AB InBev

Strategic Report

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EXECUTIVE SUMMARY

This Strategic Report has detailed the prioritisation and evaluation of issues faced by AB InBev. We, as Group 1 Consultancy, have prioritised the issues as follows:

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3. ISSUE 3: B2B and Downstream Supply Chain Strategy in Southern Africa
4. ISSUE 4: Africa Direct Entry via Nigeria
5. ISSUE 5: Environmental Hazard in China

BACKGROUND

Anheuser-Busch InBev (abbreviated as **AB InBev**) has a long history of its signature move, which is also its key business strategy, of mergers and acquisitions in order to fulfil its dream of becoming the best beer company, bringing people together for a better world.

With operations in six defined geographical areas such as, Europe, Latin America, Asia Pacific, Mexico, North America and South America and global headquarters in Leuven, Belgium, AB InBev holds a significant global beer market share of 20.8% with the help of its portfolio exceeding 200 beer brands and the acquisition of 100 breweries.

Due to its operations and having a primary listing on the Euronext Brussels stock exchange and a secondary listing on the New York Stock Exchange, it earned a revenue US$47.063 billion which was an organic increase of 5.9% from 2013.

AB InBev made its final offer of US$105.5 billion on 11 November 2015 to acquire its rival SABMiller starting its journey as 'Newco'.

[SOURCE: Wits Business School Case Study]

PRIORITISATION OF ISSUES

1. ISSUE 1: Integration, Synergies and Execution Risk
2. ISSUE 2: Deal Funding Strategy and Group Financial Performance
3. ISSUE 3: B2B and Downstream Supply Chain Strategy in Southern Africa
4. ISSUE 4: Africa Direct Entry via Nigeria
5. ISSUE 5: Environmental Hazard in China

DISCUSSION OF ISSUES

ISSUE 1: Integration, Synergies and Execution Risk

STATEMENT OF ISSUE

One of AB InBev's 5 year strategy is to undertake Mergers and Acquisitions whenever growth starts to slow down hence its current acquisition of SABMiller being its largest acquisition to date. As a result, it has led to a planning horizon of four years rather than two. AB InBev's share price increased by 1.8%, on announcing the offer, rather than it's expected goal of 25%. In regard to various market surveys, some investors felt that AB InBev had overpaid for the deal whereas some investors thought otherwise.

IMPACT ANALYSIS

1. Due to the uncertainty of some investors, share price fell below the expected 25% .
2. Extensive financial cost incurred due to acquisition of SABMiller, increasing it's debt levels.
3. SABMiller is a large and more complex company than anticipated, therefore the integration process will take longer than planned.

JUSTIFICATION & RECCOMENDATION

1. Some investors became uncertain of the acquisition of SABMiller, mainly because of the huge investment and risks that resulted in the acquisition, such as US$290 million that went into the mergers implementation and the initial acquisition in itself. Resulting in a fall its forecasted rise in share price of 25%. This in turn affected the confidence of other investors as well as future investors.To increase the value of share price AB InBev is recommended to buy back their stocks.

2. The acquisition of SABMiller increased AB InBev's debt levels. This contributed to major financial cost and this could possibly result in a delay in the company experiencing high profits as well as threatening a reduction in high dividend pay-outs. AB InBev is recommended to continue to prioritise paying back their loans .

3. The acquisition of SABMiller was much more complex than what AB InBev anticipated, from a 2 year plan to a 4 year plan, therefore this will result in a longer integration process than what they had initially planned for. This may result in an increase in cost synergies being delivered at a faster pace than anticipated, including a loss in future and current opportunities that would have gained the merger a profit as well as the confidence of investors. Through the combination of the two entities the value of it's synergy will be as follows: USD$276,610 mill (status quo) - USD$262,018 mill (synergy) = USD$14,592 mill **(APPENDIX 3)**

ISSUE 2: Deal Funding Strategy and Group Financial Performance

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STATEMENT OF ISSUE

Carlo Brito, CEO of AB InBev, made a final offer of US$105.5 billion on 11 November 2015, which SABMiller accepted. Analysts have agreed that the company's Group Treasury would have to do the acquisition through way of debt or equity, mainly because AB InBev's current cash levels are at US$6.8 billion. In September 2015 media reports stated that the company had higher debt levels to finance the acquisition affecting its credit rating of A and A2. A negative for the company's shareholders could be a possible reduction in dividend payouts after the merger.

IMPACT ANALYSIS

1. The company may need to look into financing the acquisition through way of debt or equity due to its current low cash levels.
2. The company using debt as a method of finance will affect the company's current credit ratings.
3. The shareholders may be facing a reduction in dividend pay-outs.

JUSTIFICATION & RECCOMENDATION

1. AB InBev will need to finance the acquisition through debt (a long term bank loan) or equity (capital and reserves). At present moment the company's average gearing sits at 49% despite its effort to keep gearing below 40%. AB InBev is at high financial risk because it is highly financed through debt. However this could be advantageous because debt finance is beneficial to large companies such as AB InBev in order not to compromise its capital and reserve levels.

2. If AB InBev considers financing the acquisition through debt they need to take into consideration the effects this will have on its current credit rating of A and A2. The acquisition may decrease the credit rating and this may affect the company concerning future acquisitions and projects that may require debt finance.

3. In 2008 AB InBev's previous acquisition resulted in a reduction in dividend payouts. One of AB InBev's 5 year strategy is to prioritise cash to pay for acquisitions compared to paying out dividends to share holders. A further reduction in dividend pay-outs to shareholders after the SABMiller acquisition may cause conflicts with the shareholder, discourage potential shareholders to purchase Newco's shares as well as put pressure of the merger to cut costs in order to retain profits to please shareholders.

ISSUE 3: B2B and Downstream Supply Chain Strategy in Southern Africa

STATEMENT OF ISSUE

In the global brewery industry large customers such as supermarkets and wholesalers draw the biggest changes in the supply chain practices. Always seeking to leverage their buying power and technical expertise, these groups are at the forefront of downstream supply chain developments as they drive changes in transport, warehousing and systems for the brewing companies. As this ever-growing buyer power increases, AB InBev is concerned about the impact it will have, envisioning that the SABMiller acquisition will help Newco have increased bargaining power over other major wholesalers and supermarkets.

IMPACT ANALYSIS

1. Inaccurate sales forecasts
2. Inadequate shelf space as compare to its rivals
3. High cost of servicing major supermarket customers in Africa
4. The need to acquire another company to increase its bargaining power.

JUSTIFICATION & RECCOMENDATION

1. AB InBev's initial investment is immensely dependent on the company sales forecast. AB InBev's forecast, however, is inaccurate, this means that AB InBev will run the risk of either overstating or understating its initial investment which will affect the company's finances. In the result that the forecast overstates initial investment, this may reflect badly on the company's crediting rating if AB InBev decides to invest through debt finance. In the case that the forecast understates initial investment, the company will incur unanticipated costs and may try to cut costs in unethical ways e.g exploiting cheap labour and forgoing environmentally conscious costs. AB InBev is recommended to do more research in order to create an accurate sales forecast.

2. Inadequate shelf space will be very costly to AB InBev. Inadequate shelf space means that AB InBev will always face challenges when it comes to meeting the supply demand, this will result in its customers opting to work with it's rivals that can meet the high demand of the beer market. Therefore the company needs to put more funding towards providing more shelf space.

3. Customer service is a very important factor, even to companies in the manufacturing industry. AB InBev is expected to provide a service to its major supermarket customers in Africa, however it has resulted in high servicing cost meaning that AB InBev may need to revise all its other expenses in order to cater to the good customers service it needs to provide. Besides cutting down costs, AB InBev is advised to pass on servicing costs to the customers in future.

4. It is well known that AB InBev is very much into acquisitions and mergers, however this practice seems to have decreased its bargaining power as stand alone entity in Nigeria. For AB InBev to flip back bargaining power, it needs to acquire another entity to strengthen its

chances. AB InBev needs to look toward increasing it's market share and client base in order to gain bargaining power over customers as well as the use of Porter's Five Forces (**APPENDIX 2**).

<u>ISSUE 4 : Africa Direct Entry via Nigeria</u>

<u>STATEMENT OF ISSUE</u>

AB InBev's goal is to gain a strong foothold in the African market through a Foreign Direct Investment (FDI) in Nigeria if the SABMiller deal fails to close. This FDI is part of AB InBev's strategy to challenge the key players, Nigerian Breweries and Guinness Nigeria, who have full control over the beer market, and also competing with SABMiller before launching an attack against its strongholds in various African countries including South Africa and Zambia.

<u>IMPACT ANALYSIS</u>

1. Depression of the currency in Nigeria over the 5 year forecast period
2. Batch, production and selling costs, are increasing at a greater rate than batch selling price
3. Negative Environmental and Social implications due to large scale production
4. Ethical dilemmas concerning cheap workforce
5. Facing immense competition in Nigeria beer market

<u>JUSTIFICATION & RECCOMENDATION</u>

1. In the period of the next 5 years the currency of the Nigerian Naira has been forecasted to depreciate. This factor may be advantageous to AB InBev during the initial investment and construction of a new manufacturing facility in Nigeria, however within the 5 year period imports it will prove to be expensive and the company will be reporting poor returns to its global headquarters, in Leuven, Belgium, after currency conversion. On the other hand, the devaluation of the Nigerian Naira will attract more customers, such as supermarkets and wholesalers, from other countries with stronger currencies, to purchase AB InBev's products, hence increasing the company's exports. AB InBev is recommended to pressure the government to run a budget surplus, as an inflationary gap exists in the economy, to reduce aggregate demand therefore reducing inflation.

2. It is apparent that the batch production and selling costs will continue to increase at a greater rate than the batch selling price. This factor will result in more outflow of cash than inflow, threatening AB InBev's liquidity and contributing to a significant reduction in the profit the company will retain. This may cause AB InBev to be unable to meet future demands and costs as well as threatening the dividend pay-outs to shareholders. AB InBev is recommended to cut down costs, in this case, they are spending an extensive amount on special packaging. They need to decrease the number of rush deliveries and reduce the rate of damaged goods during deliveries.

3. Nigeria being an LEDC has not been exposed to major many manufacturing industries within the country. AB InBev operating in Nigeria may come as a culture shock to the society and the community that AB InBev will be operating in. Conflicts between the company and the local community may arise. Environmentally, AB InBev's operations will may increase the rate of pollution in Nigeria, attracting the attention of environmental pressure groups and associations such as Friends Of The Earth International and Environmental Management Association of Nigeria (EMAN). AB InBev is recommended to accustom themselves with Nigeria's environmental regulations so as to avoid violating them as well as catering to the local communities immediate needs such as housing, education and medical facilities.

4. Nigeria faces a high unemployment rate. As much as AB InBev's operations in Nigeria will open up job opportunities to the local community, the company may be tempted to hire cheap labour and even go as far a exploiting child labour, as reported, that in 2006 the number of child workers were estimated at about 15 million in spite of legislative measures. Therefore AB InBev is recommended to look into strengthening its ethical values towards employment.

[SOURCE: UNICEF]

6. In the Nigerian Brewery Industry there are two major players, Nigerian Breweries and Guinness Nigeria, AB InBev is bound to face immense competition when trying to penetrate the market as well gain a substantial market share of its own. AB InBev is advised to use marketing strategies such as penetration pricing and encourage customers to buy their products by moving them along the AIDA sequence (**APPENDIX 1**).

ISSUE 5: Environmental Hazard in China

STATEMENT OF ISSUE

AB InBev is to commence production in what is considered to be its largest brewery facility to date, in China. The construction workers that the company contracted have been discarding building waste in the nearby river, resulting in the polluted water affecting wildlife. This activity has attracted the attention of local protectors and media. Chief Project Engineer, Li Wang, has reported the situation to AB InBev's Senior Management. Li Wang has expressed that the issue is not the company's responsibility, however has proposed to issue a press release to the public but intends to do nothing about it. The protests have currently delayed the operations by a week.

IMPACT ANALYSIS

1. AB InBev's operation in China is highly beneficial to the company's growth
2. Bad publicity and a bad reputation will taint AB InBev's image
3. There is need for AB InBev to take environmental issues and ethics into great consideration
4. The cost of delays in operations that AB InBev will face

JUSTIFICATION & RECCOMENDATION

1. AB InBev's operations in China will aid to its growth strategy, This will increase the company's foothold in the brewery industry. It will also intensify it's market presence in Asia.

2. Since AB InBev is the reason for construction in China, the locals are bound to directly link the faults of the contracted construction company to AB InBev. The issue has aroused the attention of media hence reflecting negatively on the way AB InBev's current consumers and investors view the company. This may also affect the way future consumers and future investors may perceive the company because the world is becoming more socially and environmentally aware .

3. AB InBev needs to consider taking environmental and ethical issues more seriously. The current situation may attract the attention of the environmental management association in China resulting in heavy fines and strict environmental sanctions concerning future manufacturing activities that AB InBev may participate in.

4. Besides the costs that may be incurred through the Environmental Management Association in China, AB InBev's delay in operations may result in wastage, an increase in running costs, loss in opportunities and a delay in meeting short term strategic goals.

APPENDICES

APPENDIX 1 : The AIDA Model

APPENDIX 2 : Porter's 5 Forces

APPENDIX 3: **Value of Synergy**

The value of synergy

	Inbev	*SABMiller*	*Combined firm (status quo)*	*Combined firm (synergy)*
Cost of Equity =	8.93%	9.37%	9.12%	9.12%
After-tax cost of debt =	2.10%	2.24%	2.10%	2.10%
Cost of capital =	7.33%	8.03%	7.51%	7.51%
After-tax return on capital =	12.10%	12.64%	11.68%	12.00%
Reinvestment Rate =	50.99%	33.29%	43.58%	50.00%
Expected growth rate=	6.17%	4.21%	5.09%	6.00%
Value of firm				
PV of FCFF in high growth =	$28,733	$9,806	$38,539	$39,151
Terminal value =	$260,982	$58,736	$319,717	$340,175
Value of operating assets =	$211,953	$50,065	$262,018	$276,610

Value of synergy = 276,610 – 262,018 = 14,592 million