31st October 2016

Food & Beverages

AB InBev

Price EUR107.25

Lowering numbers post Q3

Fair Value EUR120 (+12%) **BUY**

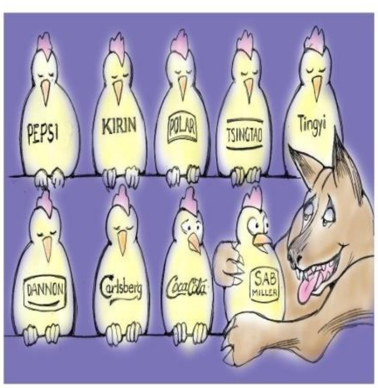
Bloomberg	ABI BB
Reuters	ABI.BR
12-month High / Low (EUR)	123.3 / 100.6
Market Cap (EURm)	181,600
Ev (BG Estimates) (EURm)	264,683
Avg. 6m daily volume (000)	1 466
3y EPS CAGR	4.9%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-9.7%	-2.7%	-4.8%	-6.3%
Food & Bev.	-5.5%	-4.7%	-1.9%	-4.7%
DJ Stoxx 600	-0.5%	0.4%	-2.3%	-6.8%

YEnd Dec. (USDm)	2015	2016e	2017e	2018e
Sales	43,604	42,637	57,957	60,632
% change		*-2.2%*	*35.9%*	*4.6%*
EBITDA	16,921	15,872	23,068	24,921
EBIT	13,768	12,793	19,113	20,842
% change		*-7.1%*	*49.4%*	*9.0%*
Net income	8,513	7,076	10,656	11,762
% change		*-16.9%*	*50.6%*	*10.4%*

	2015	2016e	2017e	2018e
Operating margin	31.6	30.0	33.0	34.4
Net margin	19.5	16.6	18.4	19.4
ROE	20.2	16.9	12.5	13.2
ROCE	10.1	9.6	10.0	8.3
Gearing	98.7	107.7	100.6	93.6

(USD)	2015	2016e	2017e	2018e
EPS	5.10	4.24	5.34	5.90
% change	*-*	*-16.9%*	*26.0%*	*10.4%*
P/E	23.0x	27.6x	21.9x	19.9x
FCF yield (%)	3.9%	3.0%	5.7%	5.1%
Dividends (USD)	2.68	2.68	2.81	3.10
Div yield (%)	2.3%	2.3%	2.4%	2.6%
EV/Sales	6.5x	6.8x	5.7x	5.4x
EV/EBITDA	16.7x	18.2x	14.3x	13.1x
EV/EBIT	20.6x	22.6x	17.3x	15.7x



Following on from last week Friday's Q3 results and changed outlook, we are lowering our EPS expectations for 2016 by 6% to USD4.4 from USD4.52 and for 2017 by 4% to USD5.34 from 5.58. This results in a fair value for the shares of EUR120 (which we lowered yesterday by 3% from EUR124). The lower earnings are driven by our expectation of 6% lower operating profit in 2016 and 4% in 2017. For 2016 we are now expecting a 17% lower EPS than in 2015, but with the inclusion of SABMiller and the start of the synergy extraction, EPS in 2017 should be 26% higher.

Overall revenues for Q3 came in at USD11.11bn which missed consensus of USD11.43bn (3% miss) and EBITDA came in at USD4.03bn vs consensus of USD4.43bn (9% miss). Organic volume decline of 0.9% was slightly better than the expected decline of 1.5%, but organic revenue growth of 2.8% fell short of the consensus of a 3.3% rise. The only comforting point for investors in the release is that the company expects some growth in the dividend for 2016 countering recent speculation that it might cut its dividend

ANALYSIS

- Especially in Brazil, price/mix was poor increasing by only 3.1% (in an inflation environment of 7% ytd). This not only prompted the company to lower its Brazilian revenue expectation for the full year from flat to declining revenue for the full year (which has a knock on to margin expectations). For the group as a whole, the company is now expecting net revenue per hl growth in line with inflation vs prior to grow organically ahead of inflation.
- In terms of cost structure, AB InBev is increasing sales and marketing investments by 15% ytd (and 12.6% in Q3), which does not seem to translate in volume or significant mix price/mix growth (expectation is pricing in line with inflation), which leaves us wondering if this area has been cut to deep in the past and the company need to pull out all registers to keep some kind of topline growth (organic +3.3% after 9 months). Areas where there has been significant increases is Mexico (+25.4%), North America (+15.5%), Latin America South (Brazil) + 12%, Latin America South (Argentina) +28.6%, but even in Europe (+8.2%), sales and marketing costs are ahead of topline (+4%).
- In the bigger regions for AB InBev, the company has been performing poorly. In the smaller reporting regions of Asia Pacific, Europe and Mexico, business is better. In Asia Pacific we are expecting for the year USD120m more operating profit as a combination of 4% organic revenue growth with lower cost of goods drive gross profit. But even in Mexico there is some margin pressure with sales and marketing expenses rising 25% ytd, which is well compensated by faster organic top line growth of +12.4%. Nevertheless with the Mexican peso down on last year, we still expect from Mexico about USD100m lower operating profit than last year. In Europe, top line growth is faster than we previous anticipated (+4% ytd), helped by increased spending on sales and marketing (+8%), but the net result with the devaluation of the EUR against the USD is about USD40m lower operating profit.
- The region with the sharpest downward revision is Latin America North (Brazil) where a 3% price mix is well below the ytd inflation of 7% (and those pricing efforts do not seem enough for the company to lose market share with volumes down 5.1% in a market down 3%). On top of that Q4 comps are very tough with last year a net revenue per hl growing at 10.7%. With the Brazilean real down by about 7% on last year, we are expecting this year USD700m lower operating profit. In Latin America South (Argentina), we are expecting about USD120m lower operating profit mainly because of the 30% decline in the value of the Argentinean peso. In North America, we expect a USD60m uptick in profit compared to 2015, but the absolute number of USD5,478m operating profit is still down on the 2010 number of USD5,546m.
- Food for thought: Without SABMiller, AB InBev's 2016e operating profits (USD12.8bn) would have been only at par of the one in 2011 (USD12.6bn) despite all the cost cutting and the Modelo acquisition. However, the value that investors put on that profit is about 80% more (EV standalone of USD280m v USD150m in 2011). Of course, interest rates have come down…

VALUATION

- Our DCF based fair valuation of AB InBev is based on a risk free rate of 1.6% and equity risk premium of 7%.

NEXT CATALYSTS

- 28 October 15.00 CET: Q3 call
- End of February: full year results

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