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Anheuser Busch InBev - Pushing premium brands but needs more volume growth

Investment summary:

- Anheuser Busch InBev (ABI), the biggest and most profitable beer company in the world, has dominant market positions in the important beer markets of the US, Brazil and Mexico (it recently acquired Grupo Modelo).
- EBIT margins in these key markets are 30% or more (Mexico will get there soon) - thus profitability is extraordinary at ABI.
- Almost 50% of ABI's profit comes from developed countries (US and then the minnows – Canada, UK, Germany and Belgium). In these countries beer consumption is either not growing or shrinking slowly but ABI still manages to increase profitability, despite flat-to-declining volume margins, by getting customers to buy more premium beers.
- This seems to be ABI's predominant mindset not only in its developed market portfolio but also in the group's developing market territories. The company appears to be worse at stimulating overall beer consumption and growing market share than at pushing their Global and broader Focus Brands portfolio which represent 70% of total volumes - so-called *premiumisation* is what they do well.
- We believe the company could be better at stimulating the overall market, and this is where their developing market strategy is missing a trick. In our view SABMiller is better at doing this.
- ABI's share price has recovered following its recent 2Q13 results as its 1Q13 volume declines moderated.
- The company's P/E multiples are 20.5x to December 2013 and 17.9x to December 2014. While earnings over this period will be buoyed by the Grupo Modelo acquisition in Mexico, we forecast EPS to grow by just 7% in FY13 and 15% in FY14. The DY to December 2013 is 2.4%.
- In our opinion ABI doesn't offer enough value at current levels but we recommend investors buy into share-price weakness as the company is a good addition to a long-term portfolio.

Background:

Belgian-Brazilian group ABI, the largest brewing company in the world with a c. 25% global market share, is the result of several mergers and acquisitions. The company was formed following the purchase of US brewer, Anheuser-Busch by Belgian-Brazilian brewer, InBev in a $52bn (or $70/ share) deal. InBev was itself the product of a merger between AmBev and Interbrew. Interbrew was established in 1987 through a merger of Belgium's two largest breweries Artois and Piedboeuf while AmBev (*Companhia de Bebidas das Américas* [Beverages Company of the Americas]) was created in 1999 when the two biggest Brazilian brewers, Antarctica and Brahma merged. The company is headquartered in Belgium

ABI, the biggest and most profitable beer company in the world, has dominant market positions in the important beer markets of the US, Brazil and Mexico. EBIT margins in these key markets are 30% or more (Mexico will get there soon). By comparison, SABMiller has margins closer to 20% in its key territories, except for Latin America which is between 25-30%. Thus, profitability is extraordinary at ABI. The only problem being that almost 50% of ABI's profit comes from developed countries (e.g. US and then the minnows – Canada, UK, Germany and Belgium) where beer consumption is either not growing or shrinking slowly as in many cases the population is ageing and people are drinking less beer and often enjoying more wine and spirits.

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We scan the globe looking for good opportunities. We provide our model portfolios, as well as news and views on our watch-list, which is continually reviewed and updated.

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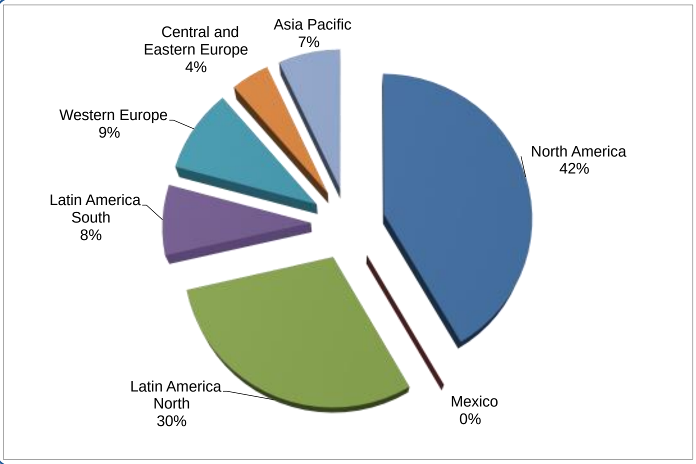
This is a very different scenario to the SABMiller portfolio where developed markets are <30% of profits and beer consumption continues to grow in many of their markets.

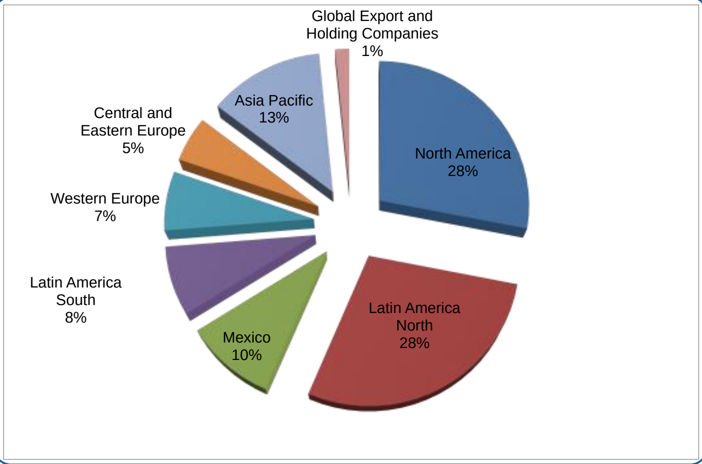
Anheuser Busch InBev revenue split FY12:



Source: Company reports, Anchor Capital

Nevertheless, ABI still manages to increase profitability despite flat-to-declining volume margins by getting customers to buy more premium beers i.e. by improving price/mix. This seems to be ABI's predominant mindset not only in its developed market portfolio but also in the group's developing market territories. However, the company does not seem to be as good at stimulating overall beer consumption and growing market share than at pushing its Global Brands (Budweiser, Stella Artois, Becks and now Corona) and its broader Focus Brands portfolio (global brands plus Skol, Brahma etc.), which represents 70% of the company's total volumes. We believe so-called *premiumisation* is what they do well. It seems to us that the company could be better at stimulating the overall market, and this is where we think ABI's developing market strategy is missing a trick. SABMiller is better at doing this.

Anheuser Busch InBev worldwide volumes FY12:



Source: Company reports, Anchor Capital

Having said that, this is a very durable and high-return venture. Although the US business (accounting for almost 40% of EBIT) is unlikely to generate volume growth going forward we think recent declines may moderate as the US economy improves. *Premiumisation* is the key driver here, and this is not that easy when the premium segment tends towards fragmentation (i.e. the rise of craft beers). The Brazilian business (c. 33% of EBIT) is being held back by recent headwinds in that economy but the long-term fundamentals remain good. The newly acquired Mexican business (c. 11% of EBIT) arguably has the best outlook in terms of profitability with margins well below ABI-type levels. Argentina is also material at c. 7-8% of EBIT. However, the remainder of the businesses are not that important. Also, although ABI is big in China it is only the third-largest player there and its margins are very thin. It is therefore difficult to predict how long it will take before China becomes a very profitable beer market for the company.

Anheuser Busch InBev metrics are as follows:

Spot (EUR)	74.51
Mkt Cap EURbn	119.8bn
12M trailing P/E	12.13
P/Book Ratio	3.35
FYE	31-Dec
12M trailing DY	2.28
12M fwd DY	2.45

Source: Company data, Anchor Capital

ABI's share price has recovered after the recent 2Q13 results because volume declines were not as bad as they were in 1Q13. We therefore have to ask the question: Is there still value in the share? We have a discounted cash flow (DCF) value of EUR81 for the share which is only c. 8% above the current share price (EUR74.51). The P/E multiples are 20.5x to December 2013 and 17.9x to December 2014. Earnings over this period will be boosted by the Grupo Modelo acquisition in Mexico. We forecast EPS to grow by only 7% in FY13 and 15% in FY14, while the dividend yield to December 2013 is 2.4%. We believe that ABI doesn't offer enough value at its current levels but we recommend investors buy into share-price weakness as the company is a good addition to a long-term portfolio.

David Gibb

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