6th May 2016

Food & Beverages

AB InBev

Price EUR109.05

Conf call feedback and updating forecasts

Fair Value EUR109 (0%) **NEUTRAL**

Bloomberg	ABI BB
Reuters	ABI.BR
12-month High / Low (EUR)	123.3 / 91.3
Market Cap (EURm)	175,379
Ev (BG Estimates) (EURm)	250,666
Avg. 6m daily volume (000)	1,720
3y EPS CAGR	6.9%

	1 M	3 M	6 M	31/12/15
Absolute perf.	0.0%	1.6%	-1.0%	-4.7%
Food & Bev.	-0.8%	-0.3%	-6.8%	-5.1%
DJ Stoxx 600	1.4%	2.1%	-12.1%	-9.0%

YEnd Dec. (USDm)	2015	2016e	2017e	2018e
Sales	43,604	43,076	59,609	62,027
% change		*-1.2%*	*38.4%*	*4.1%*
EBITDA	16,921	16,885	24,041	25,884
EBIT	13,768	13,842	20,172	21,899
% change		*0.5%*	*45.7%*	*8.6%*
Net income	8,513	7,712	11,388	12,448
% change		*-9.4%*	*47.7%*	*9.3%*

	2015	2016e	2017e	2018e
Operating margin	31.6	32.1	33.8	35.3
Net margin	19.5	17.9	19.1	20.1
ROE	20.2	17.9	13.7	14.3
ROCE	10.1	10.3	10.5	8.7
Gearing	98.7	101.3	104.7	97.1

(USD)	2015	2016e	2017e	2018e
EPS	5.10	4.62	5.71	6.24
% change	-	*-9.4%*	*23.5%*	*9.3%*
P/E	24.4x	26.9x	21.8x	19.9x
FCF yield (%)	3.7%	3.2%	5.7%	5.1%
Dividends (USD)	2.68	2.43	3.00	3.28
Div yield (%)	2.2%	2.0%	2.4%	2.6%
EV/Sales	6.5x	6.6x	5.5x	5.3x
EV/EBITDA	16.8x	16.9x	13.7x	12.6x
EV/EBIT	20.7x	20.6x	16.4x	14.9x

After poor Q1 numbers we are lowering our 2016 revenue and EBIT by about 2/3% which assumes that the business (especially Brazil and US) picks up in the coming quarters as per guidance from the company. On the call there was also some update on the state of the SABMiller process, but there was no clarification on why suddenly also the Central and Eastern European SABMiller assets are put up for sale. We read it as if the company is getting nervous about South African clearance and desperately want the European regulator Phase1 approval, out of fear that the South African one would continue to seek postponements. (not such a good sign)

On the call, the company was trying to soothe investors' fears on negative developments in Brazil, China and the US, pointing to some temporary headwinds which should subsided over the coming quarters. Nevertheless this does not take away that q1 was bad and that impacts our full year earnings outlook. We have lowered our 2016 revenue and operating profit forecasts by 2/3%. We are lowering our 2016 net revenue forecast by 2.3% to USD43.1bn from USD44.1 and our operating profit forecast by 2.9% to USD13.8bn from USD14.3bn before and are now looking for more or less flat figures for the full year 2016. We leave our fair value unchanged at EUR109.

ANALYSIS

- Although q1 volumes in Latam-North were down by 7.3% (-10% in Brazil) and revenue by 1.9%, AB InBev continues to guide to mid to high single digit organic revenue growth for the region, which would assume positive growth in brazil for the coming quarters. Although no figure has been mentioned, management insists that volume trends in Brazil in April were significantly better than the first quarter and as a result it was not making any change to their guidance for the full year. So what happened in the first quarter is definitively a reflection of the poor macro, but the earlier Carnival (regarded by consumers as the end of the summer) and price increases (ahead of competitors driving temporary loss of market share) exacerbated the volume weakness (and margin contraction).

- A similar story on China. The company believes that its lower revenue per hl growth of 2.1% (well below the 9.4% reported for the full year 2015) is temporary although that it expects industry volumes to continue to be week. The favourable brand mix development (selling more premium Budweiser) was balanced by unfavourable regional mix because the south and the east, especially Guangdong had very cool weather and very strong economic headwinds; and that is something that affected a region where Budweiser is very strong. That rippled throughout the China numbers. However, Budweiser continued to grow throughout China, with the exception of Guangdong, where it nevertheless gained share on a very weak industry numbers. Overall in China AB InBev's volumes were down just over 1% compared to an industry down 4%, leading to a 45bps market share gain for the quarter (reaching 19%). Premium and super premium beer continue to grow stronger and is now more than 50% of AB InBev's China volumes.

- On the slow down in price/mix in the US from 2.9% in 2015 to 1.2% in Q1, despite the craft brew acquisition, management clarified during the call that there was a phasing on Stella shipments. A year-plus ago it had an issue with Stella being frozen whilst crossing the ocean. And this year, they decided to ship earlier and avoid the harsher part of the winter (December-January). Not only did that impact the price/mix but also that the sales-to-retailers (-0.3%) was well ahead of the sales-to-wholesalers (-1.2%) – which comes in AB InBev's revenue figure. For the full year the difference between the two should disappear and also price/mix should be back up.

- The company also updated on the SABMiller acquisition highlighting the proactive steps it has been taking in addressing any potential regulatory considerations. It believes it has been making good progress in all four of the markets where regulatory clearance is a precondition to making the formal offer to shareholders. It did announced the sale of SABMiller's interest in MillerCoors in the U.S. and in CR Snow in China, as well as the disposal of certain of SABMiller's premium brands and related businesses in Europe, including Peroni and Grolsch. Also, last week, it announced it was divesting SABMiller's Central and Eastern Europe business and brands (Poland, Hungary, Czech Republic, Slovakia, and Romania). During the call, there was some explanation sought on the latter decision especially as there does not seem to be any obvious regulatory concerns in mostly duopoly markets (with Heineken) where profitability is relatively high. But analysts were left puzzled. Maybe, the continuous postponement of the South African regulator (today again postponement to 12 May), is putting the company in panic mode?

- There were also some interesting comments on further acquisitions. First of all the Dutra (the CFO), highlighted that M&A remains a core competency, and “we'll always be ready to look at opportunities when and if they arise, subject to our strict financial discipline”. Second there is a bonus pool of USD300m for the 65 top managers (excluding the 16 top managers who are on the executive management board), if the company would achieve USD100bn turnover target by 2020 (organic or external growth – and it could be 2020 2021 or 2022). But, although it was not said with so many words, we deduct from Brito’s (CEO) comments during the call that a similar, non-public, target exists for the managers on the executive management board, including himself and the CFO, as most of these bonus plans are there to align with internal targets and that they like “to dream big”. In our forecast the company would make USD67bn revenue in 2020, which is USD33bn short of the target. So which acquisition could fit to reach that target of lifting revenues by another 50% (and that is in the next four years!). There are two companies that could be considered: Coca Cola (USD44bn revenue) or PepsiCo (USD31bn revenue in beverages). Coca Cola’s CEO Kent has warned his management that 3G Capital Partners (controlling shareholders of AB InBev) could try to acquire the company (3G co-investor Warren Buffet already is the largest Coke shareholder). And SABMiller is bottling Coke in numerous markets in Southern Africa and Central America (Honduras and El Salvador). On the other hand AB InBev has long standing relationships with PepsiCo (including a comment buying platform in the US and being their Bottler in Brazil, Argentina, Bolivia, Uruguay, Peru and the Dominican Republic). Furthermore PepsiCo’s revenues of USD63bn are USD31bn beverages and USD32bn snacks which could facilitate a joint offer from AB InBev and Kraft Heinz (also controlled by 3G Capital Partners). Coca Cola’s operating margin is already 20%, the one of PepsiCo is 14%... But maybe first get the SABMiller deal done?

VALUATION

- Our DCF based fair value of USD109 is based on a risk free rate of 1.7%, a risk premium of 7% and a terminal growth rate of 3.7%.
- Valued at 25.7x 2016 earnings include an expectation that the SABMiller deal will be strongly earnings enhancing.

NEXT CATALYSTS

- 29-Jul-2016 Second Quarter and Half Year 2016 Results
- 28-Oct-2016 Third Quarter and Nine Months 2016 Results

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