BRYAN, GARNIER & CO

INDEPENDENT RESEARCH UPDATE

24th September 2015

Food & Beverages

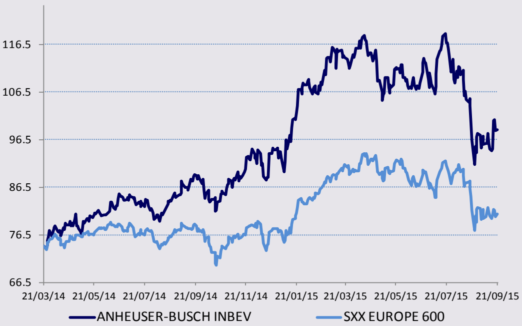
AB InBev

Bud on tap

Fair Value EUR96 vs. EUR109 (price DKK95.80) **NEUTRAL**

Bloomberg	ABI BB
Reuters	ABI.BR
12-month High / Low (DKK)	118.8 / 81.4
Market capitalisation (DKKm)	154,070
Enterprise Value (BG estimates DKKm)	225,498
Avg. 6m daily volume ('000 shares)	1,926
Free Float	47.9%
3y EPS CAGR	0.1%
Gearing (12/14)	83%
Dividend yield (12/15e)	2.51%

YE December	12/14	12/15e	12/16e	12/17e
Revenue (USDm)	47,063	44,704	44,250	45,753
EBIT (USDm)	15,308	14,608	14,516	15,281
Basic EPS (USD)	5.54	5.51	5.05	5.30
Diluted EPS (USD)	5.32	5.10	5.08	5.33
EV/Sales	5.51x	5.62x	5.63x	5.40x
EV/EBITDA	13.9x	14.0x	13.9x	13.2x
EV/EBIT	16.9x	17.2x	17.2x	16.2x
P/E	20.0x	20.9x	21.0x	20.0x
ROCE	11.1	10.3	10.0	10.4



Following the drop in the real and peso we are lowering our earnings forecasts, leading to a 12% lower fair value of EUR96.

- In China, AB InBev is the third largest brewer in terms of volumes, but because of its focus on the premium (Harbin Ice) and super premium segments (Budweiser), the company has average selling prices well above its competitors (40% higher than CR Snow and 30% higher than Tsingtao). Budweiser is the country's largest super premium brand commanding a market share of 62%. This segment has delivered growth of on average 12.3% over the past ten years compared to 6.5% for the market as a whole. In particular, in the last three years, growth has accelerated to 14.4% against a market growth of 2.5%.

- Not only are premium and super premium segments growing ahead of the market, they are also more profitable. AB InBev calculated that these segments carry a gross margin 5-9 times that of the core & value segment. We reckon that the EBITDA margins for premium and super premium beers in China are at a 35-40% level compared to 10% for the core & value segment. As a result and despite the company's recent push into new territories, AB InBev is yielding an 18% EBITDA margin compared to 12% for the other brewers in China. In some areas, AB InBev has already US-style over 40% EBITDA margins.

- We expect that the group's organic EBIT growth of 9.5% for the full year will be more than offset by unfavourable currency translation, particularly the Brazilian real, the Mexican peso, and the euro, and look for a reported adjusted EBIT of USD14,608m which is 4.6% lower than in 2014. With lower net finance costs and a lower tax rate, we are expecting adjusted net profit to be down 4.9% to USD8,435m and for 2016 we are looking for a flattish net profit at USD8,408m. Following the downward revision of 2015 and 2016 EBIT by, respectively, 6% and by 13%, we are lowering our fair value for AB InBev by 12% to EUR96 (from EUR109).

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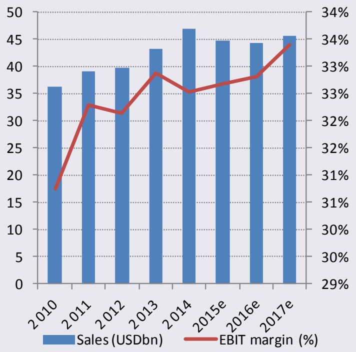
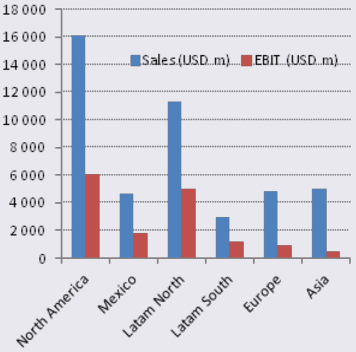




Company description

Anheuser-Busch InBev is the largest brewer in the world selling 408m hl (a 21% global market share) of beer and 50.8m hl of other beverages (soft drinks, water) in 2014. The company has a balanced portfolio with exposure to both mature markets (45% of 2014 EBIT) and developing markets (55%). Its main area of operations is North America (39% of EBIT) and Latin America (52%). AB InBev's brand portfolio comprises strong international and local brands including Budweiser, Bud Light, Stella Artois, Beck's, Skol and Brahma.

Income Statement (USDm)	**2012**	**2013**	**2014**	**2015e**	**2016e**	**2017e**
Revenues	39,758	43,195	47,063	44,704	44,250	45,753
Change (%)	*1.8%*	*8.6%*	*9.0%*	*-5.0%*	*-1.0%*	*3.4%*
Adjusted EBITDA	15,526	17,188	18,663	17,938	17,915	18,750
EBIT	12,779	14,203	15,308	14,608	14,516	15,281
Change (%)	*1.4%*	*11.1%*	*7.8%*	*-4.6%*	*-0.6%*	*5.3%*
Financial results	(2,366)	(2,203)	(1,319)	(1,144)	(2,018)	(1,945)
Pre-Tax profits	10,413	12,000	13,989	13,464	12,498	13,336
Exceptionals	(32.0)	(170)	(197)	0.0	0.0	0.0
Tax	(1,680)	(2,016)	(2,499)	(2,558)	(2,500)	(2,801)
Profits from associates	624	294	9.0	0.0	0.0	0.0
Minority interests	(2,165)	(2,124)	(2,086)	(1,790)	(1,638)	(1,757)
Net profit	7,160	7,984	9,216	9,116	8,360	8,779
Restated net profit	7,201	7,936	8,865	8,435	8,408	8,827
Change (%)	*11.7%*	*10.2%*	*11.7%*	*-4.9%*	*-0.3%*	*5.0%*
Cash Flow Statement (USDm)						
Operating cash flows	15,107	16,585	17,873	17,938	17,915	18,750
Change in working capital	1,099	866	815	(1,580)	366	724
Capex, net	(3,131)	377	(4,172)	(4,350)	(4,346)	(4,444)
Financial investments, net	(8,210)	(10,658)	(6,888)	0.0	0.0	0.0
Dividends	(3,632)	(6,253)	(7,400)	(7,563)	(7,636)	(8,017)
Other	(3,143)	(4,093)	(4,876)	(4,703)	(4,518)	(4,746)
Net debt	30,173	38,887	42,245	42,502	40,720	38,452
Free Cash flow	9,830	13,662	9,557	8,306	9,418	10,285
Balance Sheet (USDm)						
Tangible fixed assets	16,461	20,889	20,263	21,670	23,005	24,369
Intangibles assets	76,137	99,265	100,681	100,293	99,905	99,517
Cash & equivalents	14,168	10,239	8,877	8,877	8,877	8,877
current assets	7,946	9,896	11,551	10,095	9,771	9,874
Other assets	7,909	1,377	1,178	1,178	1,178	1,178
Total assets	122,621	141,666	142,550	142,113	142,736	143,815
L & ST Debt	44,341	49,126	51,122	51,379	49,597	47,329
Others liabilities	37,138	42,175	41,456	38,383	38,146	38,716
Shareholders' funds	41,142	50,365	49,972	52,352	54,994	57,770
Total Liabilities	122,621	141,666	142,550	142,113	142,736	143,815
Capital employed	91,302	100,964	113,052	114,352	115,941	116,357
Financial Ratios						
Operating margin	32.14	32.88	32.53	32.68	32.81	33.40
Tax rate	16.18	11.05	18.12	19.00	20.00	21.00
Net margin	18.11	18.37	18.84	18.87	19.00	19.29
ROE (after tax)	17.50	15.76	17.74	16.11	15.29	15.28
ROCE (after tax)	11.73	12.51	11.09	10.35	10.02	10.38
Gearing	74.54	15.76	83.48	80.48	74.23	67.50
Pay out ratio	37.98	44.13	49.58	52.50	52.50	52.50
Number of shares, diluted	1,628	1,650	1,665	1,655	1,655	1,655
Data per Share (USD)						
EPS	4.40	8.72	5.54	5.51	5.05	5.30
Restated EPS	4.42	4.81	5.32	5.10	5.08	5.33
% change	*10.7%*	*8.7%*	*10.7%*	*-4.3%*	*-0.3%*	*5.0%*
BVPS	25.60	31.32	31.08	32.56	34.20	35.93
Operating cash flows	9.28	10.05	10.73	10.84	10.82	11.33
FCF	5.58	8.45	5.64	5.97	5.47	5.78
Net dividend	1.68	2.12	2.64	2.68	2.67	2.80

Source: Company Data; Bryan, Garnier & Co ests.

1. The growing importance of China

AB InBev has been operating in China for more than 30 years. Interbrew's presence in China dates from 1986 since when it provided technical knowledge to a number of Chinese brewers including the Zhujiang Brewery in Guangzhou and the Five Star Brewery in Beijing. In 1997, Interbrew entered the Chinese market as an operator in its own right with the acquisition of the Nanjing and the Jingling Breweries. Other acquisitions followed including the KK Brewery in 2002 and Sedrin in 2006. In 1995, Anheuser-Busch established its first brewing facility in China in the city of Wuhan and launched Budweiser. In 2004, Anheuser-Busch acquired the Harbin Brewery Group, which at that time was the fourth largest Chinese brewer. After the creation of AB InBev in 2008, the group continued to expand in China, with the two latest acquisitions being Asia Breweries (2013) and Ginsber (2014). In July 2015, AB InBev increased its stake in the Guangzhou Zhujiang Brewery to 29.99%.

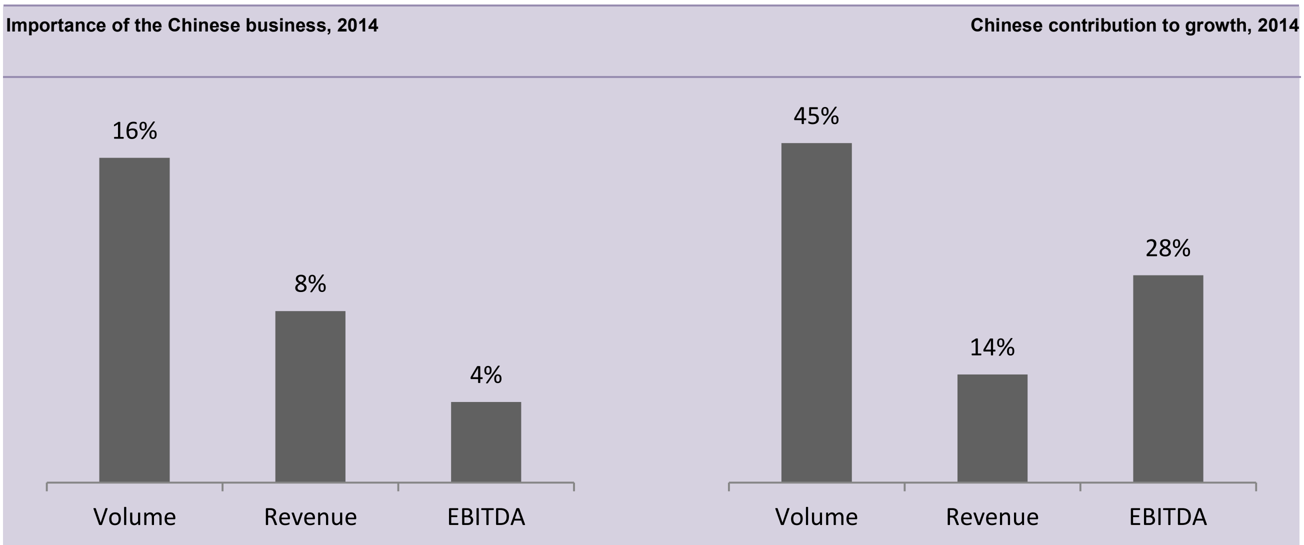
Currently AB InBev holds 39 breweries in China and is building four new ones. Its operations are primarily in North-East China (e.g. Harbin), Greater Guangdong, Greater Shanghai and Central Provinces.

China is 8% of group revenue

For AB InBev, China was responsible for, in 2014, 16% of volume, 8% of revenue and 4% of EBITDA compared to, in 2010, 14% of volume, 5% revenue and 2% of EBITDA. China, is the company's main business in Asia, ahead of South Korea, Vietnam and India. In 2014, China was 87% of AB InBev's Asia-Pacific volumes, 77% of the region's revenues and 67% of EBITDA, and has been the growth driver for the company in its Asia business unit. And that weight is expected to increase further. Although the company has not divulged any specifics on its Chinese ambitions, it is on record as stating a net Asian revenue target of 20% of group revenues (compared to 11% in 2014). Already in 2014, growth in China was 14% of the group's revenue growth and 28% of the group's EBITDA growth.

The growing importance of China is also reflected in the group's communication. It is only since the 2011 results that there was for the first time a little more detail on the Chinese operations and, since the 2014 results presentation, China has become one of the top four priority zones (next to the US, Brazil and Mexico).

Fig. 1: The weight of Chinese business for AB InBev



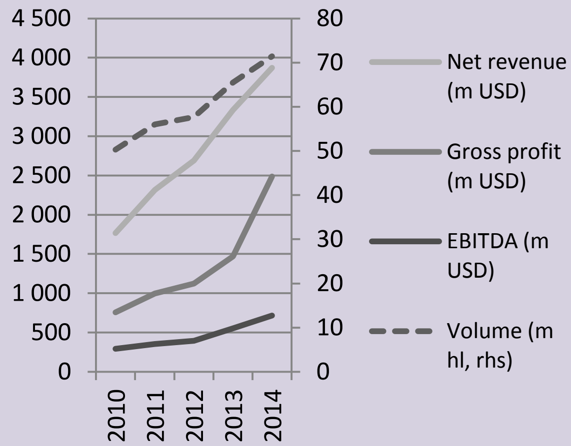
Source: Company, Bryan, Garnier & Co estimates

AB InBev's Chinese operations have increased revenues by 22% p.a. over the past four years and EBITDA by 25%.

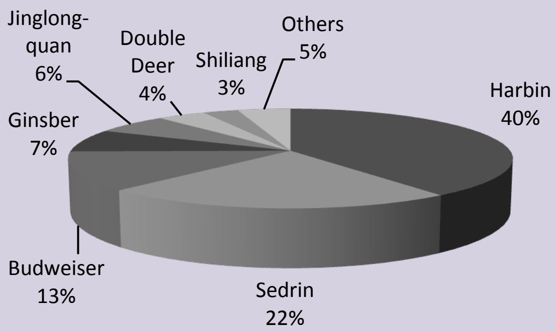
AB InBev's Chinese operations have increased revenues by 22% p.a. over the past four years and EBITDA by 25%. Indeed, over the period, the EBITDA margin inched up from 17% to 18%. With these margins, AB InBev enjoys a 29% share of the Chinese EBITDA pool. Its 18% EBITDA margin compares with 14% on average for other Chinese brewers.

Fig. 2: Growing Chinese profits and brand portfolio

AB InBev China – key financial metrics



AB InBev China – main brands

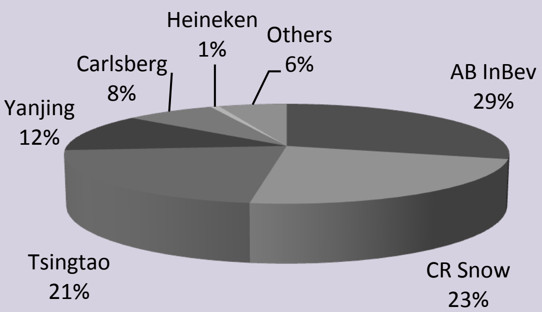


Source: Company, Canadean, Bryan, Garnier & Co estimates

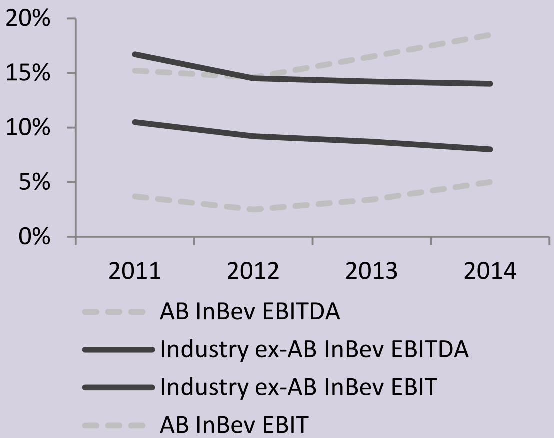
However, because of greenfield sites and brewery relocations, depreciation & amortisation has increased to a higher level than the industry and, as a result, AB InBev's Chinese EBIT margin of 5% is well below the industry level of 8%. Going forward, AB InBev expects its level of D&A to stabilise.

Fig. 3: Profitability of AB InBev in China compared

Chinese EBITDA pool



AB InBev EBIT and EBITDA margin compared with competitors



Source: Company, Bryan, Garnier & Co estimates

1.1. Strategic priorities

AB InBev's Chinese strategy is two-fold:

Drive premium sales volumes

1) Win nationally in premium brands because premiumisation is the biggest driver of revenue per hl and profit margin. The premium segment is now more than 6% of the industry, growing consistently in double-digits. Budweiser is a clear winner in premium but the company is also widening its premium portfolio with Corona Extra, Stella Artois and Hoegaarden. For this, the company is carefully selecting cities with the highest concentration of middle class and affluent households. Equally it is important to select the right trade outlets and retail chains to enhance the consumer experience. But also the upside in the country is big: according to AB InBev, Budweiser is currently distributed in 90,000 points of consumption but there are still 3.2m points that it does not reach.

Build scale

2) Build scale, leadership in its regional provincial strongholds. Through acquisitions and/or greenfield projects, the company is establishing itself in an increasing number of provinces where it is investing (distribution, wholesale partnerships, on-trade visibility, digital marketing, etc.). And although the newly-acquired businesses and greenfield developments are implementing the group's sales and marketing best practices and driving operational efficiencies, profitability is fairly low. However, as the company develops in these regional markets, their profit contribution rises. Back in 2011, most the group's profits came from Fujian, but by 2014 Guangdong, Heilongjiang and Jilin were included.

1.2. Attractive brand proposition

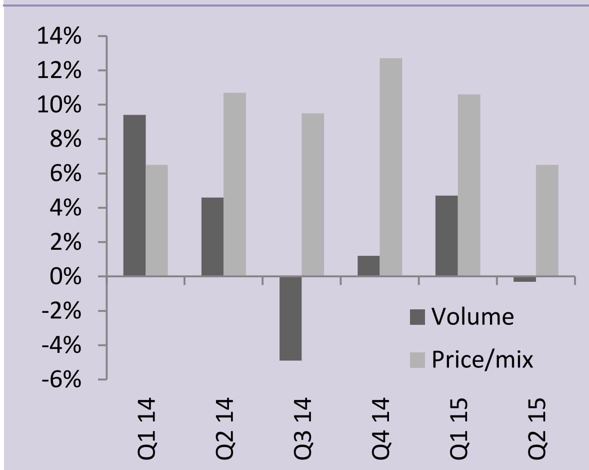
A focused portfolio with Budweiser, Harbin and Sedrin

AB InBev has defined three focus brands in China: Harbin, Sedrin and Budweiser, which together accounted last year for 73% of Chinese volumes. Harbin is the largest of the three, accounting for nearly 28m hl, and is part of the Core+ segment, followed by Sedrin which sells 15.6m hl and is in the Core segment, and Budweiser with 8.8m hl in the Super premium segment. Furthermore, the company has initiated sales of other super premium brands Corona Extra, Stella Artois and Hoegaarden but these are still very small.

AB InBev focuses on the more premium part of its portfolio because growth rates and margins are higher. Indeed Super premium brands like Budweiser sell at 5x the price of core brands. And although the quality of the product is better and raw materials more expensive, they do carry gross margins which are 9x higher than those of core brands.

Fig. 4: Profit drivers for the AB InBev China business

AB InBev China: volume and price/mix



Segment comparison, indexed at 100% for core & value segment

	Price to consumer	Net revenues	Gross margin
Super premium	5.0x	7.0x	9.0x
Premium	2.5X	3.0x	5.0x
Core+	1.5X	1.5x	1.6x
Core & value	100%	100%	100%

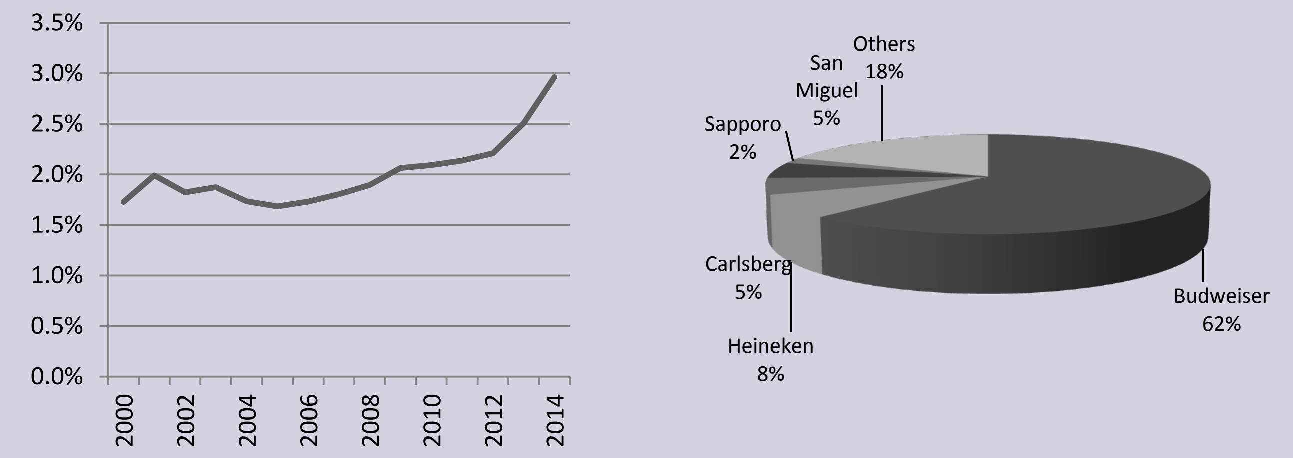
Source: Company, Bryan, Garnier & Co estimates

Budweiser has a 62% share in the International premium segment, which is delivering above market growth

Budweiser is the country's largest super premium brand commanding a market share of 62% in the International premium segment. This segment has delivered growth of on average 12.3% over the last ten years compared to 6.5% for the market as a whole. Especially in the last three years, growth has accelerated to 14.4% against a market growth of 2.5%.

Fig. 5: The Chinese International premium segment

Growth of the Chinese International Premium Segment | **Brands in IPS, 2014**

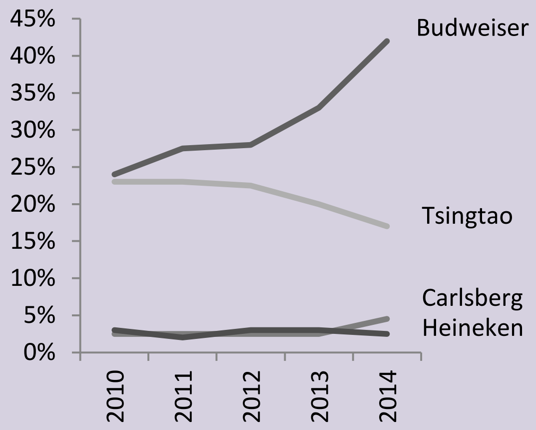


Source: Company, Bryan, Garnier & Co estimates

As an international brand, Budweiser does have a premium image, but it tries to go further and embodies a lifestyle "be free to live the life of your dreams". There is continuous attention for premium and exclusivity, e.g. the aluminium bottle, Budweiser Brewmaster Reserve. And to resonate with younger consumers, the company uses music as a platform and engages increasingly with consumers through its digital platforms. Currently the brand is distributed at 90,340 points of consumption, which are carefully selected.

Fig. 6: Budweiser in China

Budweiser is most preferred brand among premium drinkers in China | **Budweiser's China Made for Music campaign**



Source: Company, Bryan, Garnier & Co estimates

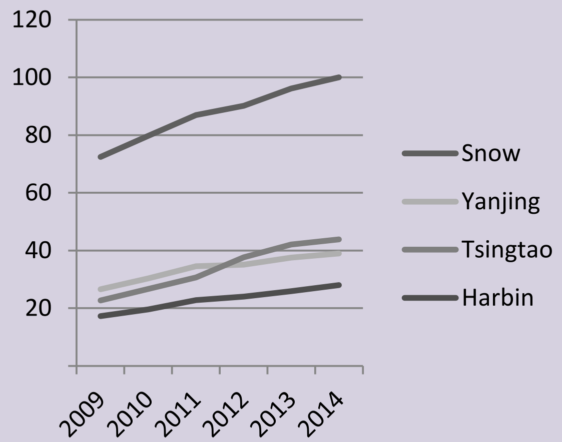
For its other international premium brands (Corona Extra, Stella Artois and Hoegaarden), the company focuses on six urban centres: Shanghai (24m population), Guangzhou (14.1m), Shenzhen (10.6m), Beijing (21.5m), Chengdu (14m) and Hong Kong (7.2m). In those centres, it builds market knowledge, distribution capabilities, a Super premium sales team, awareness and activiation.

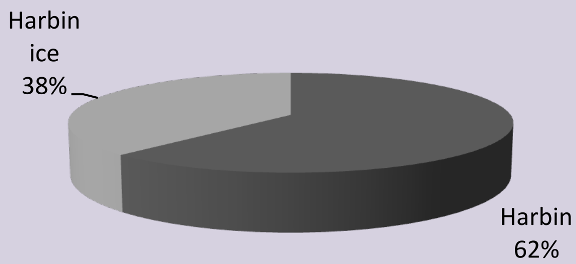
The company's largest brand in China is Harbin, for which Harbin Ice has been the driver

But the company's largest brand in China is Harbin. Harbin has a long heritage as it is the oldest beer in China, established in 1900, but has had a makeover. The brand's ambition is to be the most preferred brand among Chinese young consumers (18-29). The price position is in core and core +, which is about 70% of the market. Growth has been just over 10% p.a. over the past five years, which is more than the 7% of Snow and the 8% of Yanjing, but less than the 14% of Tsingtao. The main driver of the growth has been Harbin Ice which is now 38% of Harbin's sales compared to 15% in 2009.

Fig. 7: AB InBev's largest brand in China is Harbin

Growth of Harbin and its main competitors (m hl) | **Harbin Ice**





Source: AB InBev, Canadean

Please see the section headed "Important information" on the back page of this report.

1.3. Acquisitions and organic growth

In order to increase its presence in China the company not only participates in the consolidation of the Chinese beer industry, but also invests in greenfield breweries.

While organic growth for AB InBev in China stood at only 1.6% for 2014, volume growth including M&A activities was 9% during this period. And, in the first half of 2015, organic volume growth was 1.7% but total volume growth was 8%. AB InBev estimated that in the second quarter its market share in the country had increased by 100bps, reaching 18%.

Acquiring local brands with distribution and leveraging these with the Budweiser and Harbin brands

We believe that AB InBev might look to acquire more regional/national brands to boost its portfolio and penetrate deeper into China. Acquiring local beers with an existing distribution network allows AB InBev to increase its share of the market, leverage the acquired networks with the Budweiser and Harbin brands and leverage the group's management expertise.

Before the acquisition by InBev, Anheuser-Busch had increased its presence in China by buying Harbin Brewery, the maker of Harbin beer, and Fujian Sedrin Brewery, the maker of Sedrin beer, in 2004 and 2006 respectively. Anheuser-Busch also held a 27% stake in Tsingtao, which it had to sell in order to gain regulatory approval to merge with InBev (20% was sold to Asahi and 7% to the Chinese tycoon Chen Fashu). In April 2013, AB InBev acquired four breweries in China, with net beer capacity of roughly 9 million hectolitres, for USD439m (Jiangxi province – in South-East China), and, in April 2014, it also acquired Siping Ginsber (in the Jilin Province – in North-East China) for USD622m. In July 2015, AB InBev increased its stake in the Guangzhou Zhujiang Brewery to 29.99% (from 28.6% for USD258m), pending regulatory improvements. This is an extremely interesting move as, back in 2009, the Chinese regulators stopped AB InBev from increasing Anheuser-Busch's 27% stake in Tsingtao or InBev's 28.5% holding in Zhujiang Brewery, saying they needed to prevent the brewer from becoming too dominant. AB InBev sold the 27% stake in Tsingtao but kept its 28.5% stake in Zhujiang Brewery (which it helped to start operations in 1985) and currently holds a 2% market share in China.

And it looks like there are more Chinese deals on the horizon. Indeed, in an interview with the *FT* (16 June 2015), Mr Brito said he preferred China over Africa (asked about the company's intentions on SABMiller): "Asia offers an amazing opportunity for growth just like Latin America. There is way more action and dynamic in China than in Africa," he says. "We believe a lot in focus so if we open too many fronts, it's just hard to do it right." As it emerged later, that was throwing up a smokescreen, but it does underline the intentions in China.

In addition to acquisitions, AB InBev will look for organic growth in China, especially in the form of growth in revenue per hl. Given the company's premium positioning and growing consumer purchasing power in the country, demand for its higher-priced beers such as Budweiser and Harbin Ice (Corona since August 2014) could allow it to not only increase volumes but also to increase revenues per hl further.

1.4. Results outlook for China

How 2015 is panning out

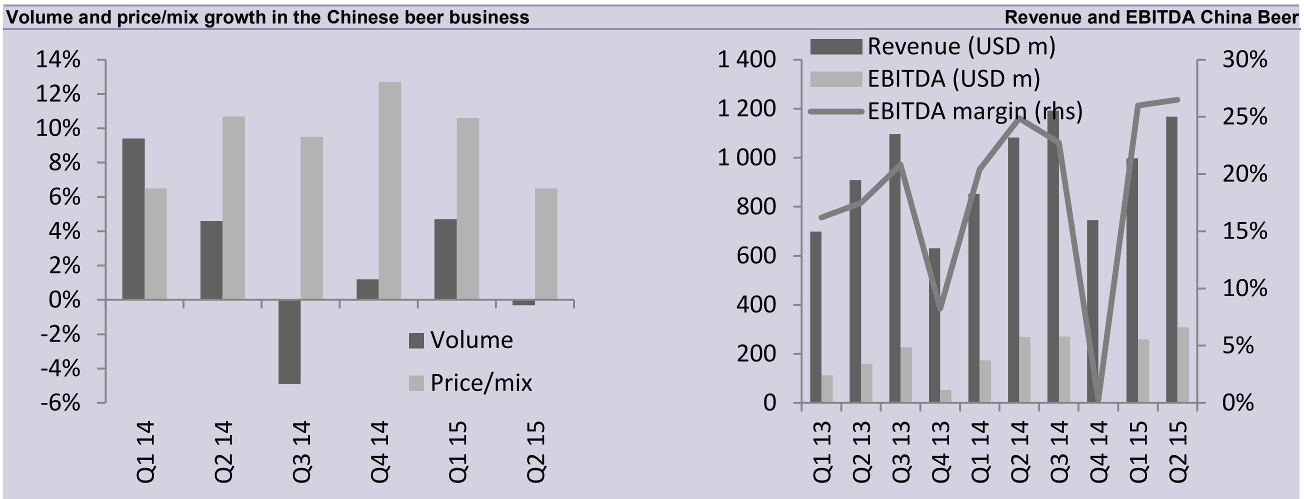
Outperforming in a challenging market

In China, the poor weather and economic headwinds led to a challenging first six months for the beer industry. AB InBev estimates that total industry volumes declined by 6.5% in the quarter and by 4.5% in HY15, with most of the impact being felt in the value and core segments. With this background, AB InBev's flattish volumes in Q2 (-0.3%), and the increase of 1.7% in H1 15, stand out positively and the company estimates that its market share increased by approximately 100bps, reaching 18.0% in the quarter. The company's three Focus Brands (Budweiser, Harbin and Sedrin) grew by 3.5% in the quarter, with Budweiser maintaining double-digit growth. AB InBev continued to invest behind Budweiser's leading position in the International premium segment, and stepped up support for its "Brewed the Hard Way since 1876" quality campaign. Revenue per hl grew by 6.5% in the quarter, with the majority of the increase coming from improved brand mix, driven mainly by Budweiser. China's EBITDA grew by 12.1% in Q2 15, driven mainly by top-line growth, leading to an EBITDA margin improvement of 139bps to 26.5%. EBITDA grew by 28.0% in HY15 with a margin expansion of 378 bps to 26.3%.

Brand mix to drive revenue per hl growth

Although there are easier comparables in the second half (last year was impacted by cold weather, especially in the south eastern and central regions), industry volumes are unlikely to return to growth as the anti-extravaganza measures continue to weigh on government spending. However, for AB InBev, the growth in the premium segment, and the subsequent further continuing growth of revenue per hl (driven by favourable brand mix), should drive margin expansion.

Fig. 8: AB InBev China's key financial metrics



Source: Company, Bryan, Garnier & Co estimates

Longer term potential

We estimate that AB InBev could carry in China a 30% EBITDA and 20% EBIT margin within the next five years

Combining the stronger than the market's organic volume growth with the increase in revenue per hl allows AB InBev to be in an enviable position of good top-line growth and superior margins. The strategy of increasing footprint (acquisitions or organic) means turning breakeven or even making losses in the new territories but, as the company expands, the impact of these expansion losses should diminish, allowing significant profit upside for the company. The combination of leading brands commanding top-line growth and operational efficiencies will continue to drive improvements in profitability. We estimate that AB InBev could carry in China a 30% EBITDA and 20% EBIT margin within the next five years.

2. Updating AB InBev's forecasts

Difficult first half in the US

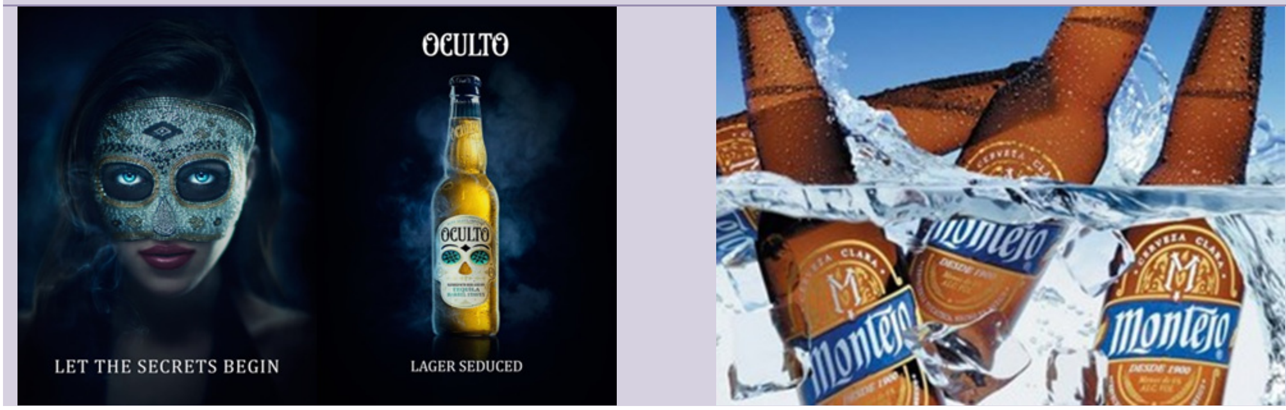
Although AB InBev in the second quarter was up against easy comparable items in the US (low Q2 2014 sales volumes because of additional Q1 volumes, anticipating labour negotiations in Q2), the company reported a decline in volumes by 1.1%. Bad weather in May and June and sales to wholesalers? (-2.2%) below sales to retailers (-1%), disappointing sales of Ritas (only one new flavour, Lime A Rita lemonade, compared to three in 2014 - Mango, Raz and Apple). EBITDA for the quarter was down 6.9%, but with more than half of this decline due to a one-time benefit of USD57m recorded in cost of sales (relating to the reversal of medical expense accruals in the US).

But in the second half, US revenues should accelerate whilst costs improve

Going into the second half, we expect some acceleration of revenues given a more normal weather pattern in Q3 and further improvements in the US economy, driving improvements in the industry. Furthermore, AB InBev is expecting STW that should outpace STR (given that both should end the year showing the same trends), improvements in the Super premium segment with Mixx Tail and the tequila-flavoured Oculto. A pick-up of growth in the Super premium should also improve the price/mix which in H1 was limited to 1.2% (mainly because of Ritas selling less). Of course, one of the key metrics is the improved performance of Budweiser with a market share loss limited to 15bps in H1, which is the best result in the last few years. The other metric to watch is the company's performance in craft beer and Mexican imports, both areas where the company has been under-represented (after it had to sell the Corona and Modelo Especial import business to Constellation Brands). With all these initiatives ongoing, we expect both the top-line and sales & marketing costs to increase. Because of an improvement in the cost of sales and distribution expenses, we are expecting that the full year will actually show an improved EBITDA margin in the US by 30bps (-189bps in H1 and -303bps in Q2).

Fig. 9: New product launches in the US

March 2015: launch of Oculto | **August 2014: Montejo to attach the Mexican segment in the US**



Source: Company, Bryan, Garnier & Co estimates

Mexican business goes from strength to strength

The Mexican business delivered a solid first half in terms of volume, revenue, and EBITDA growth. Volumes grew by 3.2%, despite the impact of the World Cup last year. Revenues were up by 8%, supported by strong revenue per hectolitre growth of 5.8% driven by revenue management initiatives and a favourable brand mix from the growth of Bud Light. This strong top-line result and the delivery of USD30m of cost savings, which brings the total to USD770m, led to growth in EBITDA of over 14% and margin expansion of more than 300bps, to 53.9%. However, because of the weakness of the Mexican peso, EBITDA was down 7%. For the second half, we are expecting the same kind of picture, except additional synergies from the Modelo acquisition could well end up at another

USD200m. We expect the full-year EBITDA margin to expand by 460bps. However, with the currency down 17% for the full year, we are expecting EBITDA to be down 1% to USD2,114m.

Guidance for mid to high single-digit organic revenue growth in Brazil confirmed

Beer industry volumes came under pressure in Brazil due to the very difficult World Cup comps and a weak macro-economic environment. Volumes declined by 3.9% for the half year and 7.9% for the second quarter. 60% of the decline in the second quarter can be explained by the tough comparables from the World Cup. However, Brazil's beer revenue per hl went up by 11.3%, partially because of the easy comps of per hl growth of only 3.8% in the second quarter of 2014 due to promotional activity around the World Cup. Although the macro-economic environment is even more challenging in the second half of the year, the company is gaining traction with, on the one hand, its affordability and pack strategy and, on the other, the continued increase in demand for premium brands in Brazil. So, AB InBev is accelerating investments behind the growth of its premium brands. These include not only the three global brands -- Budweiser, Corona, and Stella Artois -- but also domestic speciality brands and some of the brands in its recently-acquired craft portfolio.

For the full year, we are expecting organic revenue growth of 8% (similar to the 7.4% of the first half) but with less pricing (the affordability strategy) and also less volume decline.

However, despite the short-term economic challenges that we expect for this year and next, the Brazilian beer market still offers plenty of room for growth given the demographics and the beer culture:

- Premium beer: about 20% of consumers have a preference for premium beer brands, but premium is only 8.5% in AB InBev's Brazilian mix. The opportunity for AB InBev is that the market further moves towards premium and that AB InBev increases its share of the Premium segment further (currently about 75%). AB InBev recently launched Corona in the Premium segment next to Budweiser and Stella Artois.

- Near beer: Near-beer like Skol Beats Senses and non-alcoholic like Brahma Zero Zero is tapping volume from mixed drinks.

- Off-trade (35% of the beer market): Growth in returnables (from 3% in 2014 to 15% in 2015 of the off-trade) offers an affordable proposition to stimulate at-home drinking.

- On-trade: extending draft from only Brahma to Skol, which is allowing for a new consumer experience of cold beer.

But the real is down 24%

However, the biggest worry concerning Brazil is the impact of the strong devaluation of the real as, in Brazil, 40% of AB InBev's cost of sales is dollar-denominated. Nevertheless, we do not expect such a strong impact on the margin as the company has a longstanding policy of hedging the transactional part (not the translation), so there should not be too much of an impact on the margin. Furthermore, the hedging gives AmBev more time to adjust to the new situation (gradually increase consumer prices to balance inflation and volume, further increase the returnable part of the off-trade, increase cost efficiencies). Indeed with further cost savings and hedging policies for imported costs in place, we expect the EBITDA margin to edge up to 52.7% (from 51.0%), but because of the 24% lower real, reported EBITDA is expected to come in at USD4,919m, a decline of 14%.

China should continue to deliver good growth

In China, cool weather across the country and economic headwinds led to a decline in industry volumes in the first half by 4%, with most of the impact being felt in the value and core segments. Despite the headwinds in the economy, AB InBev continues to invest behind its three focus brands -- Budweiser, Harbin, and Sedrin - which represent 72% of its volume in China and which helped to deliver organic volume growth of 1.7% for the first six months. Both Budweiser and Harbin Ice with their respectively premium and core + positioning are the engines of growth. China's EBITDA increased by 12.1%, with EBITDA margin up 139bps, to 26%. For the second half, we expect a similar performance while the overall Chinese beer market remains under pressure (the hoped for rebound from last year's bad summer has not materialised) but the premium and core+ category continue to grow.

But Korea remains tough

In other Asian markets, it is mainly the Korean business which is in a transitional phase. In the second quarter, total volumes declined by high single-digits (half was an industry decline and half was market share loss in a very competitive environment). We are not expecting this situation to improve in the second half of the year.

For the full year, we are expecting organic revenue growth of 5.8% (5.1% in H1) and organic EBIT growth of 9.5% (7.2% in H1). With the slightly accelerating revenue line, there will also be a double-digit increase in sales and marketing investments (which increased by only 1.3% in H1), but this increase should be compensated by a much slower growth in cost of sales and distribution expenses. Indeed, last year, cost of sales per hectolitre growth was a 2.2% decline in the first quarter, flat in the second quarter, then 5.6% growth in the third, 6.7% growth in the fourth quarter. So, AB InBev is getting to easier comps in the second half. On distribution expenses, there is the same trend as last year, an increase of 1.7% in the first quarter, 7.6% in the second, 11.9% in the third, 12.7% in the fourth, which means, as the company enters the second half of the year, it is getting easier comps.

Adjusted net profit to be down

We expect that the organic EBIT growth of 9.5% for the full year will be more than offset by unfavourable currency translations, particularly the Brazilian real, the Mexican peso, and the euro, and look for a reported adjusted EBIT of USD14,608m which is 4.6% lower than in 2014. With lower net finance costs and a lower tax rate, we are expecting adjusted net profit to be down 4.9% to USD8,435m and, for 2016, we are looking for a flattish net profit of USD8,408m. Following the downward revision of 2015 and 2016 EBIT by respectively 6% and by 13%, we are lowering our fair value of AB InBev by 12% to EUR96 (from EUR109).

Fig. 10: Results outlook AB InBev by division

USDm	FY2013 Published	FY2014 Published	% Incr.	FY2015e New	% Incr.	FY2016e New	% Incr.
Revenues	43,196	47,063	9.0%	44,704	-5.0%	44,250	-1.0%
North America	16,023	16,093	0.4%	16,093	0.0%	16,254	1.0%
Latin America	16,915	18,849	11.4%	16,468	-12.6%	15,460	-6.1%
Europe	5,065	4,865	-3.9%	3,998	-17.8%	3,926	-1.8%
Asia Pacific	3,354	5,040	50.3%	5,818	15.4%	6,167	6.0%
Global export and holding companies	1,839	2,216	20.5%	2,327	5.0%	2,443	5.0%
Operating profit	14,203	15,308	7.8%	14,608	-4.6%	14,516	-0.6%
North America	5,932	6,068	2.3%	6,132	1.1%	6,242	1.8%
Latin America	7,483	7,945	6.2%	7,036	-11.4%	6,684	-5.0%
Europe	852	906	6.3%	777	-14.2%	794	2.1%
Asia Pacific	127	517	307.1%	786	52.0%	918	16.8%
Global export and holding companies	-191	-128	-33.0%	-123	-3.8%	-122	-1.0%
Non recurring items	124	-188	na	0	na	0	na
Operating profit margin	32.9%	32.5%		32.7%		32.8%	
North America	37.0%	37.7%		38.1%		38.4%	
Latin America	44.2%	42.2%		42.7%		43.2%	
Europe	16.8%	18.6%		19.4%		20.2%	
Asia Pacific	3.8%	10.3%		13.5%		14.9%	
Net interest	(2,203)	(1,319)	-40.1%	(1,144)	-13.2%	(2,018)	76.3%
PBT	12,124	13,801	13.8%	13,464	-2.4%	12,498	-7.2%
Tax	(2,016)	(2,499)	24.0%	(2,558)	2.4%	(2,500)	-2.3%
Minority interests	(2,124)	(2,086)	-1.8%	(1,790)	-14.2%	(1,638)	-8.4%
Net profit	7,984	9,216	15.4%	9,116	-1.1%	8,360	-8.3%
Net profit - adjusted	7,936	8,865	11.7%	8,435	-4.9%	8,408	-0.3%
Number of fully diluted shares	1,650	1,665	0.9%	1,655	-0.6%	1,655	0.0%
Diluted EPS - adjusted	4.81	5.32	10.7%	5.10	-4.3%	5.08	-0.3%
Net dividend (EUR)	2.12	2.64	24.4%	2.68	1.3%	2.67	-0.3%

Source: Company Data; Bryan, Garnier & Co estimates

Price Chart and Rating History

AB InBev

Ratings		
Date	Ratings	Price
05/05/15	NEUTRAL	EUR108.8

Target Price	
Date	Target price
05/05/15	EUR109

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