AB INBEV'S OFFER FOR SABMILLER: THE DANGER OF DELAY

John S. Marsh
Woody D. Richardson
Rachel Graefe-Anderson
University of Mary Washington

In late 2015, SABMiller accepted a takeover offer from AB InBev, but since AB InBev and SABMiller were the world's two largest brewers, the acquisition was contingent on lengthy regulatory approval. While trying to gain approval, a variety of factors changed including a poor fiscal year for SABMiller and a devaluation of the British pound due to the Brexit decision. Furthermore, the British courts split the SABMiller shareholders into two classes and ruled that the deal had to be approved by both classes, not just en masse. These issues brought into focus concerns about the value of the deal and forced AB InBev to revise their original offer in both price and structure. But was the new deal better or worse and for whom?

INTRODUCTION

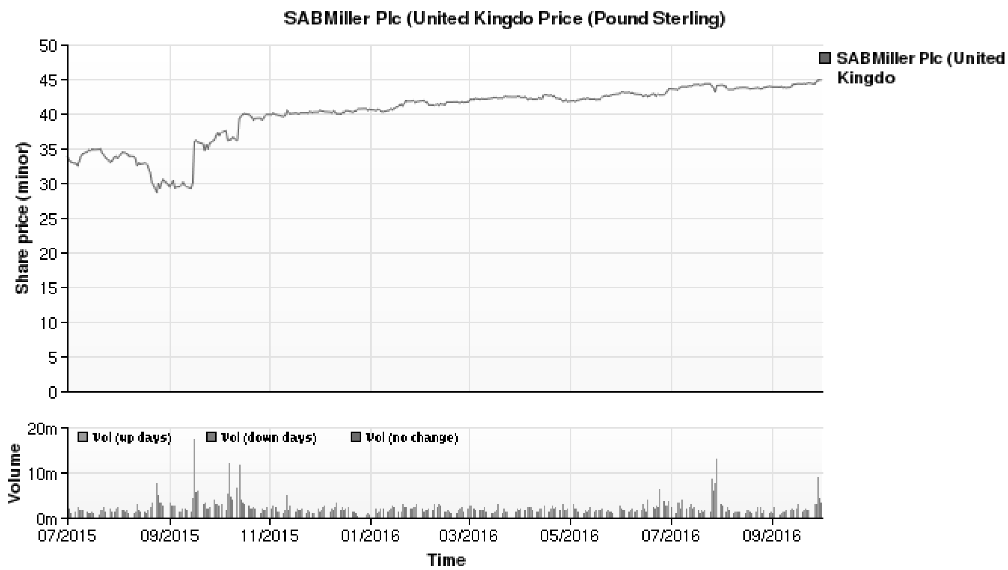
"At times it is folly to hasten at other times, to delay. The wise do everything in its proper time."

- *Ovid*

Leslie Hernandez gave a big sigh. The last thing she wanted to do in August was review more financial reports. It was the end of the summer and she wanted to get an early start on the weekend. But she knew that in the morning, she would have nervous clients calling her asking whether or not they should stay invested in Anheuser-Busch InBev. After all, she was the one who had recommended the stock to them. The planned acquisition of SABMiller, the world's second-largest brewer would make Anheuser-Busch InBev (AB InBev), already the world's largest brewer, into a global powerhouse. There had been hiccups along the way – they always were with a deal this large. But it had been nearly a year now. This was the deal that just would not end!

In the summer of 2015, AB InBev's board had made a number of private offers to acquire London-based SAB for £38, £40, and £42 per share and even a public offer for £42.15 per share. But SABMiller's board had rejected them, claiming that they undervalued their company. Finally, in September, AB InBev sweetened the offer to £44, cash, for each of SABMiller's 1.626 billion shares and SABMiller's board agreed! SABMiller's managers felt they could easily tell their shareholders that the deal was worthwhile; as can be seen in Figure 1, the £44 price was nearly a 50% premium over the early September, 2015 stock price.

FIGURE 1:
SABMiller Stock Price



(SABMiller PLC Equity Pricing, 2017)

Naturally, the £71.5 billion price tag made investors, analysts, and advisors all trepidatious about the deal. AB InBev's management had spoken confidently about significant synergies and improved market positioning in South America and Africa. But Leslie's clients had seen overly optimistic statements from managers in the past, and SABMiller had negotiated a $3 billion break-out fee should the deal fall through for any reason, and AB InBev had a slew of hoops to jump through to gain regulatory approval in all of the countries in which the two companies operated – which was most of the world. So Leslie's clients had asked her whether or not they should invest in the deal. And after much analysis, Leslie had recommended it to her clients, with the caveat that they should be patient because the deal could take time to come to fruition. But 2016 had taken longer and been even more eventful than even Leslie expected and as the summer of 2016 came to a close, Leslie could not help but think of the words of Yogi Berra, "it ain't over until it's over".

REGULATORY DELAYS

The AB InBev – SABMiller merger was a big deal. It would merge the world's two largest brewing companies. Consumer groups and regulatory bodies across the world were quick to express concern that merging the two leading brewers would result in significant market power and raise prices for consumers. AB InBev's management was confident that they could find a deal structure that would be acceptable to all. That is why they had agreed to pay SABMiller a $3 billion break fee should the deal not be approved by regulatory bodies or shareholders (Farrell, 2015). As soon as SABMiller's board agreed to the September 2015 offer, AB InBev promptly began a long and arduous process of securing both the funding and various regulatory approvals for the deal.

To win approval from antitrust regulators, AB InBev agreed to divest many of SABMiller's business components. In November, AB InBev announced it came to agreements to sell SABMiller's 59% stake in MillerCoors to joint venture partner Molson Coors for around $12 billion (Bray, 2015) to satisfy US regulators, and sell SABMiller's Peroni, Grolsch, and Meantime brands to Japanese brewing company Asahi for $2.9 billion to satisfy regulators in the European Union (Walker, 2016). In March of 2016, AB InBev agreed to sell SAB's stake in CR Snow, China's largest beer brand, to its joint venture partner for $1.6 billion (Fontanella-Kahn & Waldmeir, 2016) to satisfy Chinese regulators.

As AB InBev was finalizing formal regulatory approval in the spring of 2016, European Commission regulators raised additional concerns and in April, AB InBev had to sweeten the deal for these regulators by agreeing to divest a number of breweries in Eastern Europe potentially totaling another $5 billion (Derrick, 2016). By May, the deal was looking more positive. European regulators had formally approved the deal (European Commission, 2016) and Australian and South African regulators approved the deal after AB InBev agreed to invest in South African farmers and limit layoffs among its local operations (Kaye, 2016). In July, Chinese and American regulators had granted formal approvals of the final deal terms (Buckley, 2016a). And by August, AB InBev appeared to have secured nearly all of the regulatory approvals needed to execute the merger. Leslie had warned her clients that getting the regulatory approval necessary to allow the merger of the world's two largest brewers would take time. However, during the time it took AB InBev to formally secure all of the approvals, two large things happened that Leslie had not expected: Brexit and the end of the 2015-2016 fiscal year.

2015-2016 FISCAL YEAR

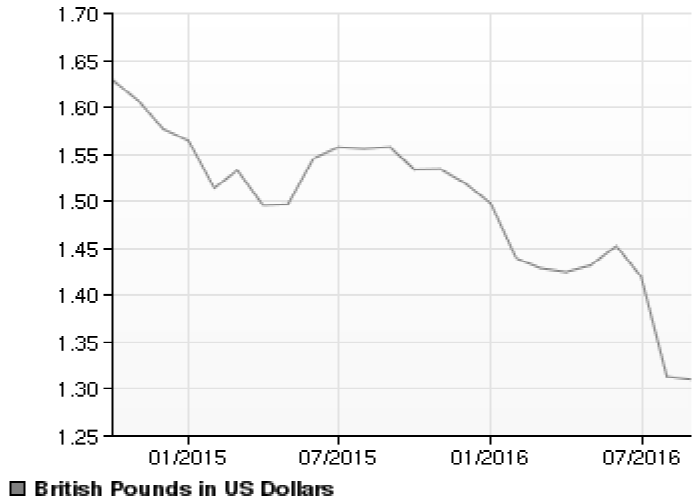
In May 2016, SABMiller announced full year results for the 2015-2016 fiscal year ended in March 2016. These financial reports are shown in Appendix A. Notably, the 2016 figures were not present at the time of AB InBev's October 2015 commitment to buy SABMiller for £44 per share. Some of this data represented enough of a change in SABMiller's operations as to affect its valuation. Worryingly for AB InBev, all of the figures indicated a significant fall in revenues and profits across the board for SABMiller – raising the possibility that AB InBev was overpaying for the acquisition. Revenues fell from $22.1 billion in 2015 to $19.8 billion in 2016. Net income fell from $3.56 billion in 2015 to $2.92 billion in 2016. Operating cash flow fell from $3.72 billion in 2015 to $3.42 in 2016, and operating cash flow excluding working capital changes fell even greater from $5.68 billion in 2015 to $5.06 billion in 2016 (SABMiller PLC Company Financials, 2016).

Looking a little more closely, Leslie thought that some of this decline was undoubtedly due to the looming acquisition. SABMiller's total investing cash flows fell from $659 million in 2015 to -$484 million in 2016 – clearly indicating a less long-term management environment. Although SAB's management team stated that the primary reason for the decline was fluctuations in international currencies, there would be no reason to make long term investments if the company would soon be acquired (Nathan, 2016). However, currency shifts would mean that beer sold locally in the UK was earning less profit as measured in U.S. dollars. While overall volumes sold grew 2% on a hectoliter basis, revenues fell 8% (SABMiller PLC Annual Report, 2016). Although some of the decline may have been due to a lack of investment, this devaluation of foreign sales was probably more the result of the Brexit.

BREXIT

In a June 2016 referendum, a majority of the people of Great Britain voted to leave the European Union. This decision was colloquially called the "Brexit". This move came as somewhat of a surprise to the financial markets and resulted in a dramatic devaluation in the British currency, the pound sterling. The size of this currency effect was quite significant. In the days following the Brexit vote, both the British pound and stock markets fell. As shown below, as compared to the U.S. dollar, the pound fell from $1.50 a pound to $1.33 a pound – a fall of around 13%. As of August 2016, the exchange rate hovered around $1.31 a pound – still almost 15% lower than its pre-Brexit days. Initially, the FTSE 100 index, a collection of the 100 largest firms in Great Britain, fell 5.6% while smaller, more local companies in the FTSE 250 index fell 13.7% (Burton, 2016).

FIGURE 2:
Exchange Rate of the Great British Pound and U.S. Dollar



(British Pounds in U.S. Dollars, 2017)

For British owners of British companies, the effect of this decline was not expected to be very worrisome. Investors largely believed that the weaker currency would make the products produced by British firms cheaper to export, reduce competition in the British domestic market by now-expensive foreign companies, and result in a net increase in sales for predominantly British companies. Thus, over the next month, British stock markets recovered and even posted gains over their pre-Brexit values. As can be seen earlier in Figure 1, on a British pound basis, the value of SABMiller held relatively constant and even posted slight gains throughout the summer of 2016.

However, for foreign owners of British companies, this currency shift was much more troubling. Although British companies would continue to be able to sell product, any profits were devalued internationally because they were denominated in the now-weaker pound sterling. This issue posed particular problems for the AB InBev-SABMiller merger because SABMiller's two largest shareholders were not British. BevCo, a privately-owned Columbian investment company, and Altria, the U.S. based cigarette maker, together owned 41% of SABMiller (Buckley, 2016b). The terms of the acquisition had been agreed upon as British pounds – but the pound was now worth less. These two shareholders started to express concerns that £44 a share now undervalued their company. If these two major, foreign shareholders felt fleeced because of the currency shift, they could easily use their voting power to kill the deal.

INVESTOR REACTION

Needless to say, many investors, including Leslie's clients had become increasingly worried that AB InBev would be forced to overpay for SABMiller lest these two foreign shareholders vote to kill the deal and AB InBev would be forced to pay the $3 billion breakout fee. To make matters worse, Altria and BevCo expressed an interest in receiving AB InBev stock in lieu of some of the cash payout for their SABMiller shares as a means of managing their tax exposure to the sale of SABMiller. This request was understandable, since a sudden cash payout could trigger a massive tax liability for these soon-to-be former owners. But once Altria and BevCo had requested stock in lieu of cash, AB InBev began exploring the possibility of more widely offering a stock-swap merger instead of the original cash deal. It would be much easier for AB InBev to issue new shares than to take on more debt. But many smaller SABMiller shareholders did not want AB InBev stock as part of the merger; they preferred the original cash offer. A number of these shareholders filed suit in British courts and eventually won the right to a dual-class vote. SABMiller's shareholders would be split into two classes: Altria & BevCo in one class and all other common shareholders in a second. The two class setup would require AB InBev to take both classes concerns into account because if either class voted against the merger, it would be blocked (Buckley, 2016b). To quell these growing concerns, AB InBev quickly sweetened its original offer. In July, it boosted the cash part of its offer to £45 per share and allowed the smaller shareholders to retain the cash-only deal (Mickle & Chaudhuri, 2016).

But by August 2016, AB InBev shareholders and their advisors like Leslie were seriously worried about the new terms. From AB InBev's perspective, the devaluation of the British pound had made SABMiller cheaper to acquire – but by raising the bid price SABMiller was no longer cheaper. Furthermore, creating new shares of stock to give to Altria and BevCo would both dilute the ownership stake of existing AB InBev's shareholders and introduce two new "blockholders" who would each own enough AB InBev voting rights to have a major influence on the direction of their company. On top of these issues, the 2016 SABMiller annual report revealed that SABMiller was not quite as strong as a takeover target as they had been the previous year. The lack in investment would hurt revenues in the long-run and SABMiller had reported its worst net income in more than five years.

But many AB InBev shareholders, like Leslie's clients, felt they did not have a choice. With a $3 billion U.S. dollar break-out clause, if the deal failed AB InBev would still be on the hook to pay SABMiller shareholders quite a lot of money – if either class of shareholder objected to the deal. Despite her misgivings, she felt it was too late to recommend backing out of the deal now. It had been such a long road to finalizing the terms of the acquisition, but AB InBev shareholders were starting to wonder if they had just been bitten by this deal. Was it necessary to create such complicated terms to cater to these two different classes of shareholders? How did the events of 2016 change the value of the deal? Assuming a cost of capital of 3.85%, how did the value of SABMiller change from 2015 to 2016, in both British Pounds and U.S. Dollars? Was it now too expensive of an acquisition target? Had Leslie made a mistake in recommending that her clients invest in AB InBev?

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APPENDIX A: SELECTED FINANCIAL STATEMENTS

Annual Income Statement
(All numbers in millions of Great British Pounds)

	SABMiller		
Fiscal Year Ending	3/31/2016	3/31/2015	3/31/2014
Total Revenue	£ 13,778	£ 14,974	£ 13,402
Total Operating Costs	11,379	12,007	10,853
Operating Income	2,400	2,966	2,548
Non-Operating Income / Expenses			
Interest Income (Expense)	(302)	(355)	(372)
Other Non-Operating Income	(49)	(77)	(15)
Total Non-Operating Income	(352)	(431)	(387)
Earnings Before Tax	2,048	2,535	2,161
Taxation	800	861	705
Minority Interests	(155)	(175)	(162)
Equity Earnings	782	733	736
Net Income	£ 1,875	£ 2,232	£ 2,031
Number of Shares (diluted)	1,626	1,621	1,617
Earnings Per Share (diluted)	£ 1.15	£ 1.38	£ 1.26

Source: Mergent Online, 2016

Annual Balance Sheets
(All numbers in millions of Great British Pounds)

	SABMiller		
Fiscal Year Ending	3/31/2016	3/31/2015	3/31/2014
Assets			
Cash & Equivalents	£ 993	£ 653	£ 1,250
Accounts Receivable	1,202	1,143	1,072
Inventories	690	697	702
Other Current Assets	244	456	212
Total Current Assets	3,130	2,949	3,235
Gross Property Plant & Equip	8,701	8,577	8,839
Accumulated Depreciation	(3,317)	(3,190)	(3,394)
Net Property Plant & Equip	5,384	5,387	5,445
Intangible Assets	14,446	14,631	16,235
Long Term Investments	6,701	6,704	6,842
Other Assets	622	716	529
Total Assets	£ 30,282	£ 30,388	£ 32,287

Annual Balance Sheets
(All numbers in millions of Great British Pounds)

	SABMiller		
Liabilities			
Accounts Payable	£ 1,027	£ 950	£ 801
Accrued Expenses	489	440	439
Current Debt	2,033	1,327	2,714
Other Current Liabilities	2,085	2,244	2,052
Total Current Liabilities	5,633	4,961	6,007
LT Debt & Leases	6,123	7,161	7,525
Deferred LT Liabilities	1,563	1,539	1,950
Minority Interests	831	800	699
Other Liabilities	228	248	297
Total Liabilities	£ 14,379	£ 14,709	£ 16,478
Shareholders' Equity			
Common Share Capital	117	114	100
Additional Paid-In Capital	4,758	4,569	3,993
Retained Earnings	13,203	12,007	9,542
Other Equity	(2,174)	(1,011)	2,174
Total Equity	15,904	15,679	15,809
Total Liabilities & Equity	£ 30,282	£ 30,388	£ 32,287

Source: Mergent Online, 2016

Annual Statements of Cash Flows
(All numbers in millions of Great British Pounds)

	SABMiller		
Fiscal Year Ending	3/31/2016	3/31/2015	3/31/2014
Operating Activities			
Net Income	£ 2,030	£ 2,407	£ 2,192
Adjustments from Income to Cash	1,482	1,436	1,218
Change in Working Capital	42	89	56
Other Operating Cash Flows	(1,182)	(1,414)	(1,405)
Cash Flow from Operations	£ 2,372	£ 2,518	£ 2,061
Investing Activities			
Purchase of Pty Plant & Equip	(841)	(943)	(842)
Sale (Purchase) of Investments	(212)	515	(233)
Proceeds from Pty Plant & Equip	51	46	42

Annual Statements of Cash Flows
(All numbers in millions of Great British Pounds)

	SABMiller		
Other Investing Cash Flows	665	829	657
Cash Flow from Investing	£ (336)	£ 446	£ (376)
Financing Activities			
Change in Debt	(551)	(2,591)	(753)
Change in Equity	(25)	55	14
Payment of Dividends	(1,398)	(1,271)	(1,102)
Other Financing Cash Flows	380	164	137
Cash Flow from Financing	£ (1,594)	£ (3,642)	£ (1,703)
Effect of Exchange Rate	(80)	(79)	(37)
Net Increase / Decrease in Cash			
Change in Cash	362	(756)	(55)
Opening Cash	521	1,264	1,177
Closing Cash	£ 883	£ 507	£ 1,122
Supplemental Information			
Depreciation & Amoritization (CF)	£ 784	£ 857	£ 793
Net Purch of Pty Plant & Equip	£ (789)	£ (897)	£ (799)

Source: Mergent Online, 2016