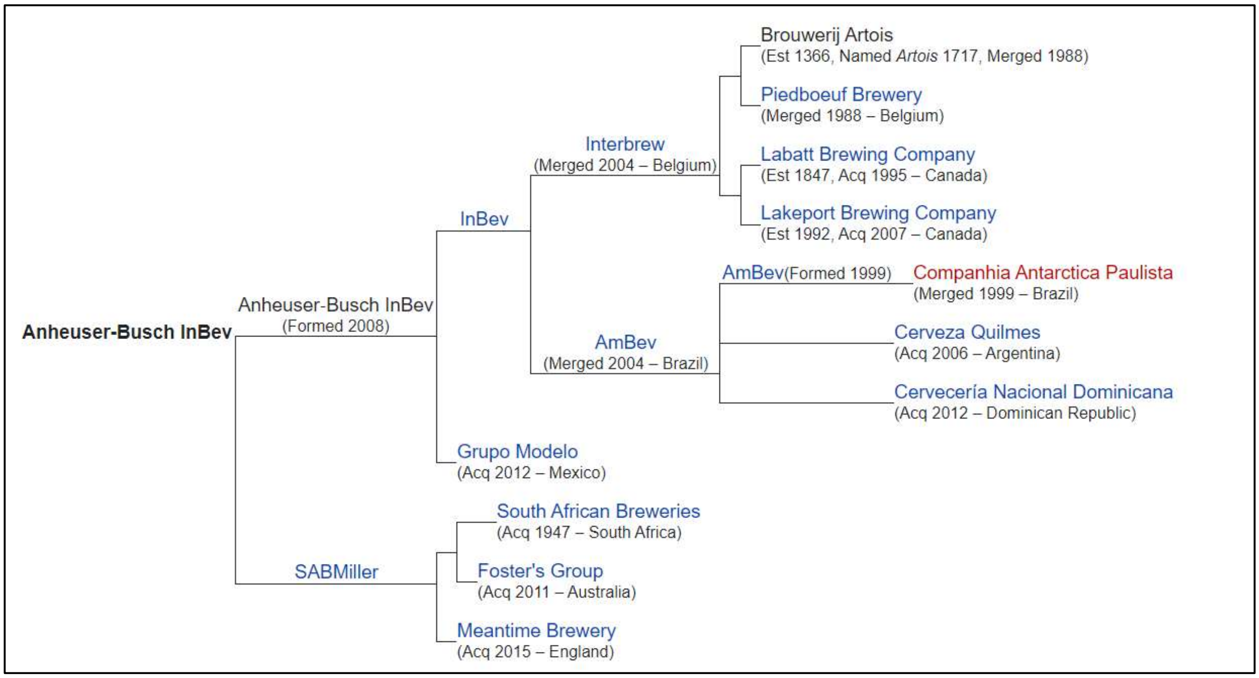
Author: Mike Gorlon
Date: 8/15/21
Company: AB InBev (NYSE:BUD)
Market Capitalization: $121.36B
Enterprise Value: $203.02B
Current Price: $61.97
Target Price: $90.36
Expected Return: 46%
Disclosure: I have an ownership position in shares of AB InBev at the time of writing.

History and Background

AB InBev is the largest brewer in the world with estimates that peg AB InBev as a producer of around 28-30% of all the beer in the world annually.

They have a long history with some of their predecessor companies dating back as far as 1366 (Brouwerji Artois) and 1847 (Labatt Brewing Company) and through many acquisitions they own some of the largest brewers in the world including Anheuser Busch and SAB Miller.

The companies that AB InBev acquired throughout the years can be difficult to follow but the chart below nicely sums up their notable acquisitions.



Source: https://en.wikipedia.org/wiki/AB_InBev

One of AB InBev's earliest mergers started in 1987 when Interbrew was formed after the mergers of Brouwerij Artois and Piedboeuf Brewery. Then in 1995 Interbrew acquired the largest brewer in Canada (Labatt Brewing Company), in 2002 Interbrew acquired Beck's and in 2004 Interbrew merged with the largest brewer in Brazil, AmBev, to form InBev and become the largest brewer in the world.

Following this merger in 2004, InBev went on to continue to acquire some of the leading brewers with their acquisition of Anheuser Busch in 2008, Modelo in 2012 and SAB Miller in 2016 to form Anheuser-Busch InBev.

Brands

AB InBev is the producer of some of the biggest beer brands in the world such as Budweiser, Corona (outside the U.S.), Stella Artois, Brahma and Michelob Ultra. They own five of the top ten beer brands in the world and have 18 brands that have retail sales over $1 billion according to Morningstar[1].

The following graph shows what the year-over-year revenue growth rates are for Q2 2021 for three of AB InBev's top global beer brands (Budweiser, Stella and Corona) outside of each beer's home market. And although the growth rate may appear misleading due to last year's revenue being much lower due to the coronavirus, keep in mind that AB InBev still delivered top-line revenue growth of 3.2% compared to Q2 2019.

Source: AB InBev Q2 2021 Presentation

"Diving a bit deeper into the performance of our global brands, the combined revenues of Budweiser, Stella Artois and Corona grew by 23% globally and by 19.3% outside of the brands' home markets, where we typically command a premium price. Compared to pre-pandemic levels of 2019, all three brands delivered growth outside of their respective home markets."

- Michael Doukeris, Q2 Earnings Call

Beer volume growth in the U.S. has been declining despite alcohol consumption in the U.S. rising in 2020 and this is due to the popularity from other categories such as hard seltzer. Despite AB InBev being primarly a beer company, they have used their global brands to branch into the hard seltzer category using Michelob Ultra's and Budweiser's well-recognized brand name to produce, market and sell Michelob Ultra Hard Seltzer and Bud Light hard selzter. This led to their "beyond beer" business segment, which includes hard seltzers and ready-to-drink cocktails, growing revenue by 45% from Q2 2020 to Q2 2021.

And despite beer volumes slowing in the U.S., this hasn't been the case in other markets outside the U.S., especially emerging markets. Beer makes up a larger precentage of alcohol consumption in these

[1] https://www.morningstar.com/stocks/xnys/bud/quote

markets and many of these markets are where AB InBev has much larger market share and stronger competitive advantages.

New CEO

Michael Doukeris was promoted to CEO of AB InBev on July 1, 2021[2]. He will be succeeding Carlos Brito who was the CEO for the previous 15 years. Michael was previously the President of U.S. Operations and has been with AB InBev for 25 years so far. He is a good choice for the position due to his long history with AB InBev and because of his experience running their operations in its biggest markets in Brazil, United States and China.

He is well-known within the company due to his strong performance in Asia where he grew Asia Pacific's operating profits by 44% during his tenure there[3].

AB InBev has been deploying a business strategy of overpaying for big brands often at the top of a business cycle when credit is cheap resulting in lower returns on capital in the early years of a business cycle but then as the debt that was used to fund the acquisitions gets paid down and synergies start to come to fruition, returns on capital start to increase back to double digits. Their business has always been pretty well insulated from recessions and then as the econony expands this has coincided with an increasing stock price in the past but coronavirus has been a different type of recession for AB InBev.

No recent recession has affected AB InBev the same way as coronavirus has because beer consumption was never effected in previous recessions in the same way it has been during coronavirus due to lockdowns and restrictions on business hours and events.

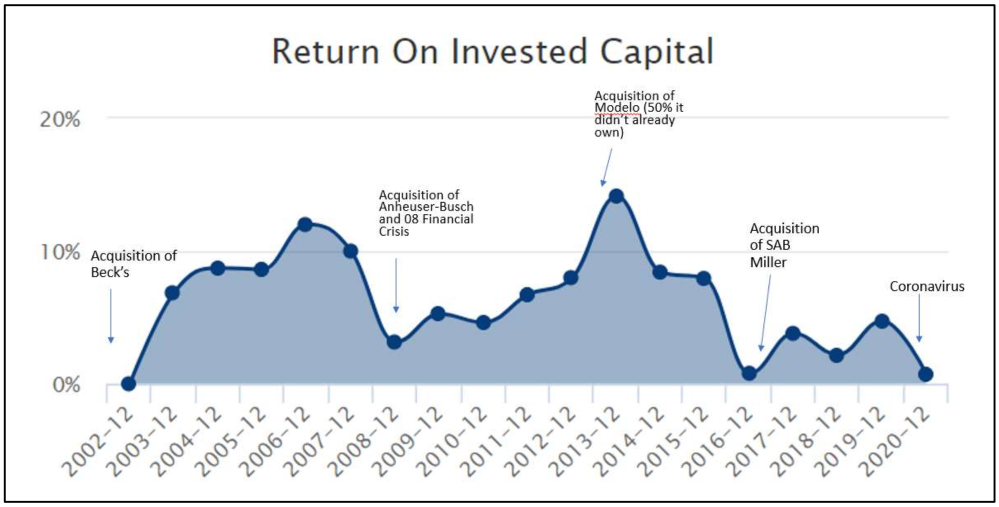
In past recessions, employees may have lost their jobs but they were still able to enjoy a beer at a restaurant, social event or at home. Coronavirus lockdowns removed a meaningful portion of AB-Inbev's revenue from restauraunts and social events meanwhile their SAB Miller purchase was very untimely since they bought it mainly for its breweries in Africa which have faced several bans on alcohol consumption throughout coronavirus.

Michael will be reponsible for leading AB InBev through this transition but with their competitive advantages and his experience I have a lot of faith that he will get it done. Right now, AB InBev's returns on capital are low because of coronavirus but as the world emerges from coronavirus, I'm expecting returns on capital to increase back to double digits as Michael Doukeris continues to deliever the strong results he achieved in his previous leadership roles within the company.

Whether he continues to take on enormous acquisitions like his predecessor did, Carlos Brito, with the acquisitions of Anheuser-Busch, Modelo and SAB Miller will remain to be seen.

[2] https://www.ab-inbev.com/content/dam/abinbev/news-media/press-releases/2021/07/070121_ABI_CEO__EN.pdf

[3] https://www.just-drinks.com/features/who-is-anheuser-busch-inbevs-next-ceo-just-drinks-looks-at-michel-doukeris-focus



Source: Quickfs.net

Why is the Stock Price Down?

Source: Google Finance

AB InBev's stock has struggled for quite some time now as you can see from the chart above. Despite the coronavirus low back in 2020, AB InBev's stock price hasn't traded this low since January 2012. Revenue over the last 12 months of $51.4 billion is 30% higher than it was for AB InBev in 2012 and operating profit over the last 12 months of $13.8B is 8% higher than 2012 levels but this includes coronavirus.

AB InBev is already on its way to realizing results similar to what they did pre-COVID though and will very likely exceed these levels over the next five years as they see higher revenue from their premium beer brands (Budweiser, Corona, Stella, Michelob, etc.), higher revenue from their fast growing beyond-beer segment which commands higher prices then their typical beers, their huge growth opportunities in Africa where it is estimated they have 87% market share[4] in the countries that they are in and from their on-premise channel as the world emerges from coronavirus.

But before going further into the reasons why AB InBev is a great buy now, let's look at why the market has given us an opportunity. Here are the four main reasons why AB InBev's stock price has been struggling: high debt, coronavirus, cost inflation and new competition (craft and hard seltzers).

Debt

One reason why a stock can get hated by the market is because of high debt levels. AB InBev has $81 billion in net debt on its balance sheet and a Net Debt-to-EBITDA ratio of 4.4 so there is some leverage here that is on the high side following their large acquisition of SAB Miller in 2016 but the debt picture isn't as bad as it seems when you take a closer look at the maturities. Their debt maturities are very spread out and their interest rate is 95% fixed at around 4%. This insulates them from the possibility of any dramatic increases in interest rates.

AB InBev has also paid back around $26 billion in debt since December 2016 due to their ability to generate high free cash flow but following the coronavirus pandemic, which effected cash flows, AB InBev has done a much better job of refinancing their debt to spread out the maturities and sell some business units to raise cash. They also cut their dividend in 2020 as well to preserve cash.

They announced the sale of their Australian business group, which owned Foster's, to Asahi which raised $11 billion[5]. This deal closed in 2020. They also sold a 49.9% interest in their U.S. based metal can plant in 2020 for $3 billion[6].

Below is a chart that shows AB InBev's bond maturity profile. As you can see, in the first half of 2021 they redeemed $6.4 billion in bonds and over the next five years they only have around $3 billion due. $3 billion is a very small amount to pay back over the next five years considering that AB InBev generates free cash flow of around $9 billion on an annual basis. The next five years will also give them more than enough time to redeem more of their debt that is due from 2026 to 2030 and strengthen their balance sheet even more to get their Net Debt-to-EBITDA ratio much closer to their target of two times.

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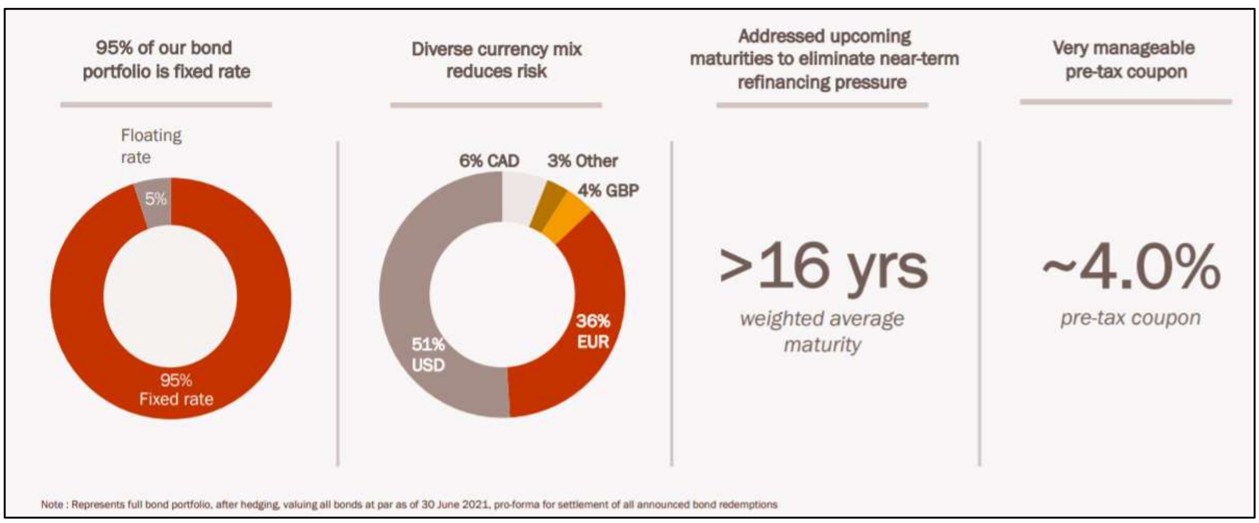
[4] https://www.statista.com/statistics/1026129/beer-market-share-south-africa/
[5] https://www.wsj.com/articles/anheuser-busch-inbev-to-sell-australian-unit-to-japans-asahi-group-11563517451
[6] https://www.reuters.com/article/us-abinbev-plant-apollo/apollo-led-group-to-buy-stake-in-ab-inbevs-u-s-can-plants-for-3-billion-idUSKBN28X2PC



Sources: AB InBev Q2 21 Presentation

So although they still do have a pretty high debt level, the risk of them filing for bankruptcy or experiencing any type of insolvency is incredibly low. The high debt will impact net income as the net interest cost makes up around 25% of operating income but as the debt gets paid back, this will lower the interest expense and increase net income. Management may even decide to distribute this to shareholders in the form of an increased dividend.

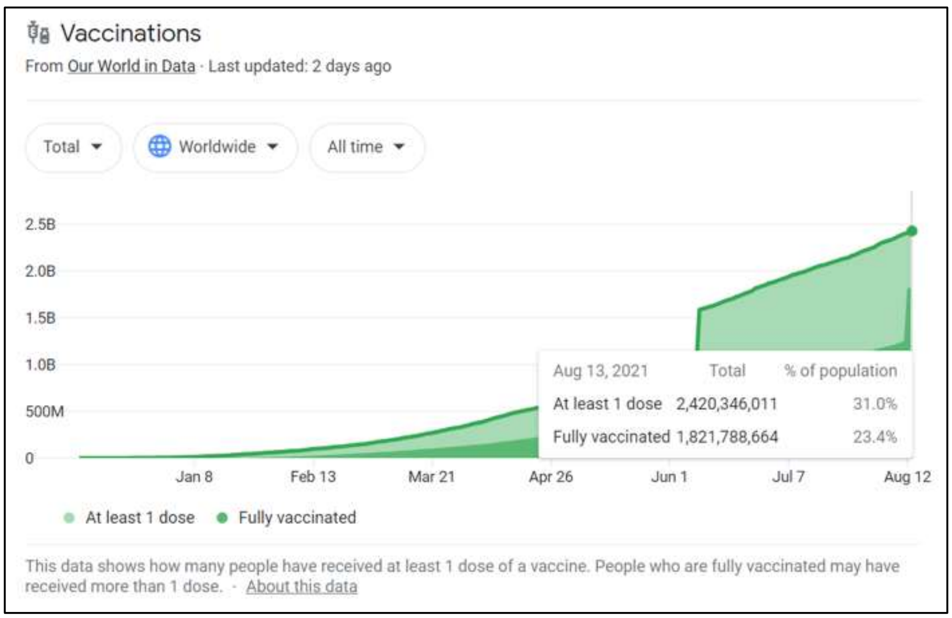
<u>Coronavirus</u>

Coronavirus has been a big headwind for AB InBev due to lockdowns; restrictions on the operations of on-premise sales in places such as sporting events, concerts and restaurants and various bans on alcohol sales in countries such as Africa which has been a key target market of AB InBev's growth. With the resurgence of the Delta variant, it is hard to say exactly when coronavirus will officially be over, but it looks like 2020 was the worst effect that coronavirus will have on AB InBev.

There is a global distribution of vaccines going on around the world right now with 31% of the world population receiving at least one dose and 23.4% achieving fully vaccinated status according to Google. The lockdowns that occurred at the start of March 2020 are very unlikely to happen again and the on-premise location (sporting events, restaurants, concerts) are operating with a mix of some experiencing some form of restrictions and some experiencing no restrictions at all.

AB InBev's massive distribution channel faced headwinds during the coronavirus but still allowed them to distribute their beverages to retailers around the world to help their off-premise channel offset some of the losses that their on-premise channel had. It also helped AB InBev to realize operating income of \$12 billion in 2020 and \$2.2 billion during the 2nd quarter of 2020.

In addition, AB InBev refinanced a large portion of their debt, so they only have around \$3 billion due over the next five years and they have a \$10 billion line of credit in addition to \$6.8 billion in cash on their balance sheet. Coronavirus won't cause permanent damage to AB InBev's business. It will be a temporary headwind that has created a great period to take a long position in the company and hold for the future.



Source: Google

Cost Inflation

A 2nd order effect of coronavirus has been a notable increase in inflation. Coronavirus led to massive stimulus from central banks around the world which added trillions of dollars to the money supply. In addition, coronavirus made it more fearful for workers to come to work and the shutdowns disrupted large parts of various global supply chains around the world. Coronavirus also led to a wide expansion of unemployment benefits that weakened the incentive for employees to work since they could make more money by staying at home on unemployment.

I have no idea what the rate of inflation will be in the short-term or long-term but don't view any variation in inflation rates as a risk to AB InBev's business value. The recent volatility in AB InBev's stock price that occurred following the Q1 2021 earnings call when AB InBev's stock price quickly fell from \$65 a share to $58 a share and more recently following the Q2 2021 earnings call which brought AB InBev's stock price into the low $60's due to mentions of inflation on their earnings call is only short-term and is a result of short-term trading as opposed to long-term investing that focuses on the fundamentals of the business.

AB InBev has well-known brands that have earnings power which should help pass along some of the higher costs to consumers and it also has a long history spanning over 100 years of dealing with various periods of fluctuating inflation levels including double digit inflation in the 1970's. Alcohol consumption won't be removed or substituted from people's habits just because of inflation.

New Competition

There have been two areas of new competition that have been discussed a lot over the last ten years as threats to AB InBev – craft beer and hard seltzer. I never saw craft beer as much of a threat since AB InBev already had a unanimous lead in the beer industry combined with economies of scale, large brands and large distribution so I didn't view craft beer as something that was going to overtake AB InBev's beer brands.

I do admit that it has been slowly dwindling at AB InBev's market share over the last 10 years but despite the many successful craft breweries, the discussion of craft beer as a viable competitor has faded a lot recently probably because of the coronavirus lockdowns which led to a large increase in off-premise beer sales which AB InBev has a large presence in compared to craft breweries who don't have much distribution into grocery stores and big box retailers like Walmart, Target and Costco. It's difficult for a small craft brewer to reach these chain stores due to the contracts required by distributors[7].

AB InBev also responded by acquiring some of the largest craft breweries and adding them to its own beer portfolio and using its large distribution channel to expand their newly acquired craft beers' presence into additional markets. The owners of these craft brewers welcomed AB InBev's investment because they got a huge payout from the acquisition and they liked the idea that partnering with AB InBev allowed them to expand their brands to much wider markets. Some of the craft brewers that AB InBev now owns are Blue Point, Goose Island, Platform Beer, Wicked Weed and Golden Road Brewing[8].

I view hard seltzer as a viable competitor to beer though and believe that hard seltzer has converted a lot of younger consumers of beer into consumers of hard seltzer instead. The biggest surge in hard seltzer consumption occurred in 2020 and continues to increase today yet the growth rate for one of the leaders (Truly) has come down recently as addressed on Boston Beer's 2nd quarter earnings call.

Nick Shields is credited with creating the first hard seltzer beverage after he created Spiked Seltzer in Connecticut in 2012. He sold it to AB InBev in late 2016 who rebranded it as Bon Viv! but despite this early acquisition in the hard seltzer market, they still fell far behind Mark Anthony Brands' White Claw and Boston Beer's Truly.

AB InBev then expanded their hard seltzer products by using the Michelob Ultra, Natural Light and Bud Light brands, and developing Cacti with Travis Scott but they are still behind Boston Beer and Mark Anthony Brands despite increasing market share.

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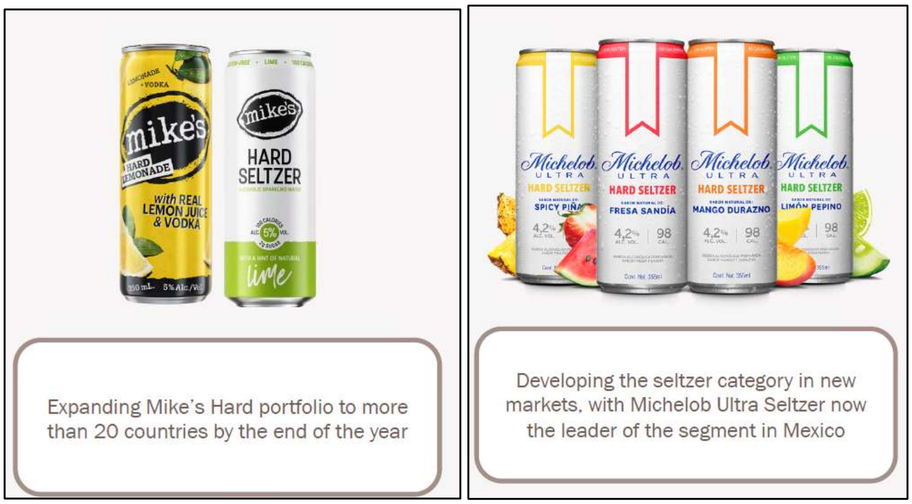
[7] https://slate.com/business/2020/07/break-up-big-beer.html
[8] https://www.beveragedaily.com/Article/2019/08/12/AB-InBev-acquires-Platform-Beer-Co

In addition to hard seltzer, AB InBev has branched out into other alcohol categories such as cocktails with their purchase of Cutwater and also wine with their purchase of Babe in 2019. Cutwater has done very well according to AB InBev on their Q2 2021 earnings call where they're reporting triple digit growth.

AB InBev continues to expand their beyond-beer segment which is realizing high growth. They own the rights to the Mike's Hard Lemonade brand internationally and announced that they're expanding distribution to more than 20 countries by the end of this year, mostly in Europe. They already introduced Michelob Ultra Hard Seltzer in Mexico where it is the current leader with an estimated 50% market share of the hard seltzer category.



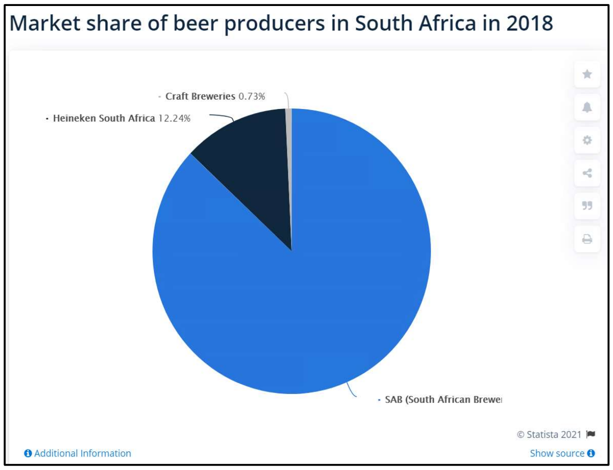
Sources: AB InBev Q2 21 Presentation

AB InBev will continue to expand their hard seltzer offerings in the U.S. with a variety of new flavors but it is unlikely to catch up to White Claw and Truly. Their distribution around the world though is unmatched by any of their competitors so if they can increase their beyond beer segment to new consumers around the world who don't already drink beer then this should be a huge opportunity for higher revenues and profits. Also beneficial to higher revenues and profits is that their beyond beer products are around 20% more profitable than their traditional beer is according to management.

Source: AB InBev Q1 2021 Presentation

Moat

AB InBev has one of the largest moats in the consumer goods industry. They have a wide distribution network that expands across at least 50 countries around the world, well-known brands with lots of pricing power and economies of scale due to their enormous size. Their market share in some countries like South Africa, Brazil, Mexico and Columbia exceeds 50%.



Sources: Statista

The chart below shows their competitive advantage from their economies of scale compared to some of their biggest competitors. Their gross profit margin and operating margin for the year 2020 are much higher than it is for their competitors since AB InBev can spread out their costs over a much larger level of volume. AB InBev spent $15.4B on selling and admin expenses during 2020 meanwhile Coors spent $2.4B, Heineken spent $4.2 billion and Boston Beer spent $565 million.

This allows AB InBev to spend much more on marketing their brands through various advertising channels than their competitors do giving them a huge advantage. There is a reason that there are so many commercials for AB InBev brands during the Super Bowl compared to all of their competitors.

	BUD	***Coors***	***Boston Beer***	***Heineken***	***Carlsberg***	***Asahi***
Total Revenues	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**
Cost Of Revenues	41.88%	60.97%	52.62%	62.14%	51.55%	63.28%
Gross Profit	**58.12%**	**39.03%**	**47.38%**	**37.86%**	**48.45%**	**36.72%**
Selling General & Admin Expenses	32.96%	24.93%	32.58%	17.70%	32.24%	25.44%
Total Operating Expenses	32.30%	24.93%	32.58%	27.94%	32.59%	29.71%
Operating Income	**25.82%**	**14.10%**	**14.79%**	**9.92%**	**15.86%**	**7.01%**

Source: SeekingAlpha Financials

AB InBev is also able to operate with negative working capital and their market position allows them to extend payment to their vendors to longer terms. They buy huge volumes of raw materials and packaging which makes them a very important customer to their vendors. They've also developed very strong relationships with distributors through ownership and business that allow them to respond quickly to competitive threats.

Their scale also allows AB InBev to spend vast sums of money on marketing to increase the value of their brands. Forbes' list of the world's most valuable brands includes both Budweiser and Corona with Budweiser ranked at number 21 and Corona ranked at 63[9]. They also have many other brands that are well recognized in their respective countries such as Brahma in Brazil, Beck's in Germany, Stella in Belgium and Castle in South Africa.

Valuation

AB InBev currently trades lower than the premium multiples that it has traded on in the past. Price-to-sales multiples hovering around 4x were much more common than the more modest multiple that AB InBev trades at today. AB InBev's P/E multiple trades at 21.3 right now but keep in mind this is using trailing twelve-month earnings which are suppressed from coronavirus. Net income over the last 12 months was $5.7B and earnings per share were $2.88 but EPS estimates for 2022 are $3.47[10] which would be a P/E multiple of 18. Earnings pre COVID were above $4 per share which results in a P/E multiple of 15. The current price-to-free cash flow multiple is 13 which is on the low side and Enterprise Value-to-EBIT is less than 15 which is also very low for AB InBev.

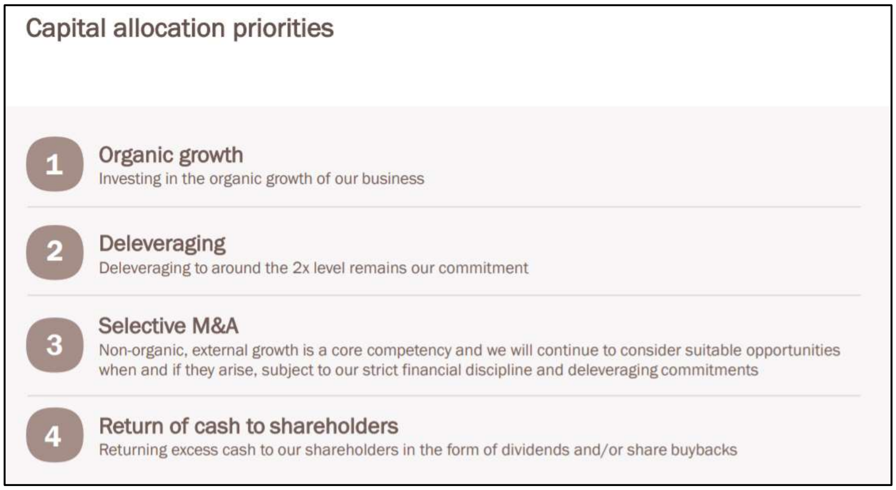
TTM Price/Sales	2.4
TTM Price/Earnings	21.3
TTM Price/FCF	13.1
TTM EV/EBIT	14.7

Market Cap	122,680.00
Enterprise Value	203,019.00
Revenue	51,415.00
Net Income	5,763.00
Free Cash Flow	9,336.00
EBIT	13,775.00
Trailing 12 Months in Millions	

Plan to Get Back on Track

Management laid out their capital allocation priorities to get the company back on track to the days of higher returns on capital and have been delivering over the past three years. Their highest priority is to invest in growing their business organically. They are then focused on deleveraging which they've been doing since the SAB Miller acquisition. Deleveraging has come at a slower pace than expected due to coronavirus but is likely to pick up following coronavirus.

[9] https://www.forbes.com/the-worlds-most-valuable-brands/#3ffe6d26119c
[10] https://seekingalpha.com/symbol/BUD/earnings

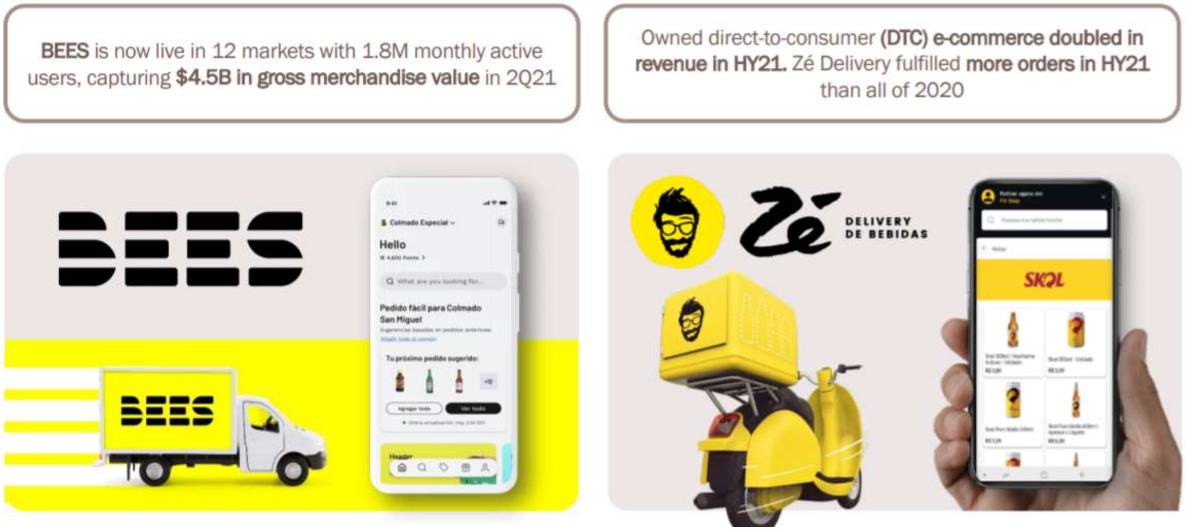


Source: Q2 21 Presentation

Analysts and investors who don't follow AB InBev very closely may not understand that there is some upside inside of AB InBev that I don't think many are aware of. AB InBev has developed two digital platforms that focus on ecommerce. One platform, BEES, was developed for retailers and wholesalers, and the other platform, Ze Delivery, is focused on consumers. Their BEES platform initially focused on digital orders in South American countries like Argentina, Brazil, Colombia, Dominican Republic, Ecuador, Panama and Peru but they also expanded the platform to China, South Africa and the U.S.

Both BEES and Ze Delivery have seen lots of user growth following the coronavirus and are being underestimated as a way for AB InBev to expand their distribution moat and become more of a consumer facing company. Lots of these consumer facing platforms have huge upside in terms of valuation and growth opportunities.

The platform that Ze Delivery reminds me a lot of is Drizzly that recently got acquired after just 9 years as a company for $1.1 billion by Uber. A $1.1 billion acquisition from an acquiror won't do much for AB InBev but I don't expect AB InBev to sell it. I expect them to use it to expand their distribution, help them manage their relationships with their customers and increase revenues through delivery fees. It also demonstrates that although AB InBev has a long history as an incumbent, they are willing to innovate and adapt as the market changes.



Source: Q2 21 Presentation

What is the Street Saying?

Evercore just came out with an outperform rating on AB InBev with +40% upside[11]. Evercore analyst, Robert Ottenstein, and his team take a similar stance as I do that the market is too focused on the short-term headwinds. They have a $90 price target on Anheuser-Busch compared to the average Wall Street price target $80.40[12].

Here is an excerpt from Evercore below:

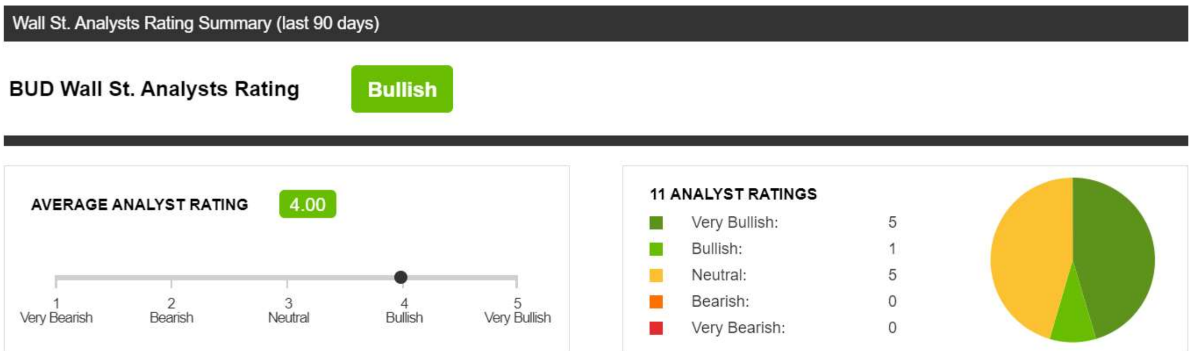
"The 2Q organic EBITDA growth miss was more driven by modeling challenges and high expectations than any operational weakness. Top line recovery is ahead of our expectations, and the firm's commercial momentum remains strong across most key markets. We continue to believe that ABI is in the midst of a transition towards what we refer to as an effectiveness-first model, with a greater emphasis on organic top line growth, while retaining ABI's hallmark financial discipline."

I view this as a time arbitrage play where most analysts acknowledge that AB InBev is undervalued and will eventually recover but aren't willing to take a view beyond two years. It's possible that investors are waiting to buy when there is more of a clear picture on the surge in new coronavirus cases due to the Delta variant and the recent price inflation effecting many input costs, but the price will very likely be beyond $70 a share by then.

Keep in mind that AB InBev's share price ran up to $80 in the middle of June 2021 from $60 in February 2021. February 2021 was during the period of peak coronavirus cases globally and June 2021 was when vaccines were starting to be widely distributed so the market was likely discounting a full return to normalization for AB InBev.

[11] https://seekingalpha.com/news/3728306-anheuser-busch-inbev-is-seen-ripping-40-gain-as-recovery-plays-out
[12] https://seekingalpha.com/symbol/BUD/ratings/sell-side-ratings

I don't know what will happen over the next couple months or a year but if you buy at the current price of $62 a share and the recovery happens in two years and AB InBev recovers to $80 per share then you will have a 14% compounded annual return not including dividends. Including dividends would push the return to 15% which is a good return for a limited amount of risk plus you get a business with a large moat and huge upside that could be a compounder over the next decade or more. AB InBev has a long history dating back hundreds of years and it's hard to see that going away anytime soon.



Source: Seeking Alpha Analyst Ratings

Catalysts

Over the next two years I see four catalysts that will bring AB Inbev's stock price to $90.36 per share. Those four catalysts are continued debt reduction, the emergence from the coronavirus pandemic, growth in Africa and its beyond beer business segment.

AB InBev also paid out a dividend of 44 cents a share on May 4, 2021. Current expectations for AB InBev's dividend at the end of November 2021 are for it to be around 44 cents as well which results in an annual dividend yield of 1%. As AB InBev continues to deleverage their balance sheet and the world emerges from coronavirus, AB InBev will increase their dividend from 1% to probably more around 3%. This will likely attract more dividend seeking investors.

Conclusion

It's arguable that AB InBev is going through its toughest challenge in their history. They took on a lot of debt to buy SAB Miller and coronavirus has not only made it more difficult to pay this debt back due to the loss of on-premise sales, they are also dealing with numerous bans on alcohol sales in Africa due to coronavirus.

In addition, they are facing new competition from hard seltzer, craft beer and other new alcoholic drinks from companies like Pepsi, Coke and Arizona who didn't compete in the alcoholic beverage industry before. I've been watching AB-InBev for a while now and have always seen it trade at a premium multiple due to its business being recession proof and due to its wide moat in brand name and distribution. Right now, AB InBev isn't trading at the premium multiple that it has in the past and I view this as a great opportunity to invest in what could be a long-term compounder as they deleverage, use their competitive advantages to ward off new competition, continue to expand in target markets and emerge from the coronavirus.

Discounted Cash Flow Model

Growth	5.0%
Required return	10.0%
Terminal Growth	2%

	0	1	2	3	4	5	Terminal Value
	TTM	2021	2022	2023	2024	2025	2026
Net Income	$ 5,763.00	$ 6,051.15	$ 6,671.39	$ 7,722.97	$ 9,387.32	$ 11,980.86	$ 12,220.48
Discount Rates		0.91	0.83	0.75	0.68	0.62	
Discounted FCF		$ 5,501.05	$ 5,513.55	$ 5,802.38	$ 6,411.67	$ 7,439.17	

Sum of Discounted FCF	$ 30,667.81
FCF in 2025	$ 12,220.48
Multiple	20
Terminal Value	$ 244,409.61
Discount Rate	0.62
Discounted Terminal Value	$ 151,759.14
Terminal Value Plus Total Disc cash flows	$ 182,426.95
Shares Outstanding	2,019.00
Value Per share	$ 90.36

*All data except per share and percentages are in millions