Board Report by Team Presec Boys on Key Issues on Strategies Concerning The Formulation of "Newco"

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INDEX

INTRODUCTION

Anheuser-Bush InBev is a global leading beer brewery company that has been formed through a number of successful mergers. However, AB InBev faces a problem at hand. It wants to acquire its rival SAB Miller, which is also a very well-developed and successful company with a 9.7% share of the global market. Carlos Brito, the CEO of AB InBev is ,however, bent on acquiring SAB Miller and has offered $105.50 billion for SAB Miller's acquisition, and this offer has been accepted. Will the merger provide synergies soon enough if the acquisition is successful? Will the company achieve its sustainability strategy in the process? Will the company be able to satisfy stakeholders before, after and during the process of acquisition? These are all problems AB InBev faces, coupled with some ethical dilemmas it must strategically handle.

The Presec Boys Team provides its recommendations for AB InBev after a series of analysis and reasoning, which when effectively followed would lead to greater successes for AB InBev or possibly "Newco" in the years to come.

PRIORITISATION OF ISSUES

1.Environmental Hazard in China

2.Africa Direct Entry via Nigeria

3.B2B and Downstream Supply Chain Strategy in Southern Africa.

4.Deal Funding Strategy and Group Financial Performance

5.Integration, Synergies and Execution Risk

ISSUE/SCENARIO : ***Environmental Hazard in China*.**

PROBLEMS:

1. Pollution of water bodies and endangerment of wildlife.
2. Inadequate action by management and the Chief Project Engineer, Li Wang.
3. Delay in the opening of the project and production which has financial setbacks to AB InBev.

EVALUATION:

1. From Problem 1, we cast our minds back to the sustainability strategy of AB InBev which is also aimed at *A cleaner world*, that is "a world where natural resources are shared and preserved for the future, with a focus on water access and security across our markets." In this statement, the focus was on water access and now the company is polluting water bodies which reduces water access thereby contradicting their strategy. This in turn, makes people lose trust in the truthfulness and effectiveness of their strategy and the company as a whole. This will lead to a reduction in the market share of AB InBev since China is their stronghold. This will also result in drastic financial fall and retrogression of the company and its goodwill, and could affect their activities in other countries and may eventually result in their collapse.
2. From Problem 2, we notice that the management of AB InBev is not taking any action or measures to solve this problem and the Chief Project Engineer, Li Wang, is also not handling the issue properly. This extend the delay in the commencement of production by the company. In addition, this attitude of obliviousness by management can make Chinese consumers lose trust in AB InBev and have the perception that the management does not care about the welfare of the Chinese people, who are their largest market, and this will make the Chinese stop purchasing their products and other companies such as Heineken will take advantage. Eventually, if this issue is not corrected, AB InBev's revenue levels would begin to fall.
3. From problem 3, the delay in the opening of the project and commencement of the production might be a very huge blow,a loss, to the company since this is their largest facility and it is anticipated to yield lots of benefits. This delay might cause financial problems to AB InBev.

RECOMMENDATION TO AB InBev:

First of all, the management has to realise that this problem is an ethical one. The wildlife in that area of operation are going to lose their lives, and in business, negative externalities must be reduced to the very least possible cost to the society. Eventually, if not handled properly, the goodwill built by AB InBev over the years would all be lost.

The management should act very quickly to this problem by clearing all the waste they have dumped into the water bodies. They should also dispose off their waste properly not into water bodies. This will make their strategy of a cleaner world be realistic and effective to the people. This will increase the trust the people have for the company and see them to be faithful and this may even increase their market share and financial status or standings. The Chief Project Engineer, must also be put to check and must be warned by management not to dispose off the waste into water bodies. Any suitable punishments which would serve as reformation and deterrence to others can also be given to him by management.

The company should also consider building a recycling site which would not only solve the problem of improper waste disposal but also build on goodwill, create employment whilst yielding profits, etc.

ISSUE/SCENARIO : ***Africa Direct Entry via Nigeria***
AB InBev with its mission and core goal to survive undertakes to invest in Nigeria as a means of gaining more power in market forces in Africa.

Rationale Behind The Use of Nigeria:
- Nigeria has one of the world's largest populations
- Demand of goods, in this case beer, is directly proportional to population
- Because Nigeria has a propensity of increased population growth, it means demand of beer in Nigeria has the propensity to grow, especially by 2050
- Higher demand also results in ready market for goods and in some cases possibility of charging higher prices
- Ceteris paribus, Revenue generated increases (assuming price remains constant) since

Revenue = Price × Quantity sold

The problem ,however, is how to manifest the goal of attaining 30% or even more of the market shares of brewery companies in Nigeria by the 5th year.
In order to fully understand and make informed decisions (The guiding principles on which accounting is based on) the transactions should be represented in US$

Capital Cost Analysis	
Initial Investment	400,000,000
Initial Ground work	100,000,000
Initial Investigation	500,000
Total	500,500,000
Average Initial Cost per Year	100,100,000

Projected Income Statement For AB InBev					
	Year 1	Year 2	Year 3	Year 4	Year 5
Sales	766,906,708.9	1,072,161,430	1,995,886,168	1,610,884,663	865,699,983.4
Discount Received	50,050,000	55,055,000	60,560,500	66,616,550	73,278,205
Total Revenue	816,956,708.90	1,127,216,430	2,056,446,668	1,677,501,213	938,978,188.4
Less Cost of Sales:					
Cost relating to production and sale of batches	99,139,240.51	145,200,000	283,168,924.3	239,429,498.2	134,798,172.4
Special Packaging Materials	105,000,000	165,375,000	347,287,500	316,031,625	191,442,234.4
Training and Development	79,311,392.41	29,040,000			
Initial Cost per Year	100,100,000	100,100,000	100,100,000	100,100,000	100,100,000
Total Cost	383,550,632.92	439,715,000	730,556,424.30	655,561,123.20	426,340,406.8
Net Profit	433406075.98	687501430	1325890243.7	1021940089.8	512637781.6

NB: The option of $100 per batch was chosen because enough money had gone into AB InBev's marketing and competitive strategy

Average Net Profit (Mean of Net Profit for 5 years) = $\frac{3981375621.08}{5}$ =796,275,124.216

Because this profit is extremely high as compared to the cost involved, if AB InBev takes over Heineken, ceteris paribus, and initial costs re-incurred every 5 years, AB InBev would make

$\frac{70}{30} \times 796{,}275{,}124.216$

= 1,857,975,289.83733333333333 net profit each year

RECOMMENDATION :
AB InBev should focus on Nigeria due to its populous nature and wait a while before entering Ghana and South Africa, for the time being. AB InBev should take over Heineken, in order to gain some level of monopoly in Nigeria, which would yield more profits. Its success in Nigeria would eventually invite African investors, including those based in Ghana and South Africa, who would serve as dealers to sell AB InBev's Products in their home countries. AB InBev would then accept these offers but then takeover the businesses set up by dealers in African countries when it is ready to do so. This initiative would lead to massive profits in the next 15 years.

ISSUE/SCENARIO: ***B2B and Downstream Supply Chain Strategy in Southern Africa.***

PROBLEMS:

1. Inaccurate Sales Forecast.
2. Lack of adequate shelf space given to its products relative to rivals.
3. High cost of servicing some of the major supermarket customers in Africa.

PRIORITIZATION AND EVALUATION:

1. High cost of servicing some of the major supermarket customers in Africa.
   SABMiller makes several or large amounts of deliveries to its supermarkets and this involves a very high cost. This is due to the types of equipment, machines or technology used to make deliveries or service their supermarkets and the way deliveries are made.
2. Lack of adequate shelf space given to its products relative to rivals.
   Due to the high cost of servicing and deliveries experienced by the company, there is low level of output or delivery and the price of the product also increases. These conditions therefore affect their shelf space since the high cost of servicing will affect their products and make their price high. Supermarkets therefore purchase few of their products and therefore do not give them large shelf space. Their products are therefore unattractive to the supermarket customers.
3. Inaccurate Sales Forecast
   Because of the problems affecting them, their market or sales is not stable and therefore they are unable to accurately forecast their sales or revenue for a particular period.

RECOMMENDATION:

1. SABMiller, under the supervision of AB InBev, should find modern and less expensive methods of servicing its supermarket customers in Africa. That is, they should look for new ways of servicing their customers which is relatively cheaper and should also use modern technology which will make servicing faster and easier and less cost generating. They should cut down on activities which generate excessive cost.
2. The company should consider making their products more attractive by improving the packaging. Also, they should slightly reduce the price of their products because they are elastic. This will in turn generate more revenue because the proportional increase in quantity demanded will be greater than the price. During this period, quantity supplied to the supermarkets should be increased to meet the demand of the customers.
3. When the market for their products become stable, they will be able to know the trend of sales and early forecast their prospective sales revenue. A qualified and well-experienced accountant, marketing manager and finance manager should be employed to allow for better results.

Issue/Scenario: ***Deal Funding Strategy and Group Financial Performance***.

Problem: Funding Strategy of AB InBev.

Evaluation:AB InBev although known for its competence when it comes to fulfilling financial commitments, faces quite a tough task in maintaining its good reputation if it is unable to find quick solutions to its funding problem. This is because as per its last quarter, the company only had cash levels of US$6.8 billion. However, the company seeks to make an acquisition of SABMiller with an offer of US$105.5 billion which is roughly 15 times its cash level. Embarking on this transaction could quite clearly negatively affect its credit rating and the dividend pay-outs to shareholders. The former may be due to higher debt levels and the latter due to cash prioritisation.

RECOMMENDATION:

Introduction to solution: Considering the long term reduction in cost, market share and synergies that would be enjoyed from this transaction, AB InBev cannot possibly miss such a glorious opportunity. The issue at hand therefore is how to fund the transaction. The cash available for AB InBev(US$6.8 billion) is quite clearly insufficient to fund the transaction which is now worth US$105.5 billion. The company therefore has to find other means of funding the transaction.

Details: First and foremost, the company should not make rush decisions to acquire the money required. It should allow a few more years to realise profit from other ventures and would have to utilize its credit worthiness to obtain some loans from financial institutions if such sources of funding are inadequate. While this is going to be a vital source of funds for the transaction, AB InBev cannot rely solely on loans. This is because complete reliance in this situation would lead to an incredibly high debt level which would certainly negatively affect the company's credit rating in the long run. As a result of this the company has to back the acquisition of loans up with other means of funding the transaction. In view of this, the company can also fund the transaction with debt acquisition and equity means. It is an undeniable fact that the former still involves debt. However, it reduces the overall debt that will be accrued as result of loans which have very high interest rates. Moreover, in accordance to the company's 5-year strategy, there should be prioritisation of cash to pay for the acquisition ahead of special dividends given to shareholders. It should also be noted that the reduction in the dividend pay-outs given to shareholders should not be a drastic one since the company's main aim is to maximize shareholder value. Finally, after its formation, Newco should work on great cost reduction even in the short run and on its cash flow by various viable means. This will make more cash available to the company in paying for the debt it has incurred.

In maximizing shareholder value, one of the company's policies is to keep gearing below 40%. However, the industry average gearing is currently 49%. Since the company is in a position where it has to borrow to fund its transaction, gearing cannot be reduced by a great margin by reducing debt. The company will therefore have to reduce gearing below 40% by floating more shares. The company, after the acquisition, would be able to increase the share price due to the synergies it would enjoy after merging.

Therefore, instead of funding the acquisition by debt or equity, the acquisition would be funded by both debt and equity.

Let Gearing be G

$$G\% = \frac{\text{Debt}}{\text{Debt + Equity}} \times 100$$

In reducing gearing, therefore, while there is going to be an obvious increase in debt, there would have to be a greater increase in equity. This, if successfully achieved, would enable AB InBev to reduce gearing from the industry average of 49% to below 40% as stated in their financial objectives.

Another key financial objective is to deliver Total Shareholder Returns of 14% year on year. Total Shareholder Returns equal to profit or loss from net share price change, plus any dividends. To achieve this objective, AB InBev will have to increase or at least maintain the level of dividend payouts given to shareholders. AB InBev will also have to ensure that their level of profitability increases which could lead to an increase in their share price. This, when achieved will lead to an increase in Total Shareholder Returns.

AB InBev could also liquidate a small percentage (which management deems fit) of its intangible assets, property, and investments, considering the fact that it is likely to receive some of these items from SABMiller if merger is successful as planned, to pay debts and facilitate. The payment of debts would increase the gearing percentage. AB InBev should also allow a few years more to realise some profits from its other ventures, in order to fund the deal.

ISSUE/SCENARIO: ***Integration, Synergies and Execution Risk***

Problem: Low share price

Evaluation: AB InBev expected an increase in share price by 25%. Unfortunately, the share price only rose by 1.8%. This will therefore lead to low financial returns. In this case, the financial status will not improve so much. Therefore their attempt to acquire SABMiller would be very difficult since the integration process will require a lot of funding to successfully implement it and would have to resort to loans and debts.

Solution as Arrived at From Deal Funding Issue: AB InBev could decide to liquidate a little part of their assets to successfully acquire SAB Miller without too much borrowing so that after acquisition they can release cost and revenue synergies after they have acquired SABMiller and this will, in the long run, make the company more profitable, have a large share of the market and eventually increase the share price of the company.

Other Identified Problem: Execution of the Deal

Evaluation: Now AB InBev is finding problems with the execution of their deal with SABMiller. The deal requires a lot of costs even though cost synergies will also be higher. Cost calculated could be $2953.95 million.

SWOT ANALYSIS

Strengths
-AB InBev has been able to make several successful mergers in the past and thus has enough experience with it.
-Has high valued assets

Weaknesses
-AB InBev has never made an acquisition this big
-It currently lacks the funds needed for the acquisition

Opportunities
-Cost synergies from acquisition would save the company millions of dollars
-Successful merger would increase global market share and eventually revenue

Threats
-Unrealised expected share price could make merger unprofitable
-Unrealised expected share price could lead to a reduction of the goodwill of the company

RECOMMENDATION: Because of the current state of affairs in AB InBev, the company could decide to pause a little bit on the integration process and focus on gaining more financial grounds or stability from other avenues such as their entry in Africa and their largest brewery in China. This will create space for the company to gain enough money and would not have to struggle with too much debts when acquiring SABMiller and this will, in turn, prevent the gearing from going higher or increasing.

The Estimate at Completion:

Estimated integration costs to be incurred by the end of integration.

2,000	- Procurement and engineering
800	- Alignment of brewery bottling...
57.75	- Staff cost management
96.20	- HQ, Regional Office Cost
US$ 2,953.95 million	

Concluding Remarks

AB InBev is likely to make huge successes in the near future. The recommendations provided, if followed, would provide increased returns and performance of AB InBev, and would ensure its firm position in global market, including Africa, in the years to come.

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