complete the acquisition. Furthermore, due to the reverse breakup fee clause in the deal, AB InBev would stand to take a significant loss should the deal fail to close.

Time earnings multiple

As per Appendix 1, SABMiller has been valued at a times earnings multiple of 21.87 based on their last year's earnings. What this means is that AB InBev is paying 21 times the last earnings for the company. In most industries this would be considered very high, however the alcohol industry is highly competitive, contains great barriers to entry, and brands contain large amounts of goodwill. Given this, the high earnings multiple is expected.

Annual rate of return

As per Appendix 1, at the given purchase price and earnings, AB InBev would be expecting about 4.5% annual returns on their investment. This is currently lower than the returns on both their equity and invested capital. However this is before factoring for synergies, distribution channel advantages as well as expected growth in the South African market. Given these factors, the annual return would likely be more in line with AB InBev's KPIs.

SABMiller's Performance

SABMiller's performance has remained steady YoY in a period where AB InBev's has deteriorated. AB InBev's corporate strategies and objectives speak to slow, steady, organic growth. This is not the case currently with AB InBev but is the case with SABMiller. SABMiller, from this perspective, would be a good candidate for acquisition, also due to the expected organic growth in SABMiller's major market.

African Market Expansion

Should AB-InBev not pursue the SABMiller acquisition deal, there would be additional options available including a foreign direct investment strategy. This would require a different funding structure and would require time for AB-InBev to create momentum and compete in the African market.

Evaluation of Strategic Options

Strategic Option	Financial Impact	Operational Impact	Risk
Proceed with SABMiller acquisition	• AB-InBev DOES NOT pay US $3 billion reverse breakup fee. • AB-InBev pays US $105.5 billion to acquire SABMiller. • Deal must be financed through a mixture of debt and equity. • AB InBev sacrifices short-term profitability/ liquidity to secure highly profitable long-term asset.	• AB-InBev immediately expands capabilities to Africa. • AB-InBev acquires SABMiller production facilities, human resources, knowledge & expertise, and brand name value.	• AB InBev fails to obtain necessary regulatory clearances. • AB InBev shareholders are not convinced that acquisition is the best overall choice.
Foreign Direct Investment (FDI) via Nigeria	• Lower immediate cost. • Potentially higher long-term cost. AB InBev must establish their own brands in Africa. • Breakup fees of US $3.6 billion.	• Production facilities must be developed. • Staff must be hired. • Significant marketing must be undertaken to complete brand ability.	• AB InBev inexperience in Africa may lead to lower sales.
Avoid African expansion in short-term	• AB InBev has to pay reverse breakup fee of US $3.6 billion to SABMiller.	• AB InBev operations continue unaffected.	• AB InBev does not capitalize on potentially lucrative opportunity in Africa.

Recommendation

Given the current position of AB InBev, analysis of the situation, and currently available options, Bluewater Consulting recommends that AB InBev pursue strategy #1 and ***proceed with the acquisition of SABMiller***.

Overall, the choice to pursue this strategy is largely based on the current financial position of AB InBev, the organization's current strengths, and the opportunity presented by SABMiller. Throughout the recent history of AB InBev, growth into new markets has been largely centered around mergers & acquisitions. With growth through M & A's being a core competency of AB InBev, continuing with the acquisition of SABMiller is a very viable strategy, especially given that AB InBev will be able to raise the necessary funds to complete the deal with debt and equity financing. FDI in Africa via Nigeria is a less attractive option as AB InBev do not have prior experience selling in the African market, and will have to develop much of their own infrastructure and brand equity. Hence, AB InBev would likely experience losses for several years before gaining traction in the African market. Avoiding Africa altogether also is not the optimal strategy as it means that AB InBev will miss the opportunity to establish themselves in a highly lucrative and growing market.

Implementation

Ethics + People

Prior to acquiring SABMiller, Bluewater Consulting believes that AB InBev should establish a **Culture Management Task Force** in order to ensure all aspects of the merger are as seamless as possible. This task force would be comprised of management executives from AB InBev, SABMiller, as well as human resources and technical personnel on both sides. This task force would examine the areas of potential culture clash between AB InBev and SABMiller and subsequently develop a strategic plan to mitigate the risk of clash between cultures.

Innovation/Integration

In order to support the new culture dynamic that will be established between SABMiller and AB InBev, human resources must adopt more innovative hiring practices in order to ensure that new hires not only fit with this culture but will also help to promote and grow it. One tool that Bluewater Consulting suggests that AB InBev utilize is **artificial-intelligence (AI)** based programs to screen and evaluate candidates to determine culture fit. AI based hiring is becoming increasingly common in order to screen candidates at a much lower cost than traditional hiring methods. One method that AB InBev could utilize is online-based games and personality tests to measure candidate response to certain questions and in certain situations. This innovative solution would allow AB InBev to ensure that talent entering the organization will be an excellent fit for the organization.

Decisiveness/Leadership

With culture transition being perhaps the most significant challenge in the acquisition of SABMiller, Bluewater Consulting believes that it is crucial to ensure that senior management support and will help grow this culture within the organization. In order to ensure that the organization remains balanced amidst the acquisition, Bluewater Consulting suggests that AB InBev select a **new executive management team** comprised of AB InBev and SABMiller executives. This new management group will ensure that both AB InBev and SABMiller is represented throughout the organization.

Risks & Mitigation

Obtaining necessary regulatory clearances

AB InBev should ensure that they are as open and transparent as possible with respective governments and highlight the benefits of the acquisition. This will ensure that this party feels included in the process and are aware of how they can benefit from this deal.

Convincing shareholders to approve merger

Similar to obtaining necessary regulatory clearances, convincing shareholders to approve the deal should involve highlighting how beneficial the acquisition will be. Although there is a significant capital investment upfront, shareholders must be convinced that this investment will be worthwhile and will lead to much higher long-term profitability.

INTEGRATION, SYNERGIES, AND EXECUTION RISK

Situation: When the takeover offer was announced, AB InBev's share price rose by 1.8%, below the rise of 25% expected. This has still not been corrected by the markets. Additionally, AB InBev's investors are not satisfied with the takeover offer AB InBev made to acquire SABMiller, as two market uncertainties exist:

1. The deal may be over-priced
2. The deal is very large and complex. Therefore, investor's believe it is difficult to fully realize all projected cost and revenue synergies within the four year time frame projected by AB InBev. This is largely due to heightened anti-competitive, trade union and other risk factors.

Objectives

- ✓ To regain investor confidence by addressing investor concerns relating to acquisition deal value and realizing synergies.
- ✓ To improve the probability of the deal closing by addressing anti-competitive and other concerns.

Analysis

Earned Value Analysis at the Midway Milestone - 3/10/2018

	Newco Integration Project: Strategic Cost engineering theme	Budget at Completion (BAC)	The Budgeted Cost of Work Performed (BCWP)	Actual Cost of Work Performed (ACWP)	Schedule Variance (SV) %	Cost Variance (CV) %	Cost Performance Index (CPI)
A	Procurement and Engineering: Raw Materials and packaging	80	2	50	-95%	-2400%	0.04
B	Alignment of brewery, bottling and shipping productivity	120	15	100	-75%	-567%	0.15
C	Staff Cost management, best practice sharing and efficiency improvement	70	40	50	14%	-25%	0.80
D	HQ/Regional Office Costs	20	10	48	0%	-380%	0.21
	Total	290	67	248			

Table 1: Earned Value Analysis at the Midway Milestone - 3/10/2018 (all figures in US $ millions)

Based on the Newco Integration project and as denoted in table 1, AB InBev will not fully integrate and realize all revenue and cost synergies within the time frame of four years. At the two year mark, the integration process will be behind schedule in terms of the identified KPI's in the areas of procurement & engineering and the alignment of brewing, bottling and shipping productivity. Additionally, at the midway point, the cost variance for all integration projects is negative - therefore the cost of implementation is greater than the budgeted cost of project. However, many revenue synergies have yet to be realized within the integration.

Valuation of SABMiller

As per Appendix 1, SABMiller has been valued at a times earnings multiple of 21.87 as per their last year's earnings. Therefore, AB InBev is paying 21 times SABMiller's last earnings. Considering the alcohol industry is highly competitive, has high barriers and companies have goodwill, the high earnings multiple is expected therefore the acquisition price of SABMiller is reasonable.

Evaluation of Synergies

A chart detailing all synergies, their value, and their realization can be found in Appendix 4. Majority of synergies can be recognized positively by AB InBev once further developed. The following synergies must be further developed before they can be recognized as revenue synergies: growing AB InBev's global brand, cross selling SABMiller's beer in different regions, raising perception of core bees and developing the African beer segment.

Evaluation of Strategic Options

Strategic Options	Description	Impact on synergies	Operational impact on anti-competitive and other concerns
Cross Sales of SABMiller products	• Cross sales of SABMiller's Castle & Castle Light Beers in Europe, North America and South America	Realize US $11million per annum	• Does not address any concerns
Focus on developing and growing presence in Asia by growing the Global Brand	• Evaluate and adjust the planning horizon of 4 years and estimated costs associated with the integration of acquisitions and realization of synergies • Form a distinct brand image, customer positioning and connections in African Market • Raise perception and relevance of core beers • Develop the near beer segment by innovating products that offer malt beverages • Hire a Government Relations Officer • Provide job assistance to terminated employees	Realize US $179million per annum	• Addresses the projected length and cost of integration process • Discusses ways to deal with SARB & South African Minister of Finance • Maximizes value from synergies • Addresses the issue of job losses of SABMiller employees in South Africa
Focus on solving anti-competitive and other concerns	• Begin discussions to sell SABMiller's interest in MillerCoors in the US - draft a contract with specific terms • Hire a government relations officer • Draft a financial plan to comply with the government requirements of spending US $5mil in next 5 years to move South Africa from net importer to next exporter	No increase realization of synergies	• Addresses monopoly in USA market • Discusses approval from South African Minister of Finance & SARB • Complies with South African Government desire to become net exporter vs importer

Recommendation

Bluewater Consulting Group recommends that AB InBev implement strategic option two - ***focus on developing and growing AB InBev's presence in Asia*** by growing their global brand. As noted above, this option will allow AB InBev to maximize potential synergies and addresses the most anti-competitive and other concerns which may prevent the deal between AB InBev and SABMiller from closing.

Implementation

Short-Term (Present - 1 year)

- Compute and adjust the planning horizon and estimated cost associated with the integration of acquisitions and realization of synergies.
- Hire a **Government Relations Officer** who will manage country risk, ensure AB InBev is meeting rules of South Africa and advocate for AB InBev by explaining to the South African Minister of Finance and SARB that the merged company with bring higher volumes of trading than SABMiller does alone, and will help increase the overall GDP of South Africa.
- Begin researching the South African market in order to better understand African consumers and how to best target them.

Medium-Term (1 year - 3 years)

- Once the merger has closed, provide assistance to terminated employees to help them find new employment opportunities.
- Elevate the core perception and relevance of Newco by enhancing marketing, focusing on the unique quality of the brand, and targeting the millennial consumer in Africa. This will allow Newco to form a distinct brand image and position in the African Market.
- Focus on innovation and formulating products that offer malt beverages and alternatives to help expand the share of the African alcohol market.

Long-Term (5 years +)

- Continue to provide assistance for terminated employees.
- Continuous evaluation and improvement of marketing and brand positioning based off of customers evolving wants and needs.
- Invest money in research and development to innovate new products targeted to South African consumers, such as malt beverages.

Risks & Mitigation

Government Relations Office notices AB InBev is not meeting certain requirements in South Africa

The Government Relations Officer will work with the government and other important parties to ensure AB InBev is meeting all requirements to successfully conduct business in South Africa.

Customers in South Africa are not receptive to advertisements

In order to mitigate this risk, AB InBev should invest more money in market research by hiring a task force of four employees to gain further insight into the South African market and the best way to target consumers.

ENVIRONMENTAL HAZARD IN CHINA

Situation

AB InBev is currently building a large brewing facility in China but have been experiencing major setbacks including disruptions from local protesters who are claiming construction workers have been discarding waste materials in a nearby river, thus causing pollution and negatively impacting wildlife in area.

Objectives

- ✓ Determining the exact nature of protester claims
- ✓ Preventing future dumping of waste
- ✓ Restoring positive public image of AB InBev

Analysis

Clearly, there is discontent among groups within China regarding the contractor constructing AB InBev's production facility in China. While this contractor is not directly employed by AB InBev, their actions are causing backlash that reflects negatively on AB InBev.

Evaluation of Strategic Options

1. Speak to contactor about concern and determine alternative waste disposal method
2. Terminate contract and select new contractor to continue project

Strategy	Benefits	Drawbacks	Net Impact
Discuss concern with current contractor and develop alternative waste disposal method	• Addresses concern immediately • Most cost effective option	• May strain relationship with current contractor	• Contractor will likely adopt new waste disposal method without large additional cost
Terminate current contract and select new contractor to continue project	• Solves problem immediately • May satisfy groups who are unhappy with current contractor actions	• Will likely lead to major delays in project • Time and money must be spent to find new contractor	• Problem will be solved but there will be higher additional costs as project will be delayed

Recommendation

AB InBev wants to be seen as a socially responsible enterprise, and claims such as these do not bode well for building a strong triple bottom line. In order to ensure that this issue is resolved quickly and efficiently, Bluewater Consulting recommends that AB InBev speaks with the current contractor to determine an alternative waste disposal method. Put simply, this is the quickest, easiest, and most cost-effective option. The issue cannot be ignored, yet it is does not make sense to terminate the contract with current contractor as it will mean that AB InBev will be significantly delayed in project completion, something that will come at a high cost.

Implementation

1. Meet with contractor management personnel and discuss issue
2. Develop several alternative waste disposal methods
3. Determine plan of action to resolve issue
4. Utilize positive PR and issue statement to address environmental concerns

Risks & Mitigation

Current contractor is not willing to discuss alternative disposal methods

When discussing this problem with the current contractor, it is important to communicate how their actions are negatively impacting all parties, including themselves. Given the nature of the concern, there will likely be cost-effective alternatives available. If the contractor is still unwilling to compromise, monetary penalties or fines could be used as a last resort.

B2B AND DOWNSTREAM SUPPLY CHAIN STRATEGY IN SOUTHERN AFRICA

Situation: If AB InBev acquires SABMiller, it must leverage its bigger size and larger bargaining power. In acquiring SABMiller, AB InBev must review SABMiller's B2B strategy and downstream supply chain strategy in dealing with supermarkets. Supermarkets currently have a lot of power; therefore, they are expensive to sell to which impacts profitability.

Objectives

✓ Leverage Newco's bargaining power to improve SABMiller's supply chain and selling strategies
✓ Reduce the costs of serving supermarkets and their impact on profitability.

Analysis

Impact of Technology and E-Business Strategy on Porter's 5 Forces Model

Threat of New Entrants: Medium to **High Pressure**

- There are multiple breweries in the region that can alter their strategies to match the technology and e-business strategy that Newco would be pursuing through the acquisition. The environment will be fast moving and will require constant improvement/ development of intranet and extranet systems to stay ahead of competitors.
- Newco will be one of the few brewery companies in Africa because of the difficulty to enter the market in this region. This will reduce the pressure of new competitors and make it easier to keep track of competitor technology developments.

Threat of Substitute Products: Medium Pressure

- There are breweries that have greater market share and could potentially be substitute brands that interfere with the growth and development of Newco. Most large organizations have e-services that improve supply chain services but considering AB InBev's previous success, Newco should be able to have better integration of systems.

The Bargaining Power of Buyers: **High Pressure**

- Supermarkets that buy in large quantities have bargaining power and are able to affect profitability by increasing supply chain costs.

The Bargaining Power of Suppliers: **Low Pressure**

- Ingredients that are commonly found in beer are grain, hops, yeast, water etc. Considering the large quantity that beer companies purchase, they are able to have the upper hand when determining prices.
- SABMiller has established supplier's that Newco can leverage to reduce pricing when market share increases with the brands growth.

Rivalry Among Existing Firms: **High Pressure**

- Competitors such as Guinness Nigeria, Nigerian Breweries, and Consolidated breweries are large competitors in Nigeria and because of their 73.7% market share, their ability to adapt and improve operations to compete with Newco, new technologies, and e-business strategies are high.
- There are smaller breweries that hold 8% of market share in Africa but are unlikely to succeed in improving their supply chain systems through technology and e-business.

ABC Costing

Activity	Cost Driver	Cost Per Activity	Top 3 Super Markets	Direct Retailing
Average discount given (%)	% of sales revenue	N/A	Total revenue = $1,900,000,000 % of discounts = 4.33% $1,900,000,000 x 4.33% = **$82,333,333.33**	Total revenue= $7,000,000,000 Percentage of discounts = 0% $ 7,000,000,000 x 0% = **$0**
Number of sales visits made	Number of visits	$685	Number of sales visits = 2240 2240 x $685 = **$1,678,250**	Number of sales visits = 0 0 x $685 = **$0**
Purchase orders processed	Cost per processing order	$148	Number of purchase orders = 13,760 13760 x 148 = **$2,036,480**	Number of purchase orders = 0 0 x 148= **$0**
Making a standard delivery	Cost per delivery	$2,250	# of standard deliveries = 10,240 10,240 x 2,250 = **$23,040,000**	# of standard deliveries = 500 500 x 2,250 = **$1,125,000**

Making a rush delivery	Cost per delivery	$6,475	Number of rush deliveries = 1,670 1,670 x 6,475 = **$10,813,250**	Number of rush deliveries = 20 20 x 6,475 = **$129,500**
Damaged product returned (% of sales revenue)	% of sales revenue	N/A	Total revenue = $ 1,900,000,000 Percentage of returns = 2.5% $ 1,900,000,000 x 2.5% = **$47,500,000**	Total revenue= $ 7,000,000,000 Percentage of returns = 1% $ 7,000,000,000 x 1% = **$70,000,000**
Total Costs:			**$167,401,313**	**$71,254,500**

This chart shows the costs associated with selling products B2B with supermarkets in comparison to retailing B2C, directly to consumers. Currently, retailing to the top 3 supermarkets is more costly than direct retailing due to larger discounts given, a larger number of deliveries, and a higher percentage of damaged products returned.

Evaluation of Strategic Options

4 Strategies	Financial Impact	Operational/ B2B vs B2C Marketing Impact	Risk
Option 1 **Stop selling to the least profitable markets**	• Significant loss in market share which will lead to low revenues and low profits. • B2B strategy would help Newco avoid activity based costs that are currently affecting profitability in certain markets.	• Lack of product exposure in select consumer markets • Potential decrease in the amount of goods supermarkets would be willing to purchase.	• Newco hasn't established its brand and large supermarkets may not be interested in working with the organization through wholesale dealers.
Option 2 **Persuade supermarkets to reduce the number of cost generating activities**	• Reduction in purchase orders, rush shipping, sales visits and discounts	• More efficient supply chain • Marketing will not change because the shelf space and activities will remain constant.	• Markets may not be willing to re-work their current systems. • Markets may become unwilling to purchase from Newco.
Option 3 **Venture into direct retailing to consumers**	• Significant increase in revenue. • Increasing profits by a significant amount by avoiding the customer costs that are attached.	• B2C approach • Reach out to consumers direct through multiple platforms such as sponsoring/hosting events and contests, social media, and ambassador programs. • Reduction in supply chain activities.	• Consumers prefer to purchase from local supermarkets that they trust, which is unlikely.

Option 4 **Introduce new technologies to reduce the cost of cost-generating activities**	● Reduces the cost generating activities through using company representatives to set-up in store displays with products.	● B2C marketing will be applied as the displays will incorporate technology platforms (ex. IPad) to personalize consumer experience. ● Essentially, making own shelf space in stores.	● Supermarkets don't allow Newco floor space to set up displays.

Recommendation

We recommend that Newco moves ahead with option three - ventures into direct retailing to consumers. The activity based costs will significantly decrease by $96,146,813.30, therefore increasing revenue and customer probability. Options one, two and four involve capitalizing on supermarkets, but are less beneficial in terms of maximizing profits, ensuring efficient operations and effective marketing. Option three can significantly improve supply chain activities and market share for Newco. This strategy would also address SABMiller's key challenges: inaccurate sales forecasts, lack of adequate shelf space, and high cost of servicing some supermarkets.

Implementation

Short Term (Present - 2 months)

- Research potential supply chain software's Newco can use to optimize supply chain.
- Research the tactics and strategies used by current market leaders.

Medium Term (2 - 6 months)

- Select brand ambassador that would influence target audience.
- Determine the events to sponsor to impact target audience.

Long Term (1 year +)

- Continue B2C marketing tactics.
- Revisit supermarkets to re-evaluate their supply chain improvements.

Risks & Mitigation

Ambassador's behavior creates media backlash on organization

In order to mitigate this risk, hire an Ethical behavior officer who will ensure that the ambassador participates in activities that will reflect the brand and the ambassador positively.

Consumers prefer to buy from local super markets

In order to mitigate this risk, AB InBev should utilize social media campaigns/ incentives to encourage consumers to support the organization.

DEAL FUNDING STRATEGY AND GROUP FINANCIAL PERFORMANCE

Situation

In January 2014, AB InBev outlined its 5-year strategy around three strategic priorities. This strategy ensures the long-term success of the organization by focusing on acquisitions and increasing shareholder value by growing dividends per share, delivering greater total shareholder returns and gearing debt/debt + equity below 40%**.**

Objectives:

✓ What would be the optimal method to finance the merger?
✓ Discuss long-term dividend payouts following the merger
✓ Is the acquisition in-line with AB InBev's 5 - year strategy and financial objectives

Analysis

Agency Theory

Proceeding with the acquisition funding presents issues to the shareholders because of the drop in dividend payout. If, shareholders do not see the benefit and long-term financial success of the acquisition they will sell shares and that can potentially harm the company. Additionally, debt holders must also be aware of the financial security of the organization, when credit ratings drop in the short term it can potentially cause unnecessary problems.

Influence of the Merger on Financial Objectives

Financial Objective 1: *Grow Dividends per Share (DPS) by 10% year-on-year*

As shown in Appendix 5, AB InBev's TTM DPS exhibits a 6.9% growth, while SABMiller's TTM DPS exhibits a 9.1% growth. In merging the companies together, the combined TTM DPS becomes 7.4%. This increase in the growth of DPS is in line with AB InBev's objective to grow DPS by 10% year-on-year and the merger is helping the company reach this goal.

Financial Objective 2: *Deliver Total Shareholder Returns (TSR) of 14% year-on-year*

In acquiring SABMiller, AB InBev will be able to increase their total shareholder returns from 4.2% to 6.49% within a year, as shown in Appendix 5. Thus, helping AB InBev get closer to reaching its overarching goal of TSR's of 14% to shareholders within five years.

Financial Objective 3: *Keep gearing (debt/debt + equity) below 40%*

Currently AB InBev's Debt/(Debt + Equity) ratio is 48% and SABMiller has a Debt/(Debt+Equity) ratio of 34%, as shown in appendix 5. In acquiring SABMiller, AB InBev's Debt/(Debt+Equity) ratio will decrease to 45% within the first year, helping AB InBev get closer to achieving their long-term goal within five years.

Evaluation of Strategic Options

Strategic Options	Benefits	Costs
Debt Financing	• Loans are temporary and relationship ends when debt is repaid. • Lender does not have a say in the running of the business • Loan interest is tax deductible • Loans can be short, medium, or long term	• Fixed principal and interest payment must be made by specific dates • Too much debt makes business more likely to miss loan payments if cash flow declines too much • Lenders typically demand assets be held as collateral for debt.
Equity Financing	• Helps gear Debt/(Debt + Equity) ratio below 40% • Less risk because there are no fixed monthly payments to be made • Does not take funds out of the company's cash flow, leaving more money for the company to finance growth.	• Equity investors expect a return on their money. This return may be higher than interest rates on debt financing • Loss of some control over the company
Debt & Equity Financing With Release	• No reliance solely on one form of financing (debt/equity) • Helps decrease amount of debt financing, therefore in line with five-year objectives • Higher cash flow available • Release of cost and revenue synergies ahead of schedule	• Loss of control over the company (more equity financed)

Recommendation
Bluewater Consulting Group recommends that AB InBev finance the merger with SABMiller by utilizing a mixture of debt and equity financing with a release to shareholders and debt holders. We recommend AB InBev utilize a higher percentage of equity than debt as it is cheaper for the company and aligns with the goal of gearing debt/(debt+equity) below 40%.

Implementation
Short -Term: (Present - 1 year)

- Issue a release to shareholders and debt holders indicating the future success of the organization.
- Implement a financing mix debt to equity ratio that will gear the ratio below 40%.
- For the first year of the merger, we recommend decreasing dividend payouts in the short-term in order to lower debt levels.

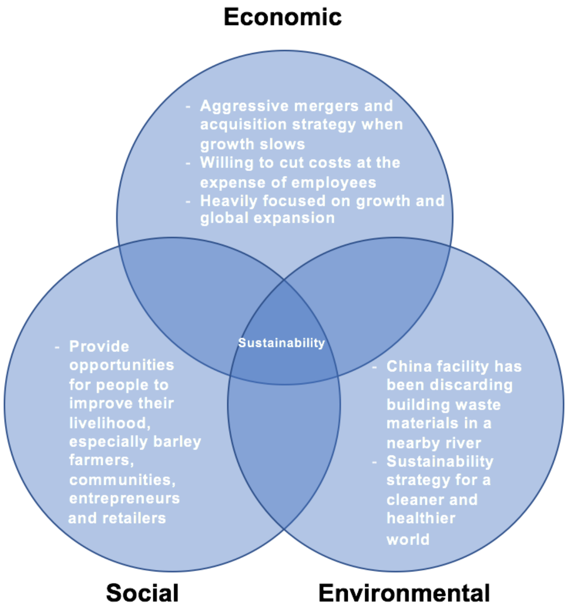
Medium-Term: (2 years - 5 years)

- Revisit the 30% debt to 70% equity ratio to ensure this mix is able to adequately help cover the cost of the acquisition.
- Begin increasing dividend payouts to shareholders by a slight amount each year.

Long-Term: (5 years +)

- Complete an overall evaluation of the merger to evaluate its impact on helping AB InBev achieve the following objectives to increase shareholder value:
  - ✓ Grow Dividends per Share (DPS) by 10% year-on-year
  - ✓ Deliver Total Shareholder returns of 14% year-on-year
  - ✓ Keep gearing (debt/debt + equity) below 40%

Risks & Mitigation
Shareholders are unhappy with the decreased dividend payouts
Explain the importance of lower dividend payouts to shareholders. Lower payouts will help decrease debt levels and will allow AB InBev to invest the money into enhancing their operations. Also explain that this is only for the short-term and that dividend payouts will begin increasing after the first year.



ETHICAL ISSUES

Triple Bottom Line Analysis

Although AB InBev has a sustainability strategy in place: to deliver 'A better world' with three pillars (1) a growing world, (2) a cleaner world and (3) a healthier world, they have not been integrating these strategies into daily business practices - many business decisions made by AB InBev are fueled by the economic value they provide, not the positive/negative impact these actions may have on environmental or social values. AB InBev is currently faced with two ethical issues.

Ethical Issue 1: Job Losses

In acquiring SABMiller, AB InBev will terminate approximately 3200 employees, almost half of all SABMiller's employees in South Africa. It is proposed that all 8 SABMiller Divisions declare 400 redundancies, saving $448 million per annum. Each divisional manager should choose who will lose their job and notify them.

Factor	Analysis	Recommended actions
Age-based discrimination in termination	Termination preference will be given to employees over the age of 50. It is unethical to terminate employees based on age	Terminate employees based on low performance, not age or salary
Employee terminations	Terminated employees will lose their jobs and will need to find other employment	Assist terminated employees in finding new employment

Ethical Issue #2: Environmental Hazard in China

Contracted construction workers on the China brewing facility site, have been discarding building waste materials in a nearby river.

Factor	Analysis	Recommended actions
Construction workers dumping waste in the river	The actions of construction workers is contributing to pollution in the river and negatively impacting wildlife	Introduce new policies and training for construction workers to ensure improper waste disposal is avoided in the future
Pollution in the water	The building waste polluted the water directly going against AB InBev's sustainability strategy of a cleaner world	Fund cleanup of the local river that has been polluted
Impact on wildlife	Wildlife has been affected by the pollution, going against AB InBev's goal of building a better world	Donate money to "Towards a Compassionate Nation" (TACN), a charity aimed at improving animal welfare in China and promoting a healthy and cruelty-free lifestyle worldwide

CONCLUSION

This report is a strategic evaluation, recommendation, and implementation plan to tackle AB InBev's current issues within their operating activities. We have recommended comprehensive solutions that maximizes AB InBev's financials, increases innovation within the company and ensures that all business practices are ethical in nature. In implementing our recommendations, Bluewater Consulting Group is confident that AB InBev will be able to follow its corporate strategy, achieve its three key financial objectives within five years and become sustainable in the long-term.

APPENDICES

Appendix 1: SABMiller Valuation (in millions USD)

SAB Valuation Millions	$ 105,500
Time earnings	21.87
Annual Rate of return	4.57%

	AB	SAB	Combined
Market Value	169,500	$ 105,500	275,000
% of Combined Worth	62%	38%	100%

Millions	2014				2013	2015
	AB	SAB	Combined		AB	SAB
Revenue	$ 47,063	$ 22,311	$ 69,374		$ 43,195	$ 22,130
Gross	$ 28,307	$ 4,242	$ 32,549		$ 25,601	$ 4,384
Profit From operations	$ 15,111	$ 4,439	$ 19,550		$ 20,443	$ 4,459
Profit	$ 11,302	$ 4,823	$ 16,125		$ 16,518	$ 4,830

Appendix 2: NPV of Synergies

<u>Calculating WACC</u>

Wacc Plugs	
Equity	$ 54,257
Debit (Interest Bearing)	$ 51,081
Cost of equity	10%
Cost of Debit	5%
Tax rate	11%

Cost of equity	10%				
Dividend growth	1.18	1.57	3.03	3.25	3.49
		0.39	1.46	0.22	0.24
Dividend growth raate				6.8%	6.9%
DPS	3.49				
MV/Shares	101.56				

Cost of Debit	5%
Interest Paid	$ 2,476
Debit (Interest Bearing)	$ 51,081

<u>NPV of Synergies</u>						
Wacc	7%		Year			
	NPV	1	2	3	4	Total
AB Synergies 4 Years	**$ 4,698**	$ 1,400	$ 1,400	$ 1,400	$ 1,400	$ 5,600
SAB Synergies	**$ 3,524**	$ 1,050	$ 1,050	$ 1,050	$ 1,050	$ 4,200
SAB 3 years	**$ 1,302**	$ 500	$ 500	$ 500		$ 1,500

Appendix 3: Foreign Direct Investment

FDI							
Reverse Break fee of 3000- 6000	4500						
FDI Would cost	388						
Therefore Total cost of FDI would be	4888						
Rest are sunk costs							
FDI would need to earn							
SAB Valuation Millions	$ 105,500						
FDI Cost	$ 4,888						
	2015	2016	2017	2018	2019	Total	5Y Return
SAB Projection	$ 4,830	$ 4,830	$ 4,830	$ 4,830	$ 4,830	$ 24,150	23%
SAB Projection + Synergies	$ 6,380	$ 6,380	$ 6,380	$ 5,880	$ 10,530	$ 35,550	34%
FDI Projection would need to be	Set up year	$ 280	$ 280	$ 280	$ 280	$ 1,119	23%
FDI Projection would need to be with Synergies	Set up year	$ 412	$ 412	$ 412	$ 412	$ 1,647	34%

Appendix 4: Evaluation of Synergies

Synergy	Value	Realization of Synergy
Cost Synergies (Post Tax)		
Implementation of Business Process Re-engineering (BPR) and Enterprise Resources Planning (ERP) systems.	Reduction in cycle time between brewery, bottling and shipping at US $3,900 per hour.	**Positive:** Introducing BPR and ERP systems into operating in South Africa will reduce cycle time between brewing, bottling and shipping.
Implement a new upstream supply chain strategy	Reduction in number of orders at US$2,100 per order.	**Positive:** Decrease in orders, forces down prices by exploiting stronger bargaining power arising from bigger scale and size.
Staff cost management, best practice sharing and efficiency improvements	Reduction in staff size at US $140,000 per employee (US $448 million per annum).	**Positive:** Reduces the amount of employees hence reducing costs and improving efficiency.
Collapse SABMiller corporate office in London	Costs saved: US $74,800,000	**Positive:** Save on corporate taxes in South Africa and reduce costs of operating the office in London.
Revenue Synergies (Post Tax)		
Growing AB InBev's Global Brand	US $160 million per annum	**Positive:** Form a distinct image, positioning and connections in African market using SABMiller's distribution channels.
Cross sales of SABMiller's Castle and Castle Light beers in Europe, North and South America	US $11 million per annum	**Positive:** Achieve further revenues by expanding areas in which products are sold.
Premiumization and invigorating beer	US $20 million per annum	**Positive:** Capitalize on Africa's growing millennial consumers.
Elevate perception and relevance of core better	US $15 million per annum	**Positive:** Conveying unique quality of brand will allow Newco to increase profits each year.
Develop new beer segment targeted towards African market	US $4 million per annum	**Positive:** Innovating products to meet African consumer needs will help increase Newco's profits each year.
Other Synergies		
Increased Market Share of the USA Market	80% Share of USA Market	**Negative:** Monopoly share of the USA market therefore AB InBev will sell SABMiller's interest in MillerCoors in the USA which could take 12 months to get approval – this would give other companies a competitive advantage to purchase MillerCoors.

South African government requirements	Cost of US $5 million in next 5 years	**Negative:** Newco must invest money to help move South Africa from a net importer to a net exporter of primary raw materials to the brewing industry.

Appendix 5: Deal Funding Strategy and Group Financial Performance

Financial Objective 1: Grow Dividends per Share (DPS) by 10% year-on-year

DPS	TTM	2014	2013	2012
AB Current DPS	3.49	3.25	3.03	1.57
Growth	0.24	0.22	1.46	
Growth %	6.9%	6.8%	48.2%	
SAB DPS	1.1	1	0.99	0.91
Growth	0.1	0.01	0.08	
Growth %	9.1%	1.0%	8.1%	
AB+SAB	4.59	4.25	4.02	2.48
Growth	0.34	0.23	1.54	
Growth %	7.4%	5.4%	38.3%	

Financial Objective 2: Deliver Total Shareholder Returns (TSR) of 14% year-on-year

USD converted	AB Current	SAB	AB+SAB
Beginning Stock Price	$ 119.32	$ 49.92	$ 169.24
Based on Growth During year of	1.80%	8.50%	
Ending Strock Price	$ 121.47	$ 54.16	$ 175.63
Dividends	$ 3.49	$ 1.10	$ 4.59
TSR	4.72%	10.70%	6.49%

Financial Objective 3: Keep gearing (debt/debt + equity) below 40%

	AB Current	SAB	AB+SAB
Debit	$ 51,081	$ 12,544	$ 63,625
Equity	$ 54,257	$ 24,355	$ 78,612
Debit/(Debit+Equity)	48%	34%	45%