UConn Student Managed Fund

Long Analyst Report 2016-2017

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University of Connecticut – Undergraduate Student Managed Fund

Consumer Staples Sector

Anheuser-Busch InBev SA/NV

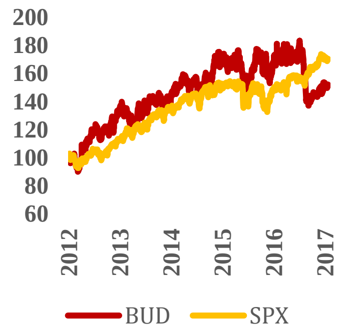
Date: 04/18/2017 **Current Price: $110.40 (04/18/2017)** **Recommendation: BUY**
Ticker – NYSE: BUD **Target Price: $133.28 (20.70% upside)**

Figure 1 – *Beer Brands*

Brand	Claim to Fame
Budweiser	"King of Beers"
Corona	Most popular beer in Mexico
Stella Artois	World's #1 Belgian Beer
Beck's	World's #1 German Beer
Bud Light	Best selling beer in the US
Skol	Most popular beer in Brazil
Hoegaarden	Served in over 70 countries

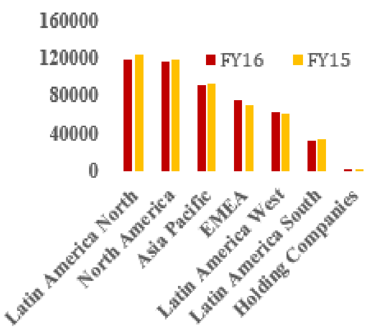
Source: AB InBev

Figure 2 – *5 Yr Performance vs. S&P 500*



Source: Bloomberg

Figure 3 – *Volumes (000 hls) by region*



Source: AB InBev

Business Description

Anheuser-Busch InBev (AB InBev) is a multinational beverage and brewing company based in Leuven, Belgium. It is a publicly traded company on EuroNext (ABI), and with American Depositary Receipts in the New York Stock Exchange (BUD). AB InBev is a product of multiple acquisitions and mergers, with history dating back to 1366. Each merger and acquisition has added value and contributed to the growth and success of AB InBev. The latest acquisition was of multinational brewing and beverage company SABMiller. In October 2015, Anheuser-Busch announced a successful all cash bid of $107B to buy SABMiller, and the acquisition was completed on October 10th, 2016. Revenues are expected to grow by 20% in 2017, and the acquisition is expected to deliver cost synergies of up to $2.8B over the next three to four years.

AB InBev produces, markets, distributes and sells over 500 beer and malt beverage brands as well as soft drinks. These brands include Budweiser (the world's #1 most valuable beer brand), Corona, Stella Artois, Beck's Leffe, Hoegaarden, Castle Lager, Castle Lite, and Redd's. AB InBev's beverage brands are sold in more than 150 countries around the world. AB InBev is the world's largest brewer by volume and one of the world's top five consumer products companies by revenue.

AB InBev follows a Focus Brands strategy in which the majority of their resources are devoted to the brands which they believe have the greatest long-term growth potential. This strategy has led to a brand portfolio with eighteen "billion dollar brands" by revenue, as well as seven of the 10 most valuable beer brands in the world. AB InBev has a disciplined approach to cost management and efficiency, with a focus on reducing expenses and increasing their industry leading margins. AB InBev supports their business strategies with their Dream-People-Culture platform, which is driven by a passion for attracting, developing, and retaining the best people and creating a culture based on ownership, meritocracy, and informality.

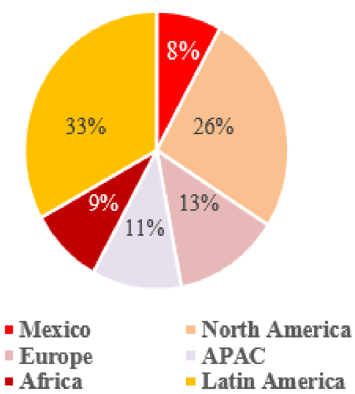
Industry Trends and Positioning

North America & Latin America

Trends

Overall growth of beer sales in the US was flat at 0.0% in 2016. However, craft beer sales jumped 6.2%, and now represents 12.3% of the American market. In

Figure 4 – *Revenue per Region (Post-Merger)*



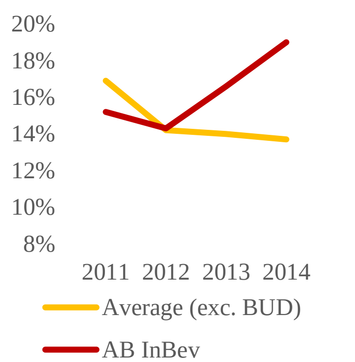
Source: AB InBev

Latin America, the Mexican and Brazilian markets are the two biggest in terms of overall size and revenue contribution for AB InBev. Mexico saw strong growth in 2016, driven by a healthy economy; currency and political concerns however are paramount for the country. Brazil is the world's third biggest beer producer, behind China and the United States. An ongoing economic downturn in Brazil is worth monitoring.

Positioning

Post-merger, AB InBev is the leading beermaker in the Americas. The Americas account for roughly 65% of global sales, and in their local markets, AB InBev typically holds market shares in excess of 40%. AB InBev holds a 68% market share in Brazil, and their oligopolistic pricing power should secure profitability for the near future despite Brazil's slowing economy; the firm continues to invest heavily in Brazil. Mexico produces the highest EBITDA margin of any region for AB InBev, yet the country has yet to fully embrace premium beers. That being said, Mexico had the highest 2016 organic volume growth of any region at 7.2%

Figure 5 – *EBITDA Margins in Asia*



Source: AB InBev

Asia

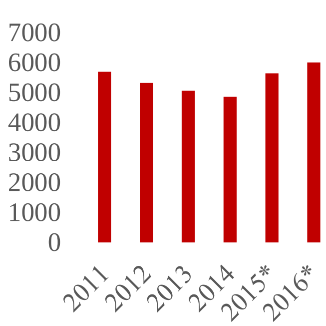
Trends

Asia Pacific (APAC) is the largest region in the beer industry, and is projected to be responsible for over 50% of the growth of the global industry between 2014 and 2025. APAC will also account for 46% of the world population growth over the same time period. Asia is still largely fragmented behind China Resources Beer, the market leader. Regional breweries hold over one-third of market share in the country.

Positioning

With the addition of SABMiller, AB InBev has become the second largest beer producer in Asia, behind China Resources Beer. AB InBev's goal is to be the leader in premium segments across Asia Pacific. The growth of the urban middle and affluent class will drive growth in the Super Premium and Premium segments. As seen in Figure 3, AB InBev's EBITDA margin is well above the rest of the industry, and will continue to grow as their premium presence builds.

Figure 6 – *Europe & EMEA Revenues*



Source: Bloomberg
*represents EMEA

Europe

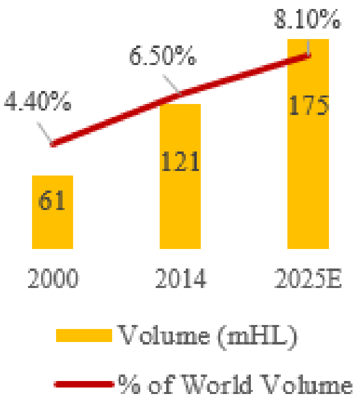
Trends

Significant price competition has hurt margins for years across Europe. Profits have been declining, but the rising popularities of premium and craft beers represent growth opportunities. Europe is the world's second largest beer producer, but is only growing at a CAGR of 1.98% because of growing demand for specialty beers and near-beer alternatives.

Positioning

Both AB InBev and SABMiller have recently reduced their European exposure by selling a group of eastern and western European brands to Asahi Group for over $10 billion. Revenues have slowed down in recent years from changing consumer preferences (Figure 6).

Figure 7 - *Africa Beer Volume*



Source: AB InBev

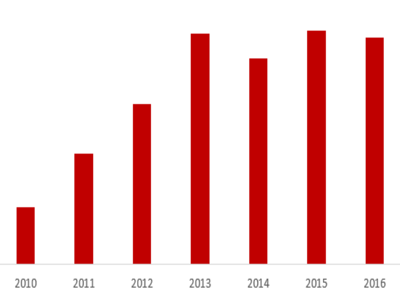
Figure 8 - *World's Most*

Brand	Company	Value
Budweiser	AB InBev	$13.8B
Bud Light	AB InBev	$12.9B
Heineken	Heineken	$9.7B
Stella Artois	AB InBev	$8.7B
Skol	AB InBev	$8.5B

Valuable Beer Brands

Source: 2015 BrandZ Beer Report

Figure 9 – *Dividend Growth*



Source: AB InBev

Africa

Trends

Africa as a continent holds strong growth potential for the beverage industry. Drivers behind Africa's appeal include increasing GDP, a growing middle class, and rise in urbanization. The UN reports that Africa will account for one-fifth of the world's population by 2025; perhaps more importantly, three-fifths of Africa's population is under the age of 25.

All of these demographic and socioeconomic factors in Africa paint a very promising picture. From a consumption standpoint, Africa is expected to represent 8.1% of the global beer industry by 2025, as seen in Figure 7. The growth rate of beer consumption in Africa is also expected to be 3x the growth rate of consumption globally over the next decade.

Positioning

Prior to the acquisition of SABMiller, AB InBev did not operate in Africa. Following the merger, 9% of the combined companies' revenues will come from Africa. SABMiller operates following a local brewing philosophy, which should resonate with African consumers as they can more easily produce beers that meet consumer tastes. Growth in Africa could help offset any stagnation of growth in more developed markets.

Investment Thesis

Strong market position in key markets can deliver improving volume growth

AB InBev has used their brand recognition to remain the number one company in three of the five largest beer markets in the world, including some of the fastest growing regions in Latin America and Africa. Additionally, AB InBev product portfolio boasts four of the five most valuable beer brands in the world (Figure 8). In addition to growing their global brands such as Budweiser, Corona, and Stella Artois, Ab InBev has focused on specialized product offerings both in the premium beer and near beer segments to continue to grow in these markets. This includes a focus on smaller craft brands in the United States, developing new near beer offerings in Brazil, introducing established United States based premium beers to Latin American markets, and a very strong premium position in Asia.

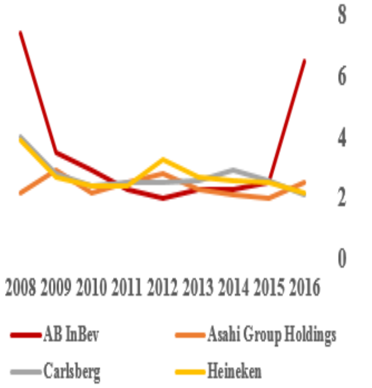
Strategic merger with SABMiller

The acquisition of SABMiller gives AB InBev an increased global presence and adds to their already impressive portfolio of beer brands. The also anticipate $2.8 billion in synergies, largely stemming from a 3% reduction in global workforce due to duplicate responsibilities. Additionally, SABMiller's local focus will allow AB InBev to penetrate emerging markets more efficiently.

High dividend

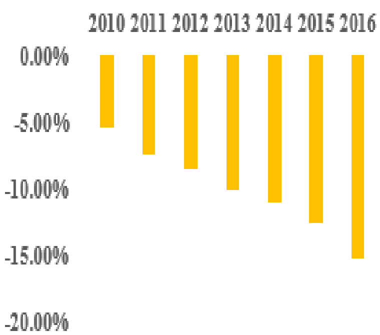
Ab InBev has consistently offered a high dividend, and their commitment to shareholder wealth can be seen when looking at their dividend history. Their policy is to declare a dividend representing at least 25% of the consolidated profit attributable to equity holders. Dividend growth, seen in Figure 9, has been steady.

Figure 10 - *Net Debt to EBITDA*



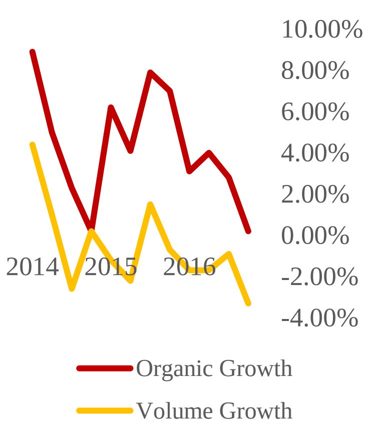
Source: Bloomberg

Figure 11 – *Core Working Capital as % of Revenues*



Source: AB InBev

Figure 12 – *Organic and Inorganic Growth*



Source: Bloomberg

Expansion into key emerging markets

AB InBev is well positioned for success in emerging markets, specifically Africa and China. Their recently released both Stella Artois and Corona into South Africa, and they plan on launching Budweiser in 2017. Introduction of their global brands, in combination with their regional product strategy, will allow them to capitalize on the one of the largest and fastest growing markets in the world while keeping margins high. In China, they continue to grow their core brands using brand experience opportunities such as music platforms and nightlife activities, and they are introducing new near beer options to increase in-home penetration.

Financials

Leverage

Following the SABMiller merger, AB InBev's leverage ratio spiked from 2.5x to 6.5x. The company has shown a strong ability to deleverage in the past, which could be pivotal for future growth as further acquisitions in local markets may be necessary. AB InBev is known for massive cost savings projects, and their current target of $2.8 billion of savings, representing about 9% of costs, is likely to be achieved over the next three years.

Improvements in Working Capital

AB InBev's negative working capital as a percentage of revenue indicates their ability to raise capital; they are basically borrowing from their vendors as they grow, financing it with strong free cash flow. AB InBev is becoming more efficient at funding their working capital cycle. AB InBev's reliance on external financing, when paired with their favorable debt maturity profile, demonstrates that the company has sufficient funds to cover both short term needs and long-term maturities.

Organic Growth vs. Volume Growth

For the firm as a whole, both organic growth and volume have been volatile over the past several years, and have been declining since the middle of 2015. This indicates opportunity, however, when looked at through the lens of our investment thesis. If AB InBev is able to stabilize volume growth (down 2% in 2016 as shown in Figure 12), their pricing prowess (up 4.4% in 2016) and cost saving initiatives will deliver significant bottom line improvements.

Valuation

Our valuation is based on a discounted cash flow model and multiples analysis. The final target price of $133.28 and margin of safely of 20.72% are based on a weighted average of the prices calculated from these models, with 50% of the weight on the DCF, 37.5% on the EV/EBITDA comparison, and 12.5% of the value on the P/E comparison.

Figure 13 – *Weighted Valuation*

Aggregate Valuation		
Valuation Type	**Value**	**Weight**
P/E Multiple	$ 105.49	12.50%
EV/EBITDA Multiple	$ 138.63	37.50%
DCF	$ 136.21	50.00%
Total	**$ 133.28**	**100.00%**
Margin of Safety		20.72%

Source: Own Data

Figure 14 – *DCF Projections*

Terminal Value	$	182,930,121
Sum of Present Value of FCF	$	121,488,900
Total Enterprise Value	$	304,419,021
Less: Net Debt & Pensions	$	54,989,000
Plus: Cash	$	13,459,000
Total Equity Value	**$**	**262,889,021**
Shares Outstanding		1,930,000
Per Share Value	**$**	**136.21**
Current Value	$	110.40
Margin of Safety		23.38%

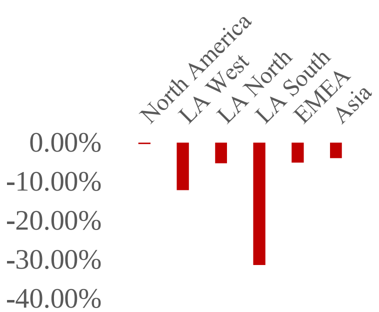
Source: Own Data

Figure 15 – *Peer Comparison Valuation*

P/E Multiple	
Industry Average P/E	23.235
BUD EPS (Expected)	$ 4.54
Share Price	**$ 105.49**
Weight	25%
EV/EBITDA Multiple	
Inudstry Average	14.5925
BUD EBITDA/Share	$ 9.50
Share Price	**$ 138.63**
Weight	75%
Comps Value	**$ 130.34**

Source: Own Data

Figure 16 – *FX Sales Growth Impact by Region*



Discounted Cash Flow

The discounted cash flow model gave us a final valuation of $136.21 per share (Figure 14). Our assumptions include a 20% revenue growth from 2016 to 2017 to take into account the projected effects of the SABMiller acquisition, followed by short term revenue growth trailing off to a 2% long term growth rate. Gross margin is expected to increase slightly in the short-term as AB InBev implements their efficiency programs and recognizes synergies from the acquisition. Our 7.75% WACC is based on their current WACC, with a slight adjustment upwards for the expected rising interest rate environment. The full DCF model can be found in the Appendices.

Market Based Models

Our market based models account for the remaining 50% of our target price. The EV/EBITDA peer comparison is 37.5% and the P/E peer comparison is 12.5%. In our P/E model, we used forward P/E instead of current P/E because earnings were low due to the acquisition. This uncertainty led to us assigning more weight to the EV/EBITDA comparison. The EV/EBITDA gave us a target price of $138.63 per share, and the P/E gave us a price of $105.49 per share. The complete multiples analysis can be found in the Appendices.

Risks to Investment Thesis

Currency Risk

The global nature of AB InBev's revenue streams means that currency fluctuations can impact profitability. Foreign exchange rates reduced EBITDA by 7% in 2016, and there is a risk that exchange rates will continue to negatively affect profitability. Per region, Latin America South had the biggest negative impact on sales growth in 2016 (Figure 16). Conversely, there is also a chance that foreign exchange rates lead to higher profitability for AB InBev.

Consumers in Emerging Markets

Consumers in emerging markets may not be able to afford the premium beers offered by AB InBev. While the company is targeting emerging economies, these economies may experiences setbacks in their growth that hinder consumers' ability to purchase premium beer (Stella Artois, Corona). One economy that is a particularly high risk is Brazil, as their growth has been especially volatile.

Declining Demand

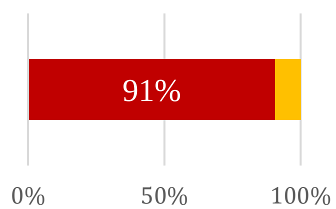
Demographic changes, tighter regulatory and tax requirements, a global economic slowdown, and shifts in consumer preferences have contributed to stagnating production volumes in recent years. Production volumes in the US have stayed flat from 2007 to 2014, and have dropped by roughly 10% in Germany, France, and the UK over the same period, according to McKinsey. AB InBev's growing presence in emerging markets will offset this trend in the short run, and their pricing power in developed markets will contribute to healthy margins and strong revenues if volume levels pick up.

Source: Bloomberg

Figure 17 – *US Market Share for Craft Breweries*

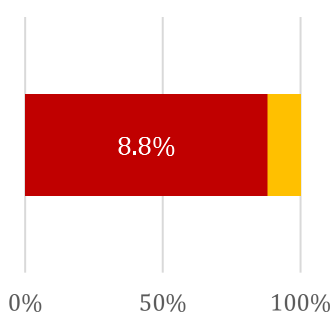
Source: Brewers Association

Figure 18 – *Percentage of Goal Met to Reduce Packaging Materials by 100k tons by 2017*



Source: AB InBev

Figure 19 - *Percentage of Goal Met to Reduce Global Energy Usage by 10% by 2017*



Source: AB InBev

Beer Alternatives

Additionally, major beer manufacturers have seen rising threats from more health-oriented drinks and from craft beers in North America and Europe. Small craft breweries now account for 12.2% of beer volume in the US, and 21% of the retail dollar value of the beer market. Though Germany and the UK have been slow to embrace craft beers, Italy saw an 8x increase of craft beers on retail shelfs from 2007 to 2012, Czech Republic saw a 5x increase, and Spain saw a 4x increase. AB InBev brands still dominate these markets, and the firm constantly innovates their product line to match consumer trends (i.e. Michelob Ultra for health-conscious drinkers). They have also been looking to introduce craft beer options both organically and inorganically.

Corporate Social Responsibility

AB InBev is engaged in a Better World platform, which aligns their environmental, social and community efforts around three core principles; A Growing World, A Cleaner World, A Healthier World.

A Growing World

Through the A Growing World program, AB InBev hopes to give everyone a chance to improve their livelihood by driving agricultural productivity and enabling small retailers to grow and thrive. Achievements in 2016 include helping over 20,000 shopkeepers develop skills to improve their business sustainability via the 4e small retail program, cultivating the highest quality barley with the best yields and lowest costs through the SmartBarley program, and brewing in Africa using local crops in order to make beer more affordable.

A Cleaner World

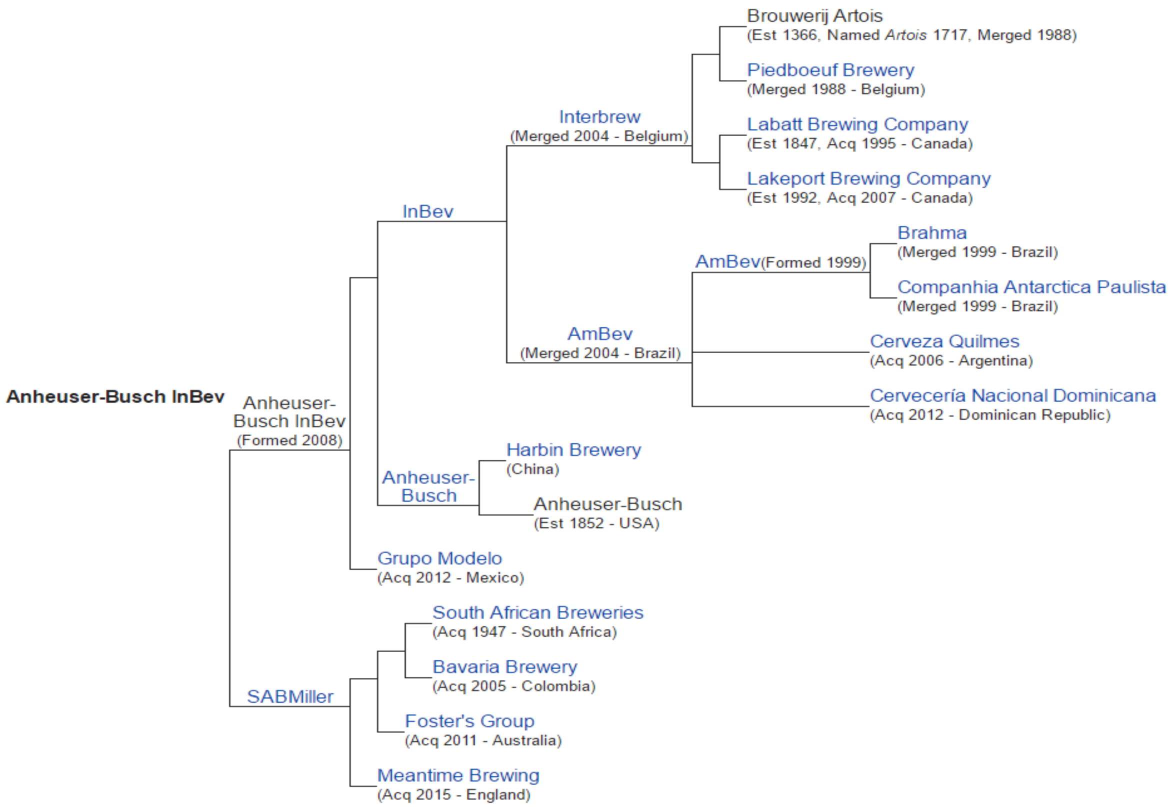
The A Cleaner World program seeks to share and preserve natural resources, improve clean water access, source renewable electricity, and recover packaging put on the market by AB InBev. Key 2016 initiatives included the Buy a Lady a Drink program with Water.org that helped provide clean water to nearly 800,000 people in developing countries, engagement in watershed protections partnerships, and early delivery of many 2017 environmental goals, such as improving water and carbon efficiency in breweries and rolling out eco-friendly coolers in retailers.

A Healthier World

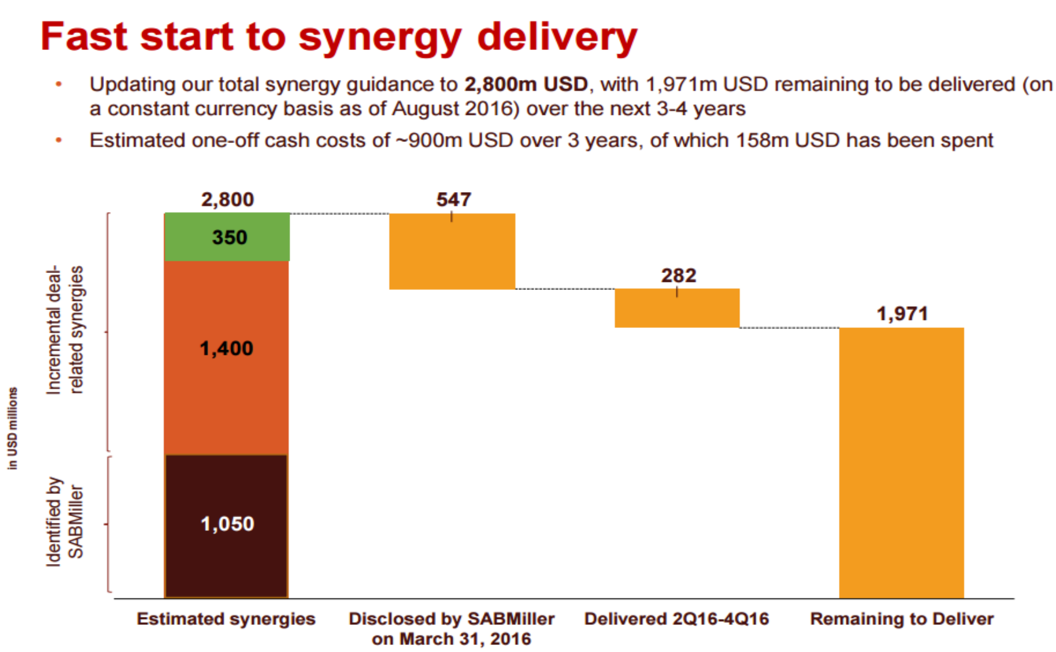
A Healthier World looks to make every experience with beer positive by reducing the harmful use of alcohol and offering no- and low-alcohol beer products around the world. Consumers are encouraged to make smart drinking decisions through the Global Smart Drinking Goals initiative, and the AB InBev Foundation is committed to addressing harmful alcohol use and spreading ideas advancing broader health and social issues. Additionally, AB InBev hopes to have low- and no-alcohol beer make up 20% of their global beer volume by 2025.

Appendices

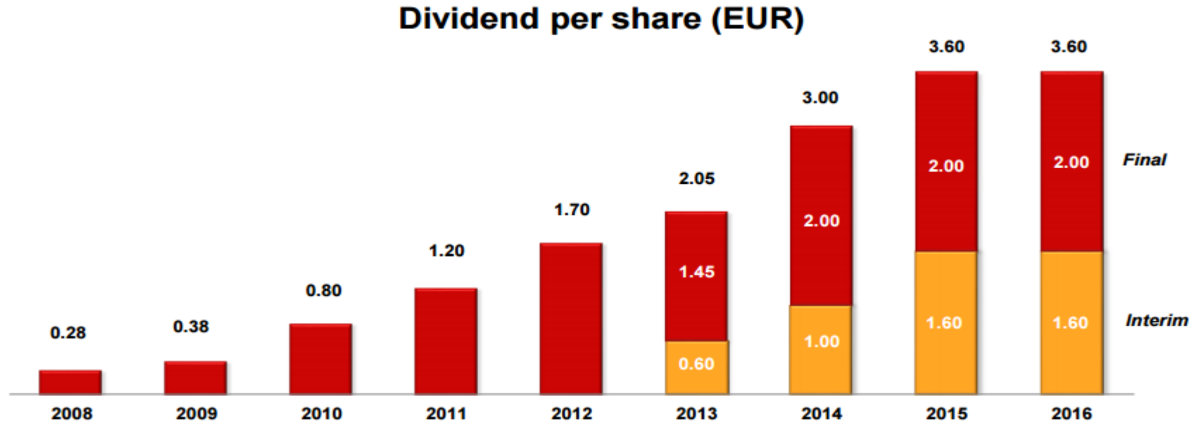
Appendix A: Merger and Acquisition History



Appendix B: Expected Synergies



Appendix C: Dividend History



Appendix D: Discounted Cash Flow Model

Anheuser-Busch InBev SA/NV

	Historical Period							Future Projections					
(in Thousands)	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Revenue	43,195,000	47,063,000	43,604,000	45,784,200	54,941,040	57,138,682	59,252,813	61,267,408	63,166,698	64,935,366	66,558,750	68,023,042	69,383,503
Growth (YoY)		*9.0%*	*-7.3%*	*5.0%*	*20.0%*	*4.0%*	*3.7%*	*3.4%*	*3.1%*	*2.8%*	*2.5%*	*2.2%*	*2.0%*
Cost of Goods Sold	17,594,000	18,756,000	17,137,000	18,296,277	21,735,769	22,376,645	22,967,569	23,503,397	23,979,336	24,391,015	24,734,556	25,006,624	25,229,222
Growth (YoY)		*6.6%*	*-8.6%*	*6.8%*	*18.8%*	*2.9%*	*2.6%*	*2.3%*	*2.0%*	*1.7%*	*1.4%*	*1.1%*	*0.9%*
Gross Margin	25,601,000	28,307,000	26,467,000	27,487,923	33,205,271	34,762,037	36,285,244	37,764,011	39,187,363	40,544,350	41,824,194	43,016,418	44,154,281
% Margin	*59.3%*	*60.1%*	*60.7%*	*60.0%*	*60.4%*	*60.8%*	*61.2%*	*61.6%*	*62.0%*	*62.4%*	*62.8%*	*63.2%*	*63.6%*
SG&A Expense	4,958,000	12,842,000	12,176,000	10,177,683	12,213,220	12,701,748	13,171,713	13,619,551	14,041,757	14,434,927	14,795,800	15,121,307	15,423,734
% of Revenue	*11.5%*	*27.3%*	*27.9%*	*22.2%*	*22.2%*	*22.2%*	*22.2%*	*22.2%*	*22.2%*	*22.2%*	*22.2%*	*22.2%*	*22.2%*
Other Operating Expenses	(644,000)	(1,124,000)	(1,301,000)	(1,047,370)	(1,256,845)	(1,307,118)	(1,355,482)	(1,401,568)	(1,445,017)	(1,485,477)	(1,522,614)	(1,556,112)	(1,587,234)
% Margin	*-1.5%*	*-2.4%*	*-3.0%*	*-2.3%*	*-2.3%*	*-2.3%*	*-2.3%*	*-2.3%*	*-2.3%*	*-2.3%*	*-2.3%*	*-2.3%*	*-2.3%*
EBIT	21,581,000	16,598,000	15,603,000	18,357,610	22,248,896	23,367,407	24,469,012	25,546,028	26,590,622	27,594,901	28,551,008	29,451,223	30,317,781
% Margin	*50.0%*	*35.3%*	*35.8%*	*40.1%*	*40.5%*	*40.9%*	*41.3%*	*41.7%*	*42.1%*	*42.5%*	*42.9%*	*43.3%*	*43.7%*
Interest/Taxes	4,769,000	5,287,000	5,726,000	5,547,024	6,722,834	7,060,808	7,393,675	7,719,111	8,034,751	8,338,208	8,627,110	8,899,124	9,160,967
% Margin	*22.1%*	*31.9%*	*36.7%*	*30.2%*	*30.2%*	*30.2%*	*30.2%*	*30.2%*	*30.2%*	*30.2%*	*30.2%*	*30.2%*	*30.2%*
NOPAT	16,812,000	11,311,000	9,877,000	12,810,586	15,526,062	16,306,598	17,075,337	17,826,917	18,555,871	19,256,692	19,923,898	20,552,099	21,156,814
% Margin	*38.9%*	*24.0%*	*22.7%*	*28.0%*	*28.3%*	*28.5%*	*28.8%*	*29.1%*	*29.4%*	*29.7%*	*29.9%*	*30.2%*	*30.5%*
Depreciation & Amort	2,985,000	3,353,000	3,153,000	3,245,490	3,894,588	4,050,371	4,200,235	4,343,043	4,477,677	4,603,052	4,718,129	4,821,927	4,918,366
% of Revenue	*6.9%*	*7.1%*	*7.2%*	*7.1%*	*7.1%*	*7.1%*	*7.1%*	*7.1%*	*7.1%*	*7.1%*	*7.1%*	*7.1%*	*7.1%*
Capital Expenditures	3,869,000	4,395,000	4,749,000	4,454,315	5,345,178	5,558,985	5,764,667	5,960,666	6,145,447	6,317,519	6,475,457	6,617,917	6,750,276
% of Revenue	*9.0%*	*9.3%*	*10.9%*	*9.7%*	*9.7%*	*9.7%*	*9.7%*	*9.7%*	*9.7%*	*9.7%*	*9.7%*	*9.7%*	*9.7%*
Change in NOWC		(1,730,000)	(1,495,000)	(1,602,447)	(1,922,936)	(1,999,854)	(2,073,848)	(2,144,359)	(2,210,834)	(2,272,738)	(2,329,556)	(2,380,806)	(2,428,423)
% of Revenue	*0.0%*	*-3.7%*	*-3.4%*	*-3.5%*	*-3.5%*	*-3.5%*	*-3.5%*	*-3.5%*	*-3.5%*	*-3.5%*	*-3.5%*	*-3.5%*	*-3.5%*
Free Cash Flow	**15,928,000**	**11,999,000**	**9,776,000**	**13,204,208**	**15,998,409**	**16,797,838**	**17,584,753**	**18,353,653**	**19,098,936**	**19,814,963**	**20,496,125**	**21,136,915**	**21,753,327**

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Total Free Cash Flow	9,776,000	13,204,208	15,998,409	16,797,838	17,584,753	18,353,653	19,098,936	19,814,963	20,496,125	21,136,915	21,753,327
Discounted FCF	9,776,000	12,254,485	13,779,778	13,427,698	13,045,693	12,636,771	12,204,093	11,750,932	11,280,635	10,796,577	10,312,237

SENSITIVITY ANALYSIS

	6.75%	7.25%	7.75%	8.25%	8.75%
1.00%	147.65	133.46	121.38	110.98	101.94
1.50%	158.02	141.81	128.20	116.62	106.66
2.00%	170.58	151.75	136.21	123.17	112.07
2.50%	186.09	163.79	145.75	130.85	118.35
3.00%	205.73	178.66	157.29	140.00	125.72

Appendix E: Market Based Models

Company Comparables				
Company	**Ticker**	**Market Cap (B)**	**EV/EBITDA**	**P/E**
Anheuser-Busch	**BUD**	**225.21**	**21.04**	**24.58**
Molson Coors Brewing Company	TAP	20.6998	12.60	29.20
Coca-Cola Company	KO	182.11	18.00	22.50
PepsiCo Inc.	PEP	160.61	13.60	21.50
Dr. Pepper Snapple Group	DPS	17.86	12.20	20.80
Diageo	DEO	58.04	16.00	20.60
AMBEV	ABEV	281.97	12.40	21.10
Boston Beer Company, Inc.	SAM	1.84	10.90	25.60
Averages		**118.542475**	**14.59**	**23.24**
BI Averages		29.13	14.47	24.87

EV/EBITDA Weight	P/E Multiple Weight				
	15%	20%	25%	30%	35%
85%	$ 133.66	$ 138.93	$ 144.21	$ 149.48	$ 154.75
80%	$ 126.73	$ 132.00	$ 137.27	$ 142.55	$ 147.82
75%	$ 119.79	$ 125.07	$ 130.34	$ 135.62	$ 140.89
70%	$ 112.86	$ 118.14	$ 123.41	$ 128.69	$ 133.96
65%	$ 105.93	$ 111.21	$ 116.48	$ 121.75	$ 127.03

Appendix F: Brand Portfolio

Appendix G: Smart Drinking Goals