# THE AB INBEV 2018

## JUNIOR CASE STUDY PACK

*(5 Scenarios For You To Resolve For The Board)*

**Researched, Designed & Developed by:**

# Contents



**NB:** This pack contains ONLY the 5 scenarios to be solved and included in your report. Before you proceed, please ensure you have read and understood the background case study, published separately and titled **'Anheurser-Busch InBev [AB InBev] and SABMIller: Would Strategic Benefits Come Easily With ''Newco''?**

## 1. INTRODUCTION

*The CFO* (Chief Financial Officer) is an international, annual multi-stage business strategy and leadership-focused case study competition organised by The CharterQuest Institute South Africa. It challenges university students around the world (and high school students across Africa, in the case of its junior version) to prove they can compete at the highest level: by solving a set of complex and integrated finance, operational and strategic problems that beset a real-world global business in the emerging markets.

CharterQuest is a global institute with local and international students, at the forefront of grooming financially qualified business leaders of tomorrow, working alongside global professional bodies such as: the South African Institute of Chartered Accountants (SAICA), the Association of Chartered Certified Accountants (ACCA), the Chartered Institute of Management Accountants (CIMA) and the CFA Institute; underpinned by 3 core values:

- **Rectitude**: Always act ethically and muster the courage to do what is right.
- **Exceptionalism**: Aim for exceptional standards for our employees and customers.
- **Determination**: Observe teamwork in our relentless pursuit of stakeholder promises.

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## 2. ASSESSMENT CRITERIA

We seek to highlight the centrality of teamwork, creativity, presentation skills, business acumen as well as the value of taking a holistic and strategic approach to management. The CharterQuest Competency Framework for *grooming financially qualified business leaders* will guide the report marking as below:

| PROBLEM SOLVING ACUMEN | Finance & Technical | Diversity, Business, Entrepreneurial | Ethics & People | Presentation (incl. Question & Answers) | Innovation & Integration | Decisiveness & Leadership | Total |
|---|---|---|---|---|---|---|---|
| **Strategic analysis** *(Prioritisation & focus)* | 5% | 10% | | | | | **15%** |
| **Strategic choice** (*Impact & options evaluation)* | 10% | 10% | 10% | 10% | 5% | | **45%** |
| **Strategic implementation** *(Recommendation & Actions)* | | | 5% | 10% | 5% | 20% | **40%** |
| | 15% | 20% | 15% | 20% | 10% | 20% | **100%** |

For best practice interpretation and application of the above marking grid, it is crucial that teams and mentors access samples of good reports, examiner's comments and also watch our *'Master Class Videos'* 1 of 2 Scene 1 of 3, 2 of 3 and 3 of 3 in our Case Study Resources section.

## 3. SUBMISSION FORMAT AND RULES

In addition to the standard Competition Rules, your final report should be in English Language, not more than 10 pages (or 3000 words, inclusive of appendices) and must not contain any text, sound or images that we, in our sole opinion, find vulgar, offensive or inappropriate for public viewing. Reports with attachments must be submitted ONLY by the team leader as a single document/file in pdf/acrobat and no more than 5MB, through the same CFO account you used to register. Submission deadline is 30 April, 2018 at midnight, without any exceptions. You will receive an automatic message to confirm that upload was successful. Once you submit, no communication is allowed until we announce. The submitted report should be the original work of the team members alone and should not contain internal information from any other organisation. You may be disqualified and other penalties applied in case of any violations.

## 4. DISCLAIMER AND WARNING

The case study is based on the 2015 AB InBev acquisition of SABMiller and attempts to simulate the strategic decisions its Group CFO and the Board faced (or potentially faces). While the facts cited are intended to re-create the general circumstances that exist or once existed, this case study has been adapted for the purpose of **The CFO Junior Case Study Competition 2018** and now provides a hypothetical situation. Apart from the background case study we provided separately, all data presented in these scenarios are for illustrative purposes only and do not necessarily represent current or historical events or projections from any of the companies cited therein. *Whilst you are encouraged to research publicly available information about Ab InBev and SABMiller and familiarize yourself with the industry, you are ONLY allowed to apply this in your analysis (or include this in your report) if any of the data so gleaned from public sources do not contradict the background case study and/or any information presented in these scenarios.* Any discussion with the staff, associates or competitors of any real life companies comparable to the case company is strictly prohibited and is cause for disqualification. You are not allowed to discuss the case with anyone other than your mentor (who must be formally registered on 'The CFO' portal).

## 5. THE REQUIREMENT

**Throwback -and assume today is 1 May, 2016!**

The AB InBev Board of Directors meets next week. Your task is to identify and define the main problem (s) in each scenario, prioritise and evaluate these, including the embedded ethical dilemmas –where applicable, and provide strategic advice. You are accordingly required to produce and present such report directly to the AB InBev Board.

***NOTE:***

*Your report should focus on the following 5 separate yet highly interconnected problems/issues scenarios. These scenarios have been broadly defined -and deliberately so, to allow a considerable degree of good judgment in deciding the core matters your report must address. A separate tutorial article has been published in our 5$^{nd}$ edition of The Future CFO Magazine; you may find it helpful. It's FREE! Subscribe and Download Now!*

# 5. THE CASE SCENARIOS *(Your Task/For ACTION)*

## Issue/Scenario: Africa Direct Entry via Nigeria

As the strategic rationale for the acquisition was to help AB InBev to gain a foothold into Africa –the only region it had not yet gained any presence, the group had, prior to making the SABMiller offer, considered (and are still considering, in case the SABMiller deal failed to close) alternative paths into Africa -through a Foreign Direct Investment (FDI) in Nigeria. The investment will be part of a strategy to initially challenge the Nigerian Breweries and Guinness Nigeria, both of whom currently control the beer market, but also take on the same SAB Miller in that country before launching an attack against other SABMiller's strongholds in South Africa, Ghana, Zambia as well as other African countries.

Nigeria is one of the most populous countries in the world, according to United Nations; the country is set to become the world's third largest population by 2050. Nigeria's beer market is also growing significantly than any other African country and is the second largest beer consumption market on the African continent –after South Africa. AB InBev has compiled the following market share and forecast data about batches of drink sales (average of beer, craft, soft drinks, wines, spirits) in Nigeria:

| Brewery companies in Nigeria | Current Market | Forecasted market share | | | | |
|---|---|---|---|---|---|---|
| | | Year 1 | Year 2 | Year 3 | Year 4 | Year 5 |
| No of batches of drinks produced and cold (in millions) | | 20 | 24 | 32 | 39 | 45 |
| Diageo (Guinness Nigeria Plc) | 21.2% | 22% | 22% | 19% | 18% | 15% |
| Heineken (Nigerian Breweries Plc, Consolidated Breweries ) | 52.5% | 51% | 50% | 48% | 45% | 40% |
| SABMiller (Pabod Breweries, Standard Breweries, Voltic) | 18.6% | 16% | 12% | 8% | 5% | 3% |
| Castel (International Breweries) | 5.1% | 6% | 6% | 5% | 6% | 5% |
| AB In Bev | 0% | 3% | 8% | 19% | 23% | 30% |
| Others | 2.9% | 2% | 2% | 1% | 3% | 7% |
| **Total** | **100%** | **100%** | **100%** | **100%** | **100%** | **100%** |

To support its direct entry strategy, AB InBev had paid a further US$ 100 million for the initial ground work that will form the key pillars of its marketing and competitive strategy to win market share from local rivals, some of which are global brands operating through defined subsidiaries in the Nigerian market and across Africa. The marketing strategy, underpinned by its sustainability strategy, focusses on delivering a 'A better world', anchored around 3 core pillars: ''(1) A **growing world** where everyone has the opportunity to improve their livelihoods -most especially, our barley farmers who grow the agricultural inputs we need, their communities as well as small scale entrepreneurs and retailers of our drinks; (2) **A cleaner world** where natural resources are shared and preserved for the future, with a focus on water access and security across our markets; (3) A **healthier world** where every experience with beer is a positive one for lives well lived, extending and expanding our Global Smart Drinking Goals, to help ensure the harmful use of alcohol is reduced significantly and measurably across all of our markets.''

The data below is a breakdown of how the US$100million was spent:

| | Amount (US$ million) |
|---|---|
| **Sponsorships:** | |
| • Payment to local private university to sponsor research on the harmful effects of alcohol in general and the specific ingredients used to produce its beers. | **20** |
| • Payment to local brewery industry trade body towards campaigns for industry self-regulation. | **15** |
| **Billboards and digital marketing:** | |
| Payment for the design and erection of marketing billboards and social media campaigns around areas where its youth and millennial market segment frequently visit (e.g. facebook, youtube, schools and universities) | **65** |
| Total | **100** |

The FDI that AB InBev planned to execute, entailed setting up a NGN140 billion manufacturing capacity in Nigeria to also cater for export sales to other countries in the West African Region. An initial investigation costing US$ 500,000 had established that just outside of Lagos, there are appropriate brewery facilities, adequate transport links and a reasonably skilled but cheap work force. The investigation also concluded that an entry into Africa through Nigeria will give AB InBev an advantage over its competitors for a period of 5 years, after which the current project will cease, due to the development of new advance brewery technologies; but that such an initial foothold will allow AB InBev, after the initial five years, to open up more manufacturing facilities to meet demand in Nigeria, and also explore further strategic moves in the form of other FDIs in other African countries, including South Africa.

The CharterQuest Institute has compiled the following data relevant to the Africa Direct Entry via Nigeria:

| | |
|---|---|
| Currency of Nigeria | Nigerian Naira (NGN) (Currently: NGN350 =US$1) and reporting currency of AB InBev is US$ |
| Average Exchange Rates (Years Y1-5) | (Y1) NGN395/US$ (Y2) NGN445/US$ (Y3) NGN502/US$ (Y4) NGN566/US$ (Y5) NGN638/US$ |
| Initial (capital) investment (required immediately) | NGN140 billion (Assume no depreciation, no salvage value and no working capital requirements) |
| Batches produced/sold each year | (Y1) 1,000,000 (Y2) 1,500,000 (Y3) 3,000,000 (Y4) 2,600,000 (Y5) 1,500,000 |
| Nature of production | In batches of product mixes. |
| Costs relating to producing and selling each batch | NGN35,600 increasing at 10% per annum |
| Special packaging materials | US$200 per batch, increasing at 5% per annum |
| Training and development costs, related to the production of batches | 80% of the production and selling costs (excluding the cost of special packaging) in the first year, before falling to 20% of these costs (still, excluding the cost of special packaging) in the second year, and then nil for the remaining years. |
| Current selling price per batch | NGN288,503 increasing at 5% per annum |
| Costs relating to producing and selling each batch | NGN35,600 increasing at 10% per annum |
| Special packaging materials | US$100 per batch, increasing at 5% per annum |
| Training and development costs, related to the production of batches | 80% of the production and selling costs (excluding the cost of special packaging) in the first year, before falling to 20% of these costs (excluding the cost of special packaging) in the second year, and then nil for the remaining years. |
| Discount rate (AB InBev's Cost of Capital) | 10% |

## Issue/Scenario: B2B and Downstream Supply Chain Strategy in Southern Africa

In the global brewery industry, the biggest changes in supply chain practices are driven by some of the largest customers of the brewers –supermarkets and wholesalers. These groups are often at the forefront of downstream supply chain developments, always seeking to leverage both their technical expertise and their ever-flexing buying power, to drive changes in warehousing, transport and systems for the brewing companies. The AB InBev Board is concerned about the impact of this ever-growing buyer power on group profitability, envisioning that SABMiller acquisition will help flip back the bargaining power over these major wholesalers and supermarkets to the advantage of Newco.

A major challenge SABMiller has hitherto faced however, is the inaccurate sales forecasts, lack of adequate shelf space given to its products relative to rivals and the high cost of servicing some of the major supermarket customers in Africa. The AB InBev Board knows too well that success at this will contribute towards realising the anticipated cost synergies, and are considering 4 strategies to deal with the least profitable supermarkets, starting with a pilot study on the Top 3 supermarkets, as part of the overall integration project: (1) Stop selling to the least profitable supermarkets –if they wish to sell Newco's products, these supermarkets have to buy them through a wholesaler; (2) Persuade the supermarkets to reduce the number of cost-generating activities; (3) Venture into retailing direct to consumers; and/or (4) Introduce new technologies to reduce the cost of the cost-generating activities.

The CharterQuest Institute has compiled forecast data for next year relating to the Top 3 supermarkets:

### Supermarkets data (US$ millions)

| Forecast for the next year | Notes | Top 3 Supermarkets | | | Direct Retailing |
|---|---|---|---|---|---|
| | | Shoprite | Pick n' Pay | Makro | |
| Sales revenue (before discounts and returns) (US$ millions) | 1 | 580 | 240 | 1,080 | 7,000 |
| Average discount given (%) | | 3 | 2 | 8 | 0% |
| Number of sales visits made | | 120 | 150 | 2,180 | 0 |
| Number of purchase orders processed | 2 | 5,900 | 260 | 7,600 | 0 |
| Number of standard deliveries made | 3 | 1,040 | 3,180 | 6,020 | 500 |
| Number of 'rush' deliveries made | 4 | 70 | 20 | 1580 | 20 |
| Damaged products returned (% of sales revenue) | 5 | 2.1 | 2.0 | 3.4 | 1% |

### Operational cost data:

| Forecast averages for the next year | Cost data (US$) |
|---|---|
| Making a sales visit | 685 |
| Processing a purchase order | 148 |
| Making a 'standard' delivery | 2,250 |
| Making a 'rush' delivery | 6,475 |

***Notes:***

1. *The prices charged to supermarket customers are calculated to generate a gross profit margin, before any discount, of 20% for supermarket customers; this will be 31% for direct retail customers;*
2. *Purchase orders are paper documents, specifying items and quantities required, and the expected date of delivery;*
3. *A 'standard' delivery is one that is ordered and scheduled in the normal way, i.e., at least 24 hours before the delivery is required;*
4. *A 'rush' delivery is one that is ordered and scheduled for delivery on the day of the order. This normally happens as a result of unexpected high demand, causing a super market to run out of stock, or due to a customer error in calculating order quantities; and*
5. *Customers are given a full refund for all damaged goods. These goods cannot be re-used or resold.*

## Issue/Scenario: Integration, Synergies and Execution Risk

The Board of AB InBev had prior to tabling their offer to SABMiller, appointed The CharterQuest Institute to quantify the potential cost synergies arising from the deal. AB InBev has in the past used a planning horizon of 2 years to fully integrate and realise all synergies from acquisitions, but it is well aware that the acquisition of SABMiller is the single biggest acquisition it has ever undertaken, so, it had revised its planning horizon to 4 years, with an estimated total cost of US$290 million for the implementation - to be incurred in 4 advance instalments, in line with the envisaged integration schedule for the acquisition, and the realisation of all synergies.

On announcing the offer, AB InBev's share price rose by only 1.8%, far below the 25% expected - and to date, it is US$61 per share –still not corrected. A separate market survey revealed that some investors felt AB InBev had overpaid for the deal; yet many others felt despite its past successful acquisition and integration track record, the SABMiller were far too large and complex to successfully realise the envisaged synergies; or if realised, it would be over a horizon much longer than the even the revised 4 years horizon. The plan was to obtain all regulatory approvals and allow for integration to commence by 3 October 2016, so that by 3 October 2018, the integration process will be 2 years in full swing -with 50% (2 of the 4 years) of the project integration costs incurred -and the cost synergies realised. Key data compiled include:

**Newco Integration Project (integration costs & performance data –all figures in US$ millions)**

| | Strategic cost engineering theme | Strategy/strategic initiative | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 |
|---|---|---|---|---|---|---|---|---|---|---|
| A | Procurement and engineering: raw materials and packaging. | Implement an upstream supply chain strategy that combines and centralises procurement, including JIT – **cutting down number of orders** and forcing down prices, by exploiting stronger bargaining power arising from bigger size and scale. | 80 | 40 | 2 | 50 | -95% | -25% | 2,000 | -30 |
| B | Alignment of brewery, bottling and shipping productivity. | Implement Business Process Re-engineering (BRP) including Enterprise Resource Planning (ERP) -to better synchronise operations, outbound logistics, marketing and sales as well as customer service, thereby **reducing the cycle time between brewery, bottling and shipping.** | 120 | 60 | 15 | 100 | -75% | -67% | 800 | -20 |
| C | Staff cost management, best practice sharing and efficiency improvements. | Strategic Head Count Reduction and Retrenchment Programme. | 70 | 35 | 40 | 50 | 14% | 6% | 57.75 | -37 |
| D | HQ/Regional Office Costs. | Collapse SABMiller corporate office in London into AB In Bev's in Brussels and save corporate taxes in South Africa. | 20 | 10 | 10 | 48 | 0% | -381% | 96.2 | 28.1 |

## Cost synergies:

| | Strategic theme. | Cost Driver/Key Performance Indicator (KPI). | KPI Targets (per annum) . | KPI Forecast Schedule Variance (SV)% on 3/10/2018. | 1 | 2 | 3 |
|---|---|---|---|---|---|---|---|
| A | Procurement and engineering: raw materials and packaging. | Reduction in number of orders @ US$ 2100 per order. | 108,000 | -95% | 907.2 | 113.4 | 5,670 |
| B | Alignment of brewery, bottling and shipping productivity | Reduction in cycle time between brewery, bottling and shipping @ US$ 3900 per hour. | 436,000 | -75% | 6,801.6 | 850.2 | 212.55 |
| C | Staff cost management, best practice sharing and efficiency improvements. | Reduction in staff size @ US$ 140,000 per employee. | 3200 | +14% | 1,792 | 224 | 255.36 |
| D | HQ/Regional Office Costs. | Costs saved from collapse SABMiller corporate office in London into AB In Bev's in Brussels and save corporate taxes in South Africa. | US$ 74,800,000 | +0% | 299.2 | 299 | 299.2 |

## Earned value conventions:

| | | | |
|---|---|---|---|
| **1** | BAC | Budget At Completion | Estimated integration cost budget (and cost savings) over the 4-year planning horizon. |
| **2** | BCWS | Budgeted Cost of Work Scheduled | Targeted integration costs (and cost savings) at the mid-way milestone -3/10/2018. |
| **3** | BCWP | The Budgeted Cost of Work Performed | Forecasted integration costs (and cost savings) at the mid-way milestone -3/10/2018. |
| **4** | ACWP | Actual Cost of Work Performed | Projected integration costs at the mid-way milestone - 3/10/2018. |
| **5** | SV% | Schedule Variance % | Estimated schedule deviation encountered in executing the integration/synergies. |
| **6** | CV% | Cost Variance% | Estimated deviation in integration costs encountered in executing the integration/synergies. |
| **7** | EAC | The Estimate At Completion | Estimated integration costs to be incurred by end of integration. |
| **8** | ETC | The Estimate To Complete | Estimated integration costs yet to be incurred from midway to the end of integration. |

## Issue/Scenario: Environmental Hazard in China

AB InBev has been developing its largest brewery facilities in the world to date in China which is due to commence production in 3 months. The project has encountered some major difficulties with local protesters claiming that the contracted construction workers on site have been discarding building waste materials in a nearby river. They claim wildlife has been affected and that the water has become polluted and the situation has aroused the interest of the local media.

The Chief Project Engineer, Li Wang, has confirmed that some waste from the site was not disposed of in the correct way but has reported to senior management that the issue is not AB InBev's responsibility. Li Wang proposed to issue a press release stating that AB InBev is taking appropriate action, but regards the issue as a minor one and does not intend to pursue it. So far, the protests have only delayed the opening of the facility by a maximum of one week and Li Wang is anxious not to risk increasing the delay.

## Issue/Scenario: Deal Funding Strategy and Group Financial Performance

When Carlos Brito, CEO of AB InBev on 11 November 2015, presented his final (cash) offer of US$105.5 billion (£69.8 or £44 pounds per share) which SABMiller accepted, analysts agreed that in order to finance the transaction, AB InBev's Group Treasury would probably have to do it by way of debt or equity, since the company only had cash levels of US$6.8 billion (as per its last quarter, which ended on 30 June 2015).

In September 2015, the media reported that AB InBev had visited various banks just prior to approaching SABMiller. Reacting to this, retail analyst Phalguni Soni commented: "Given the company's higher debt levels to finance the acquisition, its credit rating of A and A2 by credit rating agencies, Standard & Poor's and Moody's Investor Service, respectively, would likely be affected." In the short term, a negative for AB InBev shareholders could be a possible reduction in dividend pay-outs following the merger. After the acquisition of InBev in 2008, AB InBev had made reduced dividend pay-outs in order to lower its debt levels.

The company last set its 5-year strategy in January 2014 in which it re-adopted key tenets of its corporate strategy -acquisitions, acquisitions, acquisitions:
(1) undertake Mergers and Acquisitions (M&As) whenever growth starts to slow down;
(2) prioritise cash to pay for acquisitions ahead of special dividends or share buy backs; and
(3) integrate acquisitions to realise cost and revenue synergies ahead of schedule.

To maximize shareholder value, its overarching aim, it had set the following 3 key financial objectives:
(1) Grow Dividends Per Share (DPS) by 10% year-on-year;
(2) Deliver Total Shareholder Returns (TSR) of 14% year-on-year; and
(3) Keep gearing (debt/debt + equity) below 40%.

The CharterQuest Institute has compiled the following data pertinent to this issue:

| | |
|---|---|
| Share price at close of 2013, 2014; and Today | US$ 95.39; US$ 110; and US$111 |
| Cost of debt (Kd or i) Today | 6.10% |
| After tax cost synergies (per annum) | US$ 2,450 million |
| After tax revenue synergies (per annum) | US$210 million |
| Industry average gearing (D/D+E) | 49% |

=====================================THE END================================