Corona beer: Standout success for AB InBev for the year to December 2019
Bloomberg/David Paul Morris

AB INBEV

Go on, crack open a Corona

The beer, not the virus, has been a rare bright spot for brewer AB InBev as the market grapples with the health disaster

TJ Strydom

When China sneezes, the world's largest brewer catches the flu.

AB InBev lost out on $285m in sales and $170m in earnings in the first two months of this year alone due to the coronavirus outbreak in China, CEO Carlos Brito told investors last week.

Last week's stock market panic wiped more than a fifth off its market capitalisation, driving AB InBev, which snapped up SABMiller in 2016, to its lowest on record since it began trading as the merged entity in SA.

Ironically, Corona — the Mexican beer, not the virus — was a standout success for the company in its latest set of annual results, released last week. The beverage's volumes outside of Mexico increased by more than 20% for the year to end-December.

Compare that to overall beer volume growth of 0.8% and it is no wonder that AB InBev, three years after taking over SABMiller in a $106bn deal, is putting serious resources behind Corona. Last year, for the first time, it started brewing it outside Mexico.

Corona's sales jump was led by China (before the virus hit) and SA, says Brito.

But the company is facing significant cost increases globally, driven by the highest annual spike in commodity and transactional currency costs in the past decade.

Cost of sales ballooned by 7.4%.

FNB Wealth and Investments analyst Wayne McCurrie says this means AB InBev will have to do more cost-cutting across all operations.

After stitching SABMiller into AB InBev, the company last year completed the $3.2bn in "synergies and cost savings" it promised from 2016's mega-merger.

But those cost savings are now a thing of the past, says McCurrie.

"They took on serious debt when they bought SABMiller and they are still struggling to digest that," he says.

The company has net debt of $95.5bn and recently sold brewing assets in Australia to pay down some of those loans.

Two poor quarters have hampered its progress in addressing its debt challenge.

The impact of the outbreak of the novel coronavirus, which causes the disease Covid-19, could further hobble the company's strategy to get consumers worldwide to consume more of its three big premium brands — Corona, Budweiser and Stella Artois.

"[AB InBev] said [earnings before interest, tax, depreciation and amortisation] would decline about 10% in the first quarter of 2020, mainly because of the virus. We believe, given the uncertain environment, this poses a great risk to the second quarter as well," says Investec Asset Management's co-head of SA equity, Hannes van den Berg.

On top of that, cost of sales has been increasing faster than organic volume growth already, says Anchor Capital fund manager Glen Baker. "I'd be very scared of their Covid-19 guidance," he adds.

So far, the company has flagged only the impact on China and only until the end of March. But several other markets have since seen a spike in infections, which could limit the number of occasions consumers dare to venture out for a cold one.

AB InBev
BUY
Target price: **R1,307**
Potential upside: **48.7%**
* Based on analysts' consensus forecast

JPMorgan takes a dim view of AB InBev's prospects and says that while global beer markets appear to be returning to growth after five years of stagnation, "we believe AB InBev will continue to underperform, held back by its underexposure to the higher-growth premium category and greater competitive pressures in some of its higher margin pools" including Colombia and Brazil.

That underperformance is evident in its share price, which, since AB InBev began trading as the merged entity on the JSE in October 2016, has halved in value.

In SA so far, the virus has not had an impact.

Instead it's the spread of Corona (the beer) that has gone viral.

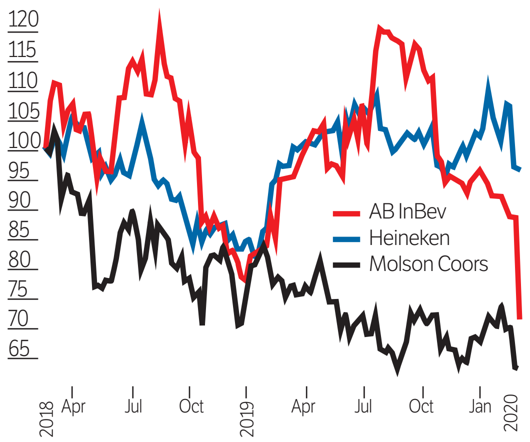
Though the brewer does not break out specific numbers, it said consumption of the Mexican beer grew by "triple digits" in SA.

"But it is still below our fair share," says Brito.

When it comes to selling premium beer in SA, AB InBev is playing catch-up.

After decades of dominance by SA Breweries (SAB), SA has in recent years become one of rival Heineken's fastest-growing markets, a feat the Dutch brewer managed by hitting the sweet spot in the premium beer category.

FIZZLED OUT
AB InBev vs Heineken vs Molson Coors – weekly



Source: Infront

Buoyed by sales of its eponymous lager as well as Amstel, Heineken reported double-digit growth in SA last year. And global CEO Jean-Francois van Boxmeer told investors last month that the expansion of the Sedibeng plant, south of Johannesburg, was one of the brewer's most significant investments of the year.

But AB InBev is clawing its way back.

"We achieved our highest-ever market share in this segment in 2019 as our premium brands continue to outperform, led by Corona," Brito said.

Of course, SAB's long-standing brands, including Carling Black Label, Castle, Hansa and Lion, still dominate the local mainstream beer business.

A few supply hiccups and weak economic growth weighed on beer sales the previous year. But by using a trick out of the SABMiller playbook, AB InBev has managed to improve its performance among more thrifty consumers. The "category expansion framework" had been developed by SABMiller to entice consumers with more options across various styles and prices. Flavoured beer Flying Fish, for example, attracts new drinkers, who might have been considering wine or ready-to-drink beverages.

The strategy means sacrificing some profit to ensure cash-strapped drinkers can still afford a beer or two.

This practice has also made it tough for its local competitors.

Richard Rushton, CEO of rival drinks maker Distell, calls it "deep beer price discounting particularly in the mainstream".

Rushton anticipates that brewers will continue to sell at deep discounts, forcing all competitors to follow suit.

But analysts are not convinced that AB InBev's strategy in SA is a good one.

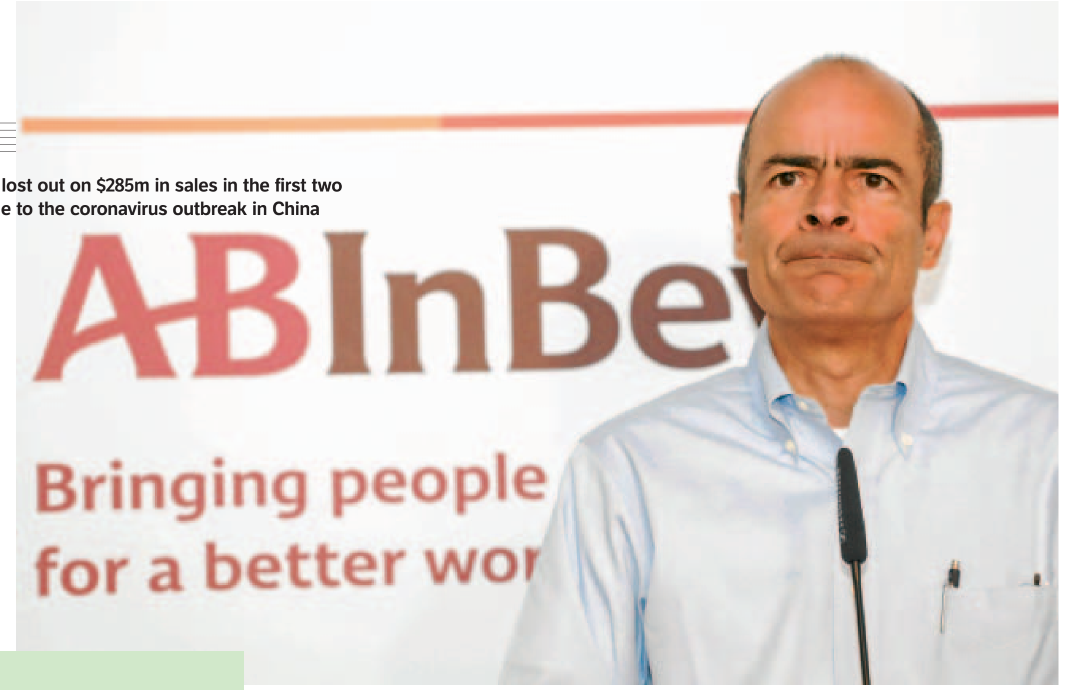
"Where they are getting it wrong is with the price mix," says Baker.

The discounting is eating into its margins, which contracted by 65 basis points in the latest results.

That means a lot more beer will have to find its way down drinkers' throats. **x**

AB INBEV
FY 2019

Ebitda	$21bn	+ 2.7%
Ebitda margin	40.3%	- 65 BPS
Finance costs	$4.35bn	- 36%



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Bloomberg/Dario Pignatelli