BRYAN, GARNIER & CO

INDEPENDENT RESEARCH UPDATE

7th June 2016

Food & Beverages

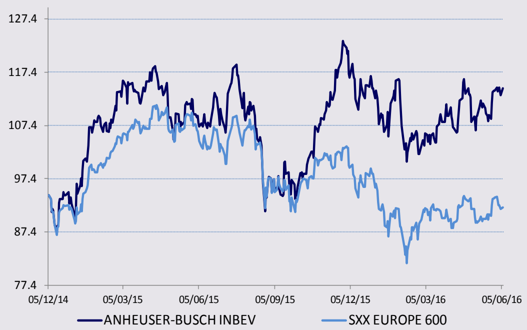
AB InBev

Already Gone

Fair Value EUR109 (price EUR114.40) **NEUTRAL**

Bloomberg	ABI BB
Reuters	ABI.BR
12-month High / Low (EUR)	123.3 / 91.3
Market capitalisation (EURm)	183,983
Enterprise Value (BG estimates EURm)	259,489
Avg. 6m daily volume ('000 shares)	1,702
Free Float	47.9%
3y EPS CAGR	5.6%
Gearing (12/15)	99%
Dividend yield (12/16e)	1.87%

YE December	12/15	12/16e	12/17e	12/18e
Revenue (USDm)	43,604	43,076	56,939	59,623
EBIT (USDm)	13,768	13,842	19,510	21,327
Basic EPS (USD)	4.96	3.69	5.43	5.99
Diluted EPS (USD)	5.10	4.62	5.45	6.01
EV/Sales	6.73x	6.85x	5.90x	5.59x
EV/EBITDA	17.4x	17.5x	14.4x	13.2x
EV/EBIT	21.3x	21.3x	17.2x	15.6x
P/E	25.5x	28.1x	23.8x	21.6x
ROCE	10.1	10.3	10.2	8.5



Despite tumbling earnings forecasts (-20% over 12 months), AB InBev shares have held up very well as the acquisition of SABMiller is expected to offset the decline with 19% earnings accretion. As a result, investors should not expect an additional share price boost from the acquisition but instead should brace themselves for increased share price volatility linked to emerging market currency movements.

- AB InBev 2017 standalone earnings expectations have tumbled by 27% since the start of 2015 to USD5.0 from USD6.9 and by 20% over the past 12 months. This has come on the back of emerging market currency weakness which impacts not only the translation of profits but also operating margins as the cost prices of some goods (e.g. packaging, wheat, transport) is linked to the USD. Indeed, the Brazilian real has fallen by 23% since the start of 2015 and the Argentinean peso by 34%. The Mexican peso and the Euro limited the decline to 9%.
- The deal with SABMiller is very timely as the acquisition is expected to enhance earnings significantly, with an accretive impact we calculate at 19% by 2020 (originally it was 25% but SABMiller earnings projections have also suffered from emerging market currency weakness). We assume that AB InBev will save USD3bn by 2020 (including the remaining USD0.5bn from the existing SABMiller plan). This is 25% of the expected SABMiller revenues from the assets that AB InBev is keeping (Africa, Latin America, and Asia outside the Chinese business).
- These are realistic but punchy savings targets to justify the current share price. As such, investors should not expect a lot of cost-cutting surprises beyond these projections and the shares risk becoming more linked to emerging market exchange rates (which of course can play both ways). Indeed, over the past couple of months the stronger Brazilian real, Argentinean and Columbian peso and South African rand have started to improve the outlook and earnings projections for AB InBev and SABMiller have stabilised.

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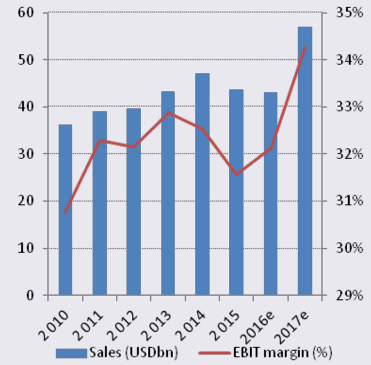
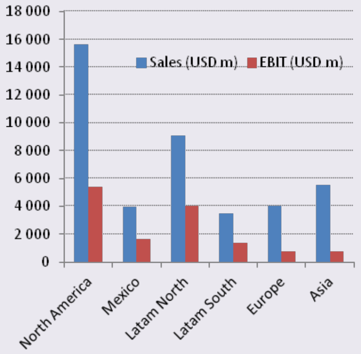




Company description

Anheuser-Busch InBev is the largest brewer in the world selling 408m hl (a 21% global market share) of beer and 50.8m hl of other beverages (soft drinks, water) in 2014. The company has a balanced portfolio with exposure to both mature markets (45% of 2014 EBIT) and developing markets (55%). Its main area of operation is North America (39% of EBIT) and Latin America (52%). AB InBev's brand portfolio comprises strong international and local brands including Budweiser, Bud Light, Stella Artois, Beck's, Skol and Brahma.

Income Statement (USDm)	**2013**	**2014**	**2015**	**2016e**	**2017e**	**2018e**
Revenues	43,195	47,063	43,604	43,076	56,939	59,623
Change (%)	*8.6%*	*9.0%*	*-7.3%*	*-1.2%*	*32.2%*	*4.7%*
Adjusted EBITDA	17,188	18,663	16,921	16,885	23,377	25,309
EBIT	14,203	15,308	13,768	13,842	19,510	21,327
Change (%)	*11.1%*	*7.8%*	*-10.1%*	*0.5%*	*40.9%*	*9.3%*
Financial results	(2,203)	(1,319)	(1,453)	(3,988)	(3,539)	(3,512)
Pre-Tax profits	12,000	13,989	12,315	9,855	15,971	17,815
Exceptionals	(170)	(197)	136	0.0	0.0	0.0
Tax	(2,016)	(2,499)	(2,592)	(2,168)	(3,514)	(4,098)
Profits from associates	294	9.0	10.0	0.0	0.0	0.0
Minority interests	(2,124)	(2,086)	(1,594)	(1,529)	(1,629)	(1,772)
Net profit	7,984	9,216	8,275	6,157	10,828	11,946
Restated net profit	7,936	8,865	8,513	7,712	10,875	11,992
Change (%)	*10.2%*	*11.7%*	*-4.0%*	*-9.4%*	*41.0%*	*10.3%*
Cash Flow Statement (USDm)						
Operating cash flows	16,585	17,873	16,277	16,885	25,877	25,309
Change in working capital	866	815	1,337	(512)	724	994
Capex, net	377	(4,172)	(4,135)	(4,038)	(5,263)	(5,331)
Financial investments, net	(10,658)	(6,888)	(4,850)	0.0	(99,800)	0.0
Dividends	(6,253)	(7,400)	(7,966)	(7,537)	(9,832)	(10,713)
Other	(4,093)	(4,876)	(6,734)	(6,156)	34,593	(7,609)
Net debt	38,887	42,245	42,392	43,750	84,873	82,223
Free Cash flow	13,662	9,557	7,740	6,179	14,285	13,363
Balance Sheet (USDm)						
Tangible fixed assets	20,889	20,263	18,952	20,385	31,620	33,407
Intangibles assets	99,265	100,681	94,738	94,300	169,562	169,124
Cash & equivalents	10,239	8,877	7,074	7,074	7,074	7,074
current assets	9,896	11,551	12,476	8,650	13,174	13,497
Other assets	1,377	1,178	1,395	1,395	2,395	2,395
Total assets	141,666	142,550	134,635	131,805	223,825	225,497
L & ST Debt	49,126	51,122	49,466	50,824	91,947	89,297
Others liabilities	42,175	41,456	43,032	37,891	45,397	45,915
Shareholders' funds	50,365	49,972	42,137	43,090	86,481	90,285
Total Liabilities	141,666	142,550	134,635	131,805	223,825	225,497
Capital employed	100,964	113,052	108,373	104,448	149,149	193,274
Financial Ratios						
Operating margin	32.88	32.53	31.58	32.13	34.27	35.77
Tax rate	11.05	18.12	20.82	22.00	22.00	23.00
Net margin	18.37	18.84	19.52	17.90	19.10	20.11
ROE (after tax)	15.76	17.74	20.20	17.90	12.58	13.28
ROCE (after tax)	12.51	11.09	10.06	10.34	10.20	8.50
Gearing	15.76	83.48	98.68	101	97.18	91.20
Pay out ratio	44.13	49.58	52.50	52.50	52.50	52.50
Number of shares, diluted	1,650	1,665	1,668	1,668	1,994	1,994
Data per Share (USD)						
EPS	8.72	5.54	4.96	3.69	5.43	5.99
Restated EPS	4.81	5.32	5.10	4.62	5.45	6.01
% change	*8.7%*	*10.7%*	*-4.1%*	*-9.4%*	*18.0%*	*10.3%*
BVPS	31.32	31.08	26.20	26.80	44.72	46.68
Operating cash flows	10.05	10.73	9.76	10.12	12.98	12.69
FCF	8.45	5.64	4.63	4.01	6.80	6.20
Net dividend	2.12	2.64	2.68	2.43	2.86	3.16

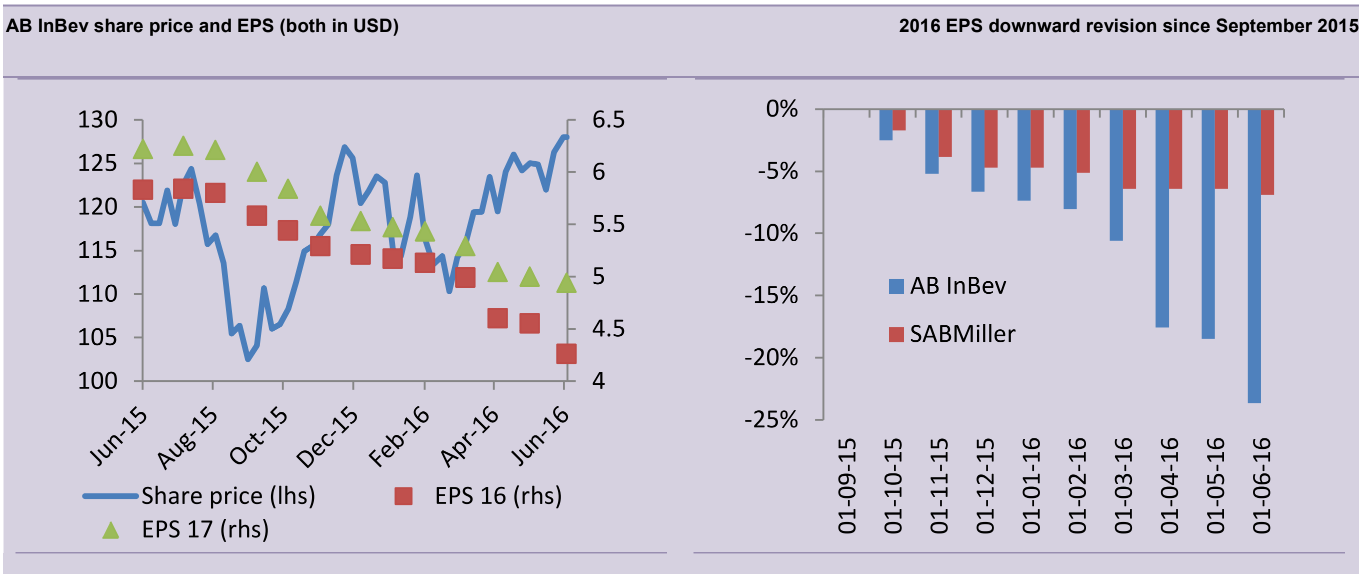
Source: Company Data; Bryan, Garnier & Co ests.

1. Tumbling AB InBev earnings

Share price no longer connected to falling earnings forecasts

In general share prices are a good reflection of the underlying earnings outlook of a company. But this relationship does not seem to hold up at AB InBev, at least not at first sight. Over the past year, AB InBev's 2016 and 2017 earnings per share forecasts (on a standalone basis) have tumbled by 20% whereas its share has been roughly flat over the same period. Indeed, the stock fell by 15% over the June-September 2015 period, but after the group approached SABMiller (mid-September) the stock rebounded in October and November where it has stayed ever since – although earnings forecasts have fallen by 13% since the start of December.

Fig. 1: AB InBev and SABMiller earnings revision



Source: Vuma, Bloomberg, Bryan, Garnier & Co

The downward revision for both companies has mainly been due to emerging markets currency weakness against the USD (both companies account in USD). The greater diversification at SABMiller probably lowered the impact compared to AB InBev which derives about 30%, 12% and 10% of EBIT respectively from Brazil, Mexico and Argentina.

2. SABMiller could enhance earnings by around 20%

Paying a 46% premium was well worth it

In September 2015 however, AB InBev approached SABMiller to acquire its business, which despite offering a 46% premium (GBp4,400 compared to a share price on 15 September 2015 of 3,016p) was widely regarded as accreditive for AB InBev shareholders (the shares did rebound during the last quarter of 2015). Now the dust has settled and we have a clearer idea of which assets AB InBev is going to keep, we calculate the earnings enhancement for AB InBev shareholders at around 20% by 2020.

2.1. Acquiring SABMiller assets for USD99bn

AB InBev has pledged to sell assets worth well over USD20bn

The price that AB InBev is paying for the assets it wants (is allowed) to keep has not changed that much over the past six months. Some divestments were agreed at cheaper prices, some at more expensive prices. Expected selling prices for both the MillerCoors (US) and the CRB assets (China) were not high as there was only one natural buyer. Nevertheless, at 2016 EV/EBIT of 14.8x, the USD12bn price-tag for the 58% stake in MillerCoors came in a touch below expectations, especially since the buyer Molson Coors (who already owned the other 42%) is set to gain more than USD250m in cash tax benefits over the first 15 years. Furthermore, AB InBev agreed to sell the 49% stake in the Chinese CR Snow for USD1.6bn (2016 EV/EBIT of 10.1x), which was well below the USD4.4bn valuation that the quoted CR Beer (which held the 51%) was trading on (EV/EBITA of 23.6x). On the other hand, the USD2.5bn (EV/EBIT of 20x) that Asahi was willing to pay for Grolsch, Peroni and Meantime was probably at the higher end. For the remaining European business which has been put up for sale, we assume a selling price of 15x EBIT or USD5.5bn (although last weekend's Sunday Times speculated that Asahi might be willing to pay USD7.3bn). After these divestments, AB InBev is keeping the Latin American, African and Asian (ex. China) assets for about USD99bn and there could be some additional divestments such as the 57% in Coca Cola Beverages Africa, the 24% in Anadolu Efes or the 27% in Distell.

Furthermore, AB InBev has locked in the GBP44 that it is offering per SABMiller share at a rate of 1.5295 to the USD (this agreement was made in December when the rate was very similar to the 1.5222 GBP/USD exchange rate of 11th November when the bid was made). As a consequence, the company was not able to benefit from the weakening in the GBP relative to the USD during Q1.

Fig. 2: SABMiller's acquisition price

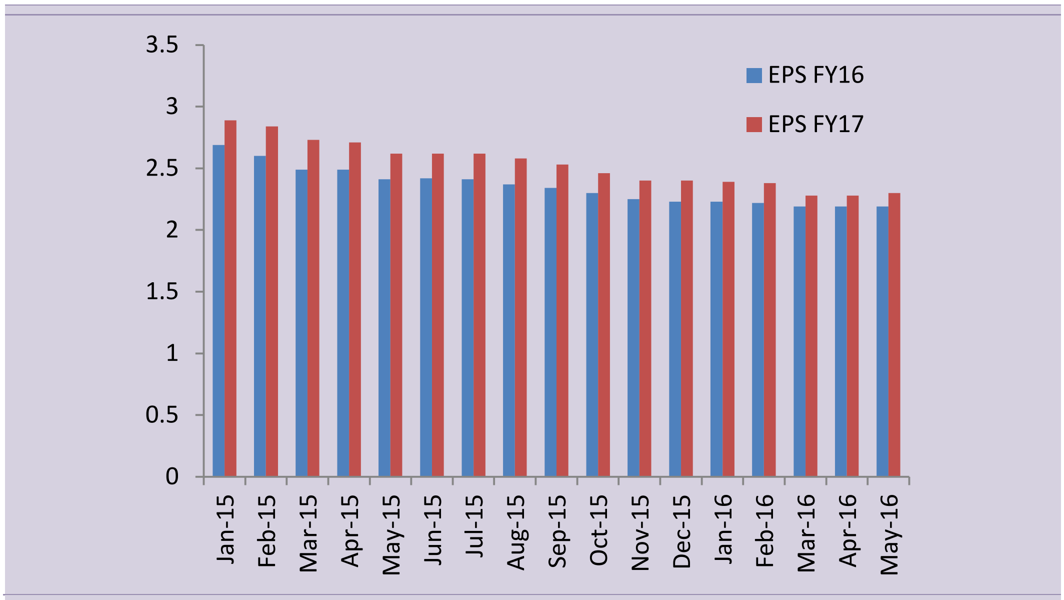
	USD m
Acquisition price shares	110,204
Debt at SABMiller (March 2016)	10,496
58% in MillerCoors	-12000
49% in SR Snow	-1,600
Grolsch Peroni	-2,500
European assets	-5,500
Acquisition price	99,100
of which cash	57,464
of which shares	41,636

Source: AB InBev; Bryan, Garnier & Co ests.

2.2. SABMiller's earnings outlook still stable

However, SABMiller earnings forecasts and prospects have been remarkably stable since AB InBev approached the group in September, helped by price increases making up for currency weaknesses (having 80%+ market share helps) and cost savings programmes delivering ahead of guidance and expectations (USD221m in FY15 and USD326m in FY16, achieving already over half of the USD1050m 2020 target).

Fig. 3: Earnings forecasts SABMiller (in USD)



Source: SABMiller; Bryan, Garnier & Co ests.

2.3. How much does the SABMiller business contribute to AB InBev earnings?

In terms of efficiency improvements, SABMIller has its own Cost & Efficiency programme, which was originally targeting USD500m in savings by FY18, but was upped to USD1.050bn in savings by FY20. In addition, AB InBev has indicated that it hopes to save an additional USD1.4bn by the end of the fourth year after the acquisition, which assuming that the acquisition takes place in 2016 (as per the original plan), would look to improve efficiency by the end of 2020. These two programmes together would mean that there is still a total of USD1.9bn in cost savings to be expected, which equates to 16% of acquired (and kept) net revenues. In our modelling we take a more aggressive approach and bank on USD3bn in savings, representing 25% of acquired revenues in line with what AB InBev managed to deliver with the Modelo acquisition (which is about USD2.5bn on top of the remaining programme from SABMiller).

Enhancing earnings per share by 19% assuming USD3bn cost savings (25% of acquired revenue)

With these assumptions in terms of cost savings, we believe that the acquisition adds 9% to earnings per share in the first year of consolidation (assumed to be 2017) and 19% after four years (by 2020). So indeed, although the consensus has revised AB InBev's earnings downwards by about 20% for 2016 and 2017, the prospect of the SABMiller acquisition enhancing earnings by 19% explains why the share price has remained stable over the past year.

Fig. 4: Earnings boost from the SABMiller acquisition

	2017	2018	2019	2020
Acquired EBIT	3962	4274	4596	4996
Cost savings cumulative	1500	2200	2900	3000
EBIT contribution SABMiller	5462	6474	7496	7996
Cost of debt 3.75%	-2155	-2155	-2155	-2155
Pretax	3307	4319	5341	5841
Tax 25%	-827	-1080	-1335	-1460
Net profit	2480	3239	4006	4381
Net profit per 1934m shares	1.28	1.67	2.07	2.27
Dilutive impact of new shares	-0.85	-0.95	-1.05	-1.15
EPS consensus pre	5.02	5.29	5.57	5.86
EPS consensus post	5.45	6.01	6.59	6.97
Uplift	9%	14%	18%	19%

Source: Company Data; Bryan, Garnier & Co ests.

3. Valuation

AB InBev is the more expensive brewer

As a result, we do not believe that the shares are a Sell and remain at Hold. However, at 18.7x 2020 earnings (that is after all the synergies are incorporated), the stock is significantly more expensive than Heineken shares which, according to our forecasts, trade on 14.4x 2020 earnings. Furthermore, with a current year net debt/EBITDA multiple of 2.2x, Heineken has significantly more opportunities to acquire or buy back shares than AB InBev (that will have a net debt/EBITDA multiple of over 4x when concluding the SABMiller transaction). On the other hand, AB InBev has steep ambitions to generate USD100bn in sales by 2020 through a combination of internal and external growth. This would mean that the company needs to add 50% to its 2020 USD65bn net revenues that we believe the combination with SABMiller will generate.

Fig. 5: PE valuation for brewers

	local ccy	Share price	P/E				
			2016	2017	2018	2019	2020
AB InBev	EUR	114.3	28.2	23.9	21.7	19.8	18.7
Carlsberg	DKK	642.5	20.9	19.5	17.9	16.1	14.5
Heineken	EUR	83.9	20.8	18.9	17.3	15.8	14.5
Molson Coors	USD	102.9	27.9	20.8	19.4	18.0	16.8
SABMiller	GBp	4,317.0	29.5	26.8	24.6	22.5	20.6
Royal Unibrew	DKK	305.3	21.0	19.8	18.5	17.2	16.0

Source: Company Data; Bryan, Garnier & Co ests.

Fig. 6: Multiples valuation for brewers

	local ccy	Share price	Market Cap (EURbn)	P/E		EV/EBIT		EV/EBITDA not adj.		FCF yield		Net debt/ EBITDA	Net yield
				2016	2017	2016	2017	2016	2017	2016	2017	2016	2016
AB InBev	EUR	114.3	170.5	28.2	23.9	21.4	19.5	17.6	16.3	3.1%	5.2%	2.8	2%
Carlsberg	DKK	642.5	11.4	20.9	19.5	18.9	16.6	11.5	10.6	2.9%	5.8%	2.4	1%
Heineken	EUR	83.9	40.7	20.8	18.9	17.0	15.3	12.8	11.5	4.1%	5.0%	2.2	1%
Molson Coors	USD	102.9	16.8	27.9	20.8	39.6	16.9	22.6	12.6	3.7%	5.6%	3.2	2%
SABMiller	GBp	4,317.0	86.4	29.5	26.8	25.5	23.0	19.7	18.0	3.1%	3.9%	1.9	2%
Royal Unibrew	DKK	305.3	2.2	21.0	19.8	17.1	16.2	13.0	12.4	5.8%	5.5%	0.9	2%

Source: Company Data; Bryan, Garnier & Co ests.

DCF based Fair Value of USD109

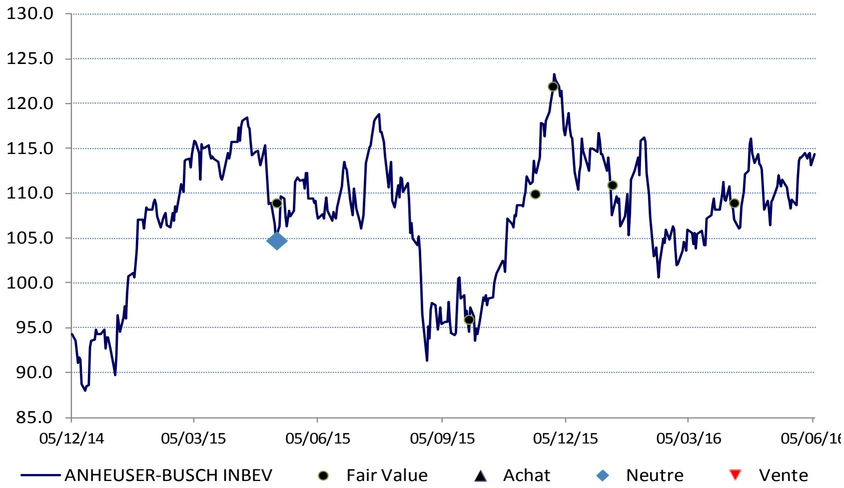
Using a risk free rate of 1.6% and a risk premium of 7%, we derive a Fair Value for AB InBev of EUR109 per share assuming a long-term growth rate of 3.7%

Fig. 7: DCF Valuation

DCF Valuation	DEC 2016e	2017e	2018e	2019e	2020e	2021e	2022e	2023e	2024e
Sales	43,076	56,939	59,623	62,254	65,037	67,982	71,043	73,944	76,861
EBIT	13,842	19,510	21,327	23,109	24,413	25,810	27,242	28,558	29,830
Tax rate	22.0%	22.0%	23.0%	24.0%	24.0%	24.0%	24.0%	24.0%	24.0%
Taxes	(3,045)	(4,292)	(4,905)	(5,546)	(5,859)	(6,194)	(6,538)	(6,854)	(7,159)
Operating profit after taxes	10,797	15,218	16,422	17,563	18,554	19,615	20,704	21,704	22,671
+ Depreciations	3,043	3,867	3,982	4,102	4,225	4,353	4,485	4,605	
-Investments in fixed assets	(4,038)	(5,263)	(5,331)	(5,475)	(5,625)	(5,782)	(5,936)	(6,074)	
Total net investments in fixed assets	(995)	(1,397)	(1,349)	(1,373)	(1,400)	(1,429)	(1,451)	(1,470)	0
-Investments in working capital	(512)	724	724	724	724	724	724	724	724
=Operating cash flow	9,289	14,546	15,797	16,915	17,879	18,911	19,977	20,959	23,396
Discount factor	0.97	0.90	0.84	0.77	0.70	0.63	0.58	0.52	0.48
Present value of free cash flow	8,976	13,123	13,307	12,953	12,447	11,968	11,494	10,962	11,125
Cumulative present value of free cash flow	106,357								
+Present value of terminal value	261,594								
=Enterprise value	367,951								
Adjusted net debt incl pension provisions (restated cash)	(87,598)								
Revalued minority interests	(32,520)								
(Assoc. + revalued investments)	110								
=Fair value	247,943								
Fair value fully diluted per share	124								
Fair value fully diluted per share (EUR)	109								

Price Chart and Rating History

AB InBev



Ratings		
Date	**Ratings**	**Price**
05/05/15	NEUTRAL	EUR108.8

Target Price	
Date	**Target price**
07/04/16	EUR109
08/01/16	EUR111
25/11/15	EUR122
12/11/15	EUR110
24/09/15	EUR96
05/05/15	EUR109

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Bryan Garnier stock rating system

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Stock rating

BUY	Positive opinion for a stock where we expect a favourable performance in absolute terms over a period of 6 months from the publication of a recommendation. This opinion is based not only on the FV (the potential upside based on valuation), but also takes into account a number of elements that could include a SWOT analysis, momentum, technical aspects or the sector backdrop. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.
NEUTRAL	Opinion recommending not to trade in a stock short-term, neither as a BUYER or a SELLER, due to a specific set of factors. This view is intended to be temporary. It may reflect different situations, but in particular those where a fair value shows no significant potential or where an upcoming binary event constitutes a high-risk that is difficult to quantify. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.
SELL	Negative opinion for a stock where we expect an unfavourable performance in absolute terms over a period of 6 months from the publication of a recommendation. This opinion is based not only on the FV (the potential downside based on valuation), but also takes into account a number of elements that could include a SWOT analysis, momentum, technical aspects or the sector backdrop. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.

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BUY ratings 56.2% NEUTRAL ratings 34% SELL ratings 9.7%

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15	Other disclosures	Other specific disclosures: Report sent to Issuer to verify factual accuracy (with the recommendation/rating, price target/spread and summary of conclusions removed).	No

Summary of Investment Research Conflict Management Policy is available www.bryangarnier.com

Please see the section headed "Important information" on the back page of this report.

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