AB InBev Case Study

Team Synergy

St. Patrick's CBC

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Inroduction:

AB InBev is global brewing company based in Leuven Belgium and has a primary listing on the Euronext Brussels Stock exchange and has a secondary listing on the New York Stock Exchange. The company is a market leader in the global beer market and has seen an organic increase of 5.9% in revenue totalling US$ 47 063 Billion in 2014 compared to 2013. The company has a huge geographical footprint with operations in 25 different countries in its six defined locations. The company also has sales in 100 countries and employs a workforce of approximately 155 000 and also has more than 200 beer brands on its portfolio these brands include global sensations such as Budweiser, Corona and Stella Artois.

Executive Summary:

AB InBev is considering acquiring its closest rival, SAB Miller. On the 11 November 2015 Carlos Brito CEO of AB InBev presented a final offer to SAB Miller of US$ 105.5 Billion . This offer was accepted by SAB Miller in principle and the acquisition has already started however SAB Miller had certain requirements before it would accept. .The new group will be called Newco and would list on the Euronext Brussels, with secondary listings in Johannesburg, New York and Mexico.

Currently AB InBev has seen slow growth the last few years and analyst agree that according to AB InBev's business strategy the announcement of the acquisition is nothing unusual. The company however is under financial strain with it becoming more reliant on debt to finance its activities, debt: equity ratio at 1.6:1 appendix (A.1) and it unable to satisfy short-term debt , current ratio at 0.68:1 appendix (A.2). The revenue increased at 5.9% but the net profit after tax is below by US$ 5.216 Billion appendix (A.3). AB InBev is dealing with the current problems:

- Environmental Hazard in China
- Deal Funding strategy and Group Financial Performance
- Integration, Synergies and Execution Risk
- Africa Direct Entry via Nigeria
- B2B and Downstream supply chain management

Prioritisation:

1. Environmental Hazard in China

The facility has been marred by protests that have delayed the opening of the facility by one week. SWOT: Threat; Time: (**less than one week**)

2. Deal Funding Strategy and Group Financial Performance

AB InBev needs to find a way to finance the acquisition with little cash levels and possible credit rating downgrades. SWOT: Threat; Time(**Less than one year**)

3. Integration, Synergies and Execution Risk

AB InBev needs to find a way of successfully integrating the companies as swiftly and as cost effective as possible. SWOT: Opportunity, and Threat; Time (**Less than six months**)

4. Africa Direct Entry via Nigeria

AB InBev is currently establishing operations in Nigeria for its FDI into the rest of Africa.

SWOT: Opportunity; Time (**Within one year**)

5. B2B and Downstream Supply Chain Strategy in Southern Africa

After the acquiring of SAB Miller AB InBev will take the controls of its branches in South Africa and will have to manoeuvre around the supermarkets and their activities. SWOT: Threat; Time (**In following year**)

Summary of Recommendations:

Environmental Hazard in China

AB InBev should consult with Li Wang before issuing a press release that should include a formal apology.

Deal Funding Strategy and Group Financial Performance

AB InBev should consider taking out a loan to finance the acquisition.

Integration, Synergies and Execution Risk

AB InBev should continue to integrate as the cost synergies generated by the integration far outweigh the costs incurred.

Africa Direct Entry via Nigeria

AB InBev should continue with its FDI into Nigeria and establish its manufacturing plant.

B2B and Downstream Supply Chain strategy in Southern Africa

AB InBev should consider direct retailing as it generates the biggest return.

Issue: 2.1 Environmental Hazard in China

AB InBev has recently developed its largest brewery facilities in the world to date in China. The project however, has faced opposition by the surrounding community after waste from the construction site was irresponsibly disposed of in a nearby river this has threatened the nearby wildlife and has caught the attention of the local media, and protests as well.

The Chief Operations officer Li Wang has notified AB InBev that the waste was disposed of but that it wasn't AB InBev's fault. He is soon to release a press release saying that AB InBev is taking appropriate action but regards the issue as a minor one and does not intend to persue it.

Analysis of Problem:
There seems to be a delay in the opening of the manufacturing plant by at least a week.
The community is not happy and protests have started and the local media has also gotten involved.
This could give AB InBev a bad public image.

2.1.1 Key Recommendations:

The polluted water source would affect the standard of living of the community, many of whom could be potential consumers of our products. AB InBev should try as best as it can to avoid tension in the community as their public image and brand could take a beating especially with the media involved, therefore AB InBev should consult with Li Wang before giving out the press release.

The press release should include a formal apology to the community and the people affected, it should state that AB InBev will take the necessary action against workers involved and that AB InBev cares about the environment in which it operates in. Thereafter proper waste disposal procedures will have to be put in place and followed in order to prevent such an event from happening again.

Water is a scarce resource and one that needs to be looked after, it is also used in the producing of AB InBev's products and therefore AB Inbev would have to institute a possible brand rebuilding strategy that will invest into CSR and CSI, specifically water related in order to recover. The community will see that AB InBev looks after its environment and is an eco-friendly company.

Protest issue:

The protest groups outside the plant will have to be calmed and controlled. AB InBev will have to make it clear to the people that this will never happen again. AB InBev will also have to follow up with the protestors at a later stage as to the CSR and CSI initiative the company has invested in.

Issue: 2.2 Deal Funding Strategy and Group Financial Performance

On the 11 November 2015 CEO, Carlos Brito present his final (Cash) offer of US$ 105.5 Billion which SAB Miller accepted. The company however only has cash levels of US$ 6.8 Billion. The only way AB InBev would be able to finance the acquisition would be by way of debt or equity.

AB InBev currently has a credit rating of A and A2 by credit ratings agencies Standards and Poor's and Moody's investor services respectively. Retail analysts believe that financing this acquisition would likely affect our credit ratings.

The company last set a 5 year strategy in 2014 in which it adopted 3 key tenets for its competitive strategy:

1. Undertake M and A's whenever growth starts to slow down.
2. Prioritise cash to pay for acquisitions over special dividends or share buybacks.
3. Integrate acquisitions to realise cost and revenue synergies ahead of schedule.

To maximise shareholder return AB InBev has 3 key financial objectives:

1. Grow dividends per share by 10% year on year.
2. Deliver total shareholder returns of 14% year on year.
3. Keep gearing below 40%

Analysis of Problem:

AB InBev needs to find a way to finance the acquisition but doesn't have the cash to do so.

AB InBev will also have to satisify its shareholders aswell as keep its gearing within the targets set and also not risk getting downgraded by the credit ratings agencies.

2.2.1 Key Recommendations:

AB InBev should take out the loan to acquire SAB Miller. If the loan is for a duration of 20 years at and interest rate of 6.10% AB InBev would need US$ 32 280 836 610 in principle to secure the loan (B.1) . This can be taken from AB InBev's retained earnings or its investment securities. This would however negatively affect our gearing but in the long-term combined cost synergies of US$ 2.6 Billion (B.2) will help in positively gearing the balance sheet. This will however not sit well with the Credit Ratings agencies we could risk a ratings downgrade in the short-term.

In order to keep its gearing below 40% AB InBev could negotiate with its creditors to convert the loans into share options. This will contribute to dropping AB InBev's gearing that currently sits at 55% (B.3). AB InBev will thereafter institute a share buyback having free cashflow of US$ 9.749 Billion and possibly finance from other sources. This will help grow dividends per share by 10% year on year and with the acquiring of cost and revenue synergies generated by the acquisition AB InBev would be able to deliver total share holder returns of 14% year on year. This will help satisfy all stakeholders involved.

Issue: 2.3 Integration, Synergies and Execution Risk

The Board of AB InBev prior to tabling their offer to SAB Miller, appointed the Charterquest Institute to quantify the potential cost synergies arising from the deal. AB InBev had used a planning horizon of two years to fully integrate, it does concede however that due to the complexity of SAB Miller the planning horizon will have to be revised to four years.

However some investors feel that AB InBev won't be able to realise cost synergies or if realised would be over a planning horizon much longer than four years. AB In Bev's share after announcing the deal only rose by 1.8% far below the expected 25%.

Analysis of Problem:

Currently the integration project is behind schedule by 156% of the total schedule, because both companies have two very different operating systems and SAB Miller's huge geographical footprint.

The planned budget for the integration was US$ 290 Million but after schedule and cost variances the total budgeted for completion is US$ 2.9 Billion (C.1). Cost synergies budgeted for the project is US$ 9.8 Billion (C.2) with total cost synergies forecasted at the midway milestone being US$ 6.4 Billion (C.3). Currently the cost of integration at the midway milestone is sitting at US$ 248 Million C.4), this is more than 50% of the total integration cost consumed in just two years.

The share price rose by only 1.8% compared to the expected 25% this could have a negative impact on the acquisition as a whole and could reflect a negative investor sentiment.

2.3.1 Key Recommendations:

AB InBev continue with the integration project as total synergies of US$ 6.4 Billion far outweigh the total cost of the project US$ 2.9 Billion (C.5) if we continue with the same schedule and cost variances.

AB InBev should consider increasing the intregration period to 5-6 years due to the fact that SAB Miller and AB InBev both have two very different opereating systems namely centralised and decentralised. AB InBev should also consult the relevant specialists to help make the project more efficient and cost effective. By doing these things AB InBev will be able to get the most secure and cost effective integration project possible.

Issue: 2.4 Africa Direct Entry via Nigeria

As a Strategic rationale for the acquisition of SAB Miller was to gain a foothold into Africa the only continent where AB InBev has no presence, AB InBev is pursuing a venture in the form of a foreign direct investment (FDI) this will aim to compete against local rivals and the same SAB Miller before launching an attack on the rest of its strongholds.

To supports it bid to win market share in Nigeria AB InBev has invested US$100Million on ground work on which its sales and marketing strategy will be based upon, and underpinned by 3 key values.

1. **A growing world**
2. **A cleaner world**
3. **A healthier world**

In addition to this the FDI that AB InBev plans to execute include a US$400Million capacity manufacturing plant. An initial investigation costing US$500 Thousand concluded that there were suitable brewing facilities just outside of Lagos with a reasonably skilled but cheap workforce. The investigation also concluded that an entry into Nigeria would give it a competitive advantage for five years thereafter due to technological advancements the current project will cease.

Analysis of Problem:

AB InBev needs to decide if it will invest into Nigeria or not.

AB InBev will also have to decide what to do after operations cease after the initial five years of the FDI.

AB InBev will also have to deal with possible competitive issues arising from SAB Miller if acquisition is finalised.

2.4.1 Key Recommendations:

AB InBev should invest into Nigeria as it will give them an initial foothold into Africa. The venture will see profits of US$440Million in yr1 (D.1) this will already appease our creditors with us realising our cost of capital of 10%. AB InBev will then generate profits of US$574Million in yr2 (D.2), US$981Million in yr3 (D.3), US$714Million in yr4 (D.4), and US$337Million in yr5 (D.5). This venture would've already realised start-up costs of US$400million in yr2 (D.6).

These funds should then be used to invest into better technology to reduce the variable costs increases on the plant and keep it running for more than five years thereafter with the profits generated by the venture after the medium-term we use that to invest into new FDIs.

Issue: 2.5 B2B and Downstream Supply Chain Strategy in Southern Africa

AB InBev is concerned with the ever-flexing buying power of customer (Supermarkets) in South Africa by SAB Miller. AB InBev has also seen the huge challenges SAB Millers faces with regards to inaccurate sales forecasts and lack of shelf space given to its products relative to its rivals. AB InBev knows too well that success at this will help it in realising the targeted cost synergies. It has come up with four strategies:

1. Stop selling to the least profitable supermarkets.
2. Persuade supermarkets to reduce the number of cost-generating activities.
3. Venture into Direct retailing.
4. Introduce new technologies to reduce the cost of cost-generating activities.

Analysis of Problem:

AB InBev needs to decide how it will deal with the future of Newco in South Africa.

Supermarkets are increasing their buying power through SAB Miller.

High cost of selling to supermarkets.

2.5.1 Key Recommendations:

AB InBev should venture into direct retailing as it produces revenue of US$ 7Billion. This will help towards realising anticipated cost synergies and will produce a gross profit of US$ 6.9Billion (E.1). It will also produce cost savings of US$ 1.6Million in sales visits (E.2), and US$ 2Million on processing purchase orders (E.3).

Direct retailing will also open up a new income stream for AB InBev and will effectively add another business function to its core business, and will also produce a total cost saving of US$ 91Million (E.4). This will also help reduce the bargaining power of customers and contribute towards the sustainability of the company in the future. Direct retailing will also have a positive impact on the brand image of the company with more direct interaction with the brand. This will help Newco in developing and reaching its targeted synergies.

3.1 Ethics:

Environmental Hazard in China:

AB InBev should act with care in the way it deals with the protests, the initial disposing of waste was unethical and the perpetrators need to be put to book, AB InBev cannot view this as a minor issue. AB InBev must also pursue its CSR initiatives in order to show the community it acts in an ethical.

Deal Funding strategy and group financial performance:

AB InBev needs to prioritise the workforce of the company over the financial performance of the group. If at all it comes to sacrificing the employees to deliver profits the employees should be the businesses first priority, even the shareholders will be glad to see that their company acts in an ethical manner.

Integration, Synergies and Execution risk:

AB InBev needs to be very cautious when dealing with employee retrenchments in order to do it in a dignified way to produce a better integration project. Proper compensation should be given out and short-term CSI initiative put in place to make a peaceful transition.

Africa direct entry via Nigeria:

When AB InBev invests in Nigeria it should stick to the values outlined in its marketing strategy this will show that it is an ethical competitor and will help gain public trust. When setting up the facility AB InBev should make sure that it meets all standards they should also invest into CSR initiatives at a later stage and keep the people as number one priority.

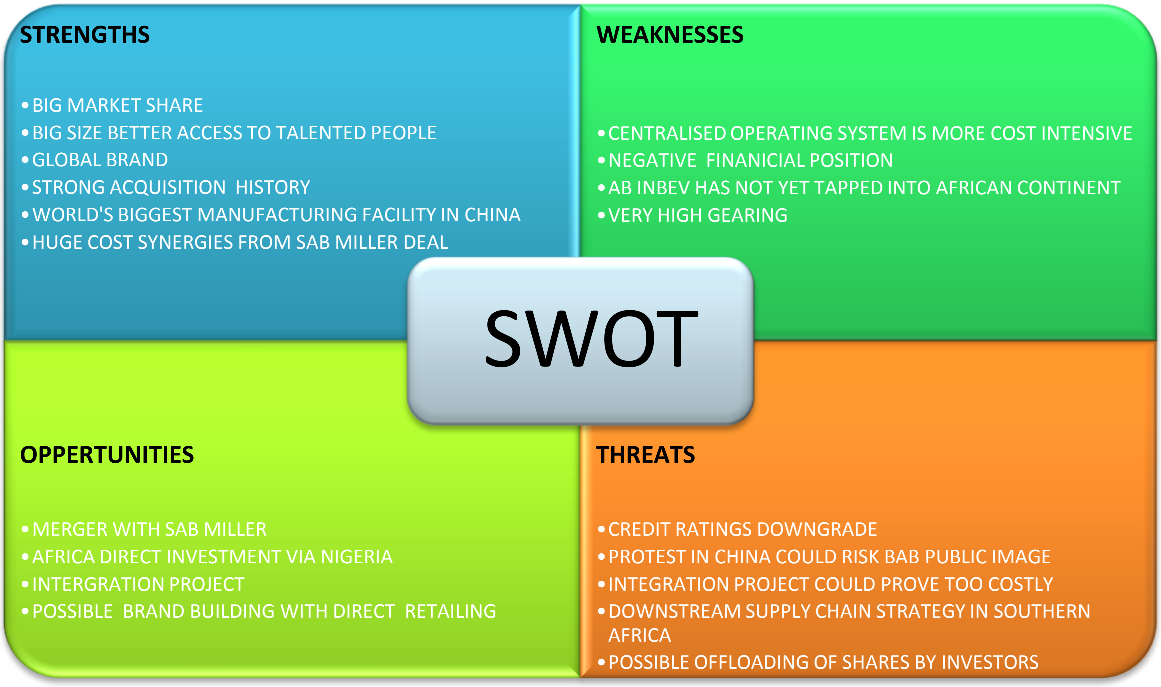
B2B and Downstream Supply Chain strategy in Southern Africa:

When letting go of the supermarkets in South Africa AB InBev should bear in mind the effect it will have on the supermarkets. AB InBev should invest in initiatives that will make people aware of how community orientated the company is. Direct retailing will entail a more hands on approach with customer. This will make the company look like cares for the people which it does.

4.1 Appendices:

1. Debt: equity 61085: 36910=1.6: 1(A.1)
2. Current ratio 18541: 27208=0.68: 1(A.2)
3. Profit after tax 16518 Billion-11302 Billion=US$5.216Billion(A.3)
4. Principle to secure loan 105500000000=P(1+6.10%)20;P=US$32280836610(B.1)
5. Combined cost synergies 24150 Billion+ 210 Million=US$2.660Billion(B.2)
6. Gearing 61085/111 057x100=55%(B.3)
7. Budgeted total for completion millions 2000+800+57.75+96.2=US$2953950000(C.1and5)
8. Budgeted synergies millions 907.2+6801.6+1792+299.2=US$9.8Billion(C.2)
9. Forecasted synergies millions 5670+212.55+255.36+299.2=US$6437110000(C.3)
10. Total cost of integration at Midway millions 50+100+50+48=US$248Million(C.4)
11. Profit yr1 730387341-209126582=US$440260759(D.1)
12. Profit yr2 1021106124-447000000=US$574106123(D.2)
13. Profit yr31900844104-918926294=US$981917808(D.3)
14. Profit yr4 1534175982-819628180=US$714547802(D.4)
15. Profit yr5 824476246-487193793=US$337282453(D.5)
16. Capital NGN140000000000/350=US$400000000(D.6)

17. In millions 7000000000-1125000+129500+70000000=US$6928745500(E.1)
18. Sales visits 82200+102750+1493300=US$1678250(E.2)
19. Purchase Orders 873200+38480+1124800=US$2036480(E.3)
20. Total savings 1678250+2036480=US$3714730(E.4)



Through this SWOT analysis we can see the various situations facing AB InBev and what impact each of them has on the viability and sustainability of the business. In order to make the right decision we would constantly refer to the SWOT and the situation itself.