Business Is Improving, But Slower Than I Anticipated

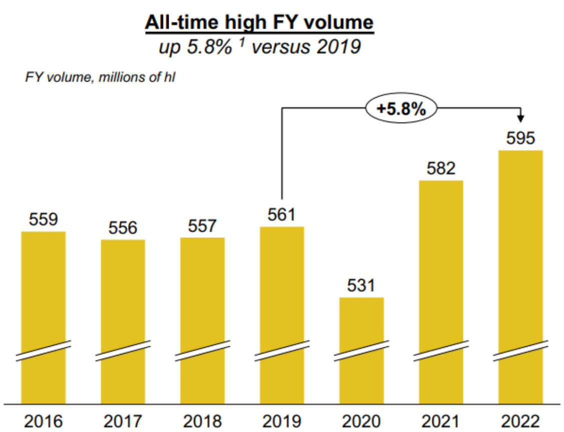
Summary

For the 4Q 2022, AB InBev reported total revenue +10.2%, total volume -.6%, normalized EBITDA +7.6%, and underlying profit of $1.7 billion. EBITDA came in at the high end of guidance and overall, I felt it was a good quarter, except for the volume decline.

Management explained that the volume decline was due to some one-offs, such as poor weather in the U.S., and COVID-19 restrictions in China. The restrictions in China have been removed, leading to a strong recovery to start 2023, and volumes are up so far in the U.S. at the start of this year, according to IRI.

For the full fiscal year, AB InBev reported total revenue +11.2%, total volume +2.3%, normalized EBITDA +7.2%, and underlying profit of $6 billion. Normalized EPS for the year was $3.21 and underlying EPS was $3.03. The company reached all-time high volumes at 595 million HLs. Progress continues to be made, but slower than I originally anticipated.

Exhibit A: All-Time High Volumes



Source: Company Filings

Debt Reduction

The company is making good progress on reducing its debt load. Net Debt/EBTIDA decreased to 3.51x at the end of the year. $8.9 billion of gross debt was repaid during the quarter and $23.1 billion has been repaid since 2019.

95% of AB InBev's debt is at a fixed rate with an average pretax coupon of 4%. As interest rates continue to increase all over the globe, bond prices are declining, and this is allowing the company to buy back its debt at a discount. This is helping management deleverage at a quicker pace.

The company's target ratio is still 2x. I expect the company to continue to shore up the balance sheet by paying back debt in 2023, which should take their Net Debt/EBITDA ratio closer to 3x at the end of this year.

As the company pays back debt, interest expense will decline, giving a boost to operating income and net income. In 2018, interest expense was $4.1 billion compared to $3.58 billion in 2022. Interest income is increasing as well, adding another boost to the bottom line, but not as material as the decline from interest expense.

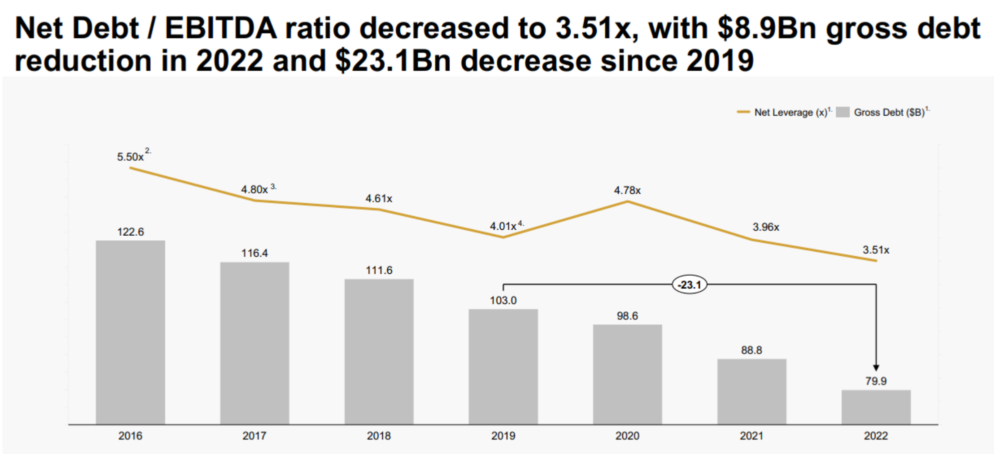
Exhibit B: Interest Expense is Declining

	2018	***2019***	***2020***	***2021***	***2022***
Interest Expense	4,141	4,168	4,016	3,674	3,588

In millions

Source: Company Filings

Exhibit C: Net Debit/EBITDA Ratio



Source: Company Filings

Margins and Input Costs

Rising input costs have been a big drag on the company for the past two years. Gross margin declined from 62.4% in 2018 to 54.48% in 2022, meanwhile, operating margins declined from 32% in 2018 to 25% in 2022.

Exhibit D: Margin Compression

	2018	**2019**	**2020**	**2021**	**2022**
Revenue	100.00%	100.00%	100.00%	100.00%	100.00%
Gross Margin	62.42%	61.09%	58.12%	57.47%	54.48%
Operating Margin	31.92%	30.87%	25.82%	25.92%	24.94%

Source: SeekingAlpha

Michele was asked a question on the call in regards to when he expects to get margins back. He didn't provide much insight here, although, he ended his response by saying, "We expect our margins to come back", but he didn't give a more specific timeline. I don't expect margins to come back to where they were pre-pandemic anytime soon, if at all.

I expect certain input costs like wages, energy, and other costs related to distribution and transportation to be structurally higher going forward. Therefore, margins may not go back to where they were pre-2019 when they were at 32% for operating and 62% for gross margin, but I do expect some recovery.

On an absolute basis, gross income and operating income will increase in dollar terms because of the recent price increases the company took last year. Also, commodity prices have come down recently, as shown in the exhibits below, so the company is well setup to start taking back ***some*** of the margin it lost.

Exhibit E: Wheat Prices Have Been Declining

Source: Trading Economics

Exhibit F: Aluminum Prices Have Been Declining

Source: Trading Economics

Conclusion

AB InBev continues to be ignored by the market. The analyst from Evercore highlighted some of the value on the Q4 earnings call:

"It's striking to me that where the stock is valued today is on a multiple that is well below kind of transactions that everybody has done in the beer industry for the slowest growing businesses. And if you even put a multiple on your consensus estimates for EBITDA for '24 at the lowest valued kind of international transactions, you get a stock price of $100 or more. So it just seems remarkably cheap."

The stock trades at right around the same price when I did my writeup in August 2021, despite the company making big strides in its deleveraging process, passing COVID headwinds (China was likely the last of it, in my opinion), contained competition from craft beer and hard seltzer, increasing revenue, increasing operating income and increasing EPS. The company also continues to bring in lots of free cash flow.

Exhibit G: Free Cash Flow

	2018	2019	2020	2021	2022
Cash from Operations	14,936	14,036	10,891	14,799	13,298
Cap Ex	(5,005)	(5,174)	(3,781)	(5,640)	(5,169)
Free Cash Flow	9,931	8,862	7,110	9,159	8,129

In millions

Source: Company Filings

It currently trades at:

TTM P/S: 2x
TTM P/E: 20x
TTM EV/EBIT: 13x
TTM P/FCF: 15x

The company has historically been a recession proof stock, and with the recent dividend increase and deleveraging progress, I expect the market to give AB InBev a more favorable look over the next year, given the macro headwinds the economy faces. The company is guiding for 4%-8% growth in adjusted EBITDA in the medium term, a target I view as very reasonable, especially after coming in right below this range in 2022.