Beer has big changes on tap

by Sarah Theodore

Posted: September 15, 2008

What will A-B InBev and MillerCoors mean for wholesalers, consumers and others?

Summer is the height of beer season, but this year, industry eyes have been focused not on the typical beer venues of baseball games and backyard barbeques, but on boardrooms and a pair of mergers that have the potential to significantly alter the brewing landscape.

Just prior to the Fourth of July, SABMiller, London, and Denver-based Molson Coors launched Miller- Coors, the North American joint venture that combined the second- and third-largest brewers in the United States. Two weeks later, after a heated round of negotiations, Anheuser-Busch, St. Louis, agreed to be acquired by Belgium's InBev. The industry that started the year with three U.S. brewers narrowed to two much larger, potentially more powerful entities, leaving many to wonder how distributors, consumers and other brewers may be affected.

The creation of Anheuser-Busch InBev, as the combined company will be called, is still subject to both regulatory and shareholder approval, but is expected to get the go-ahead by the end of the year. Depending on the perspective, opinions on the acquisition and the MillerCoors partnership range from "cataclysmic" to business as usual, while some have predicted it will lead to further global consolidation and may even affect companies outside the beer industry.

Tom Pirko, president of Bevmark LLC, Santa Barbara, Calif., is in the camp that sees these moves as a seismic change for the U.S. brewing business. "The beer industry has undergone a virtually cataclysmic event," he says, pointing out that the landscape has moved from a local, to regional and now national business dominated by two companies. Combined, A-B InBev and MillerCoors will hold about 80 percent of U.S. market share.

"We have two suppliers who have a tremendous hand locked on the business itself and on the distribution of product, since they sell ... just an enormous amount of beer," he says.

In many ways, the companies already were linked, even without official ownership changes. Miller and Coors already shared many of the same wholesalers, and thanks to a 2006 U.S. import and distribution agreement, Anheuser-Busch and InBev products also went to market together.

Ilhan Geckil, director of Anderson Economic Group's Chicago office, sees the emergence of two major players as a less ominous prospect, helping the smaller of

the two companies, MillerCoors, in particular. "Basically, the industry will become more efficient because of the duopoly factor," he says.

A Belgian king of beers

MillerCoors may have made news first, but the big headlines have come from the A-B InBev deal due to its big price tag and negotiations that, at times, veered into hostile territory.

The idea of combining the companies has been talked about for some time and was not a surprise to most industry observers. But InBev's initial bid of $65 per share, made in mid-June, came as an unsolicited offer that was rejected by A-B's board.

The price, it said, undervalued A-B's brands and earnings growth plans, which included a five-year strategic plan of price increases and a cost-savings program dubbed Blue Ocean that would save the company $1 billion by 2010. InBev responded to the rejection with action that sought to remove A-B's board members and replace them with new directors. A-B called the action a "self-serving effort" to purchase the company for a financially inadequate price.

In the end, InBev returned with an offer of $70 per share, or $52 billion, making it the second-largest cash takeover ever of a consumer products company. If approved, the combined company will be the world's largest brewer, with volumes of 460 million hectoliters and revenues of $36.4 billion, the companies say.

Budweiser will lead the combined company's flagship brands, which also will include Belgium's Stella Artois and Germany's Beck's. A-B's St. Louis headquarters will be the global base for the Budweiser business and all 12 of the company's U.S. breweries will remain open. InBev Chief Executive Officer Carlos Brito will head the company, and A-B President and Chief Executive Officer August Busch IV and one yet-to-be-determined A-B director will sit on the board of directors.

In announcing the agreement, the companies did their best to downplay the argumentative tone of the negotiations. "Let me stress that this is a friendly business agreement," Busch IV told analysts during an investors call. "Carlos Brito is a strong leader with an ambitious plan for building this new great business. I respect him and he has my firm backing on the operation of the future company."

"This combination is transformational for the industry and provides Anheuser-Busch InBev with an undisputed position in the global beer industry, both in terms of size and profitability," Brito said. He told analysts the company expects cost synergies of $1.5 billion from the combination, to be phased in equally over three years.

"Clearly a global behemoth is being created out of this," says Benj Steinman,

president of Beer Marketer's Insights. "One in four beers around the world will be A-B InBev, and they will be dramatically larger than their next largest competitor, which is SABMiller, and more than double the profitability too. So across a lot of different dimensions, this changes the landscape competitively for global beer and creates a No. 1 by a wide margin."

Beer wholesalers in the United States initially will feel few changes, most industry experts say.

"This is really not going to have much of an impact in the U.S. at all," says Brian Sudano, managing director at Beverage Marketing Corp., New York City. "A-B was already distributing InBev product so there's going to be no change there.

"As far as the relationship with the wholesalers in the short term, InBev has agreed to a certain degree of status quo. So in the short term, I don't see much of a change in strategy in the U.S. for the wholesaler network. There will be some consolidation but there shouldn't be a lot of change in the short term."

Steinman adds, "Brito certainly said repeatedly that he respects the three-tier system and that he understands the issues of wholesaler profitability."

But he says, "Where it gets real interesting are around some of the areas like what will happen with Anheuser-Busch's branches. There are some wholesalers that are hoping that maybe some of them that don't really meet InBev's investment criteria will come up for sale. It's not something to which Brito has been willing to say anything about. He's just said it's too early to say. But you know Anheuser-Busch has company-owned branches that some wholesalers would hope to purchase."

Cultural differences

The fate of Anheuser-Busch's famed advertising is another area of speculation, as InBev's frugal spending policies and cost-cutting goals come up against A-B's big-budget ways. It is estimated that A-B spent a little less than $380 million on U.S. advertising last year.

InBev has said it expects to achieve its $1.5 billion cost savings goal without sacrificing marketing. A-B's planned price increases, as well as the Blue Ocean plan, which includes overhead reductions through early retirement offers, SKU cuts, improved supply chain and materials usage, and other factors, will account for much of the savings, it says. In addition, cost synergies in China as well as procurement efficiencies, the elimination of corporate overlap and "cost management best practices" will result in savings.

But Bevmark's Pirko says the flat sales environment in the United States will leave little room for price increases, and InBev will have no choice but to cut advertising dollars.

“Those budgets are going to take a major hit,” he says. Although, he adds, the sheer volume of A-B’s advertising means budget cuts could be felt by the media and advertising communities but be virtually imperceptible to consumers.

Others have a more optimistic view. “I do believe totally that Anheuser-Busch’s skill at marketing is one of the things that InBev is purchasing, and that it is well aware that it needs to improve as a marketing company,” Beer Marketer’s Insights’ Steinman says.

Credit Suisse investment analyst Carlos Laboy took an even more positive view in his written analysis of the potential acquisition. “We would expect the A-B marketers to be big winners out of this transaction as their sphere of influence is about to spread from the United States to the entire InBev global organization,” he said.

Brito himself has said InBev recognizes A-B’s advertising prowess. “We understand that Budweiser was built on a platform of some properties that are very important like NASCAR, NFL, NHL, the Super Bowl,” he said in a video press release on the company’s Web site. “All those things are an integral part of how consumers see and love and are loyal to the brand. So nobody would, in his right state of mind, change that thing because that’s such an integral part of the way the business was built.”

But even if InBev is willing to invest in A-B’s advertising, will consumers be willing to hear it and accept “The Great American Lager” from a foreign company? Most say yes.

“Brand nationality is all about where it was born, and also the ingredients of that beer and how they make that beer,” says Anderson Economic Group’s Geckil.

“Basically, it doesn’t matter who owns it,” he says. “We are in a global world right now.”

While Brito maintains A-B will keep its legendary marketing, he makes no bones about InBev’s aggressive cost-cutting reputation. “We see costs as something we can control,” he said in the video release. “We cannot control the market because there is competition, there’s regulations, there’s the weather, there’s customers. There’s so many other forces in the marketplace. But costs we can control.”

InBev’s frugality starts at the top, as Brito is known to eschew the idea of corporate jets, flying first class and staying in top-tier hotels.

“There’s no question that there’s going to be a change in the way they do business,” Sudano says. “That will happen shorter term. It won’t take long.”

Additional cost cutting will come from procurement synergies. “Probably half of the savings they’re talking about could be procured on the production side,” he says.

In regards to overlapping corporate functions, Geckil says he expects to see most cuts in areas outside of brewing and production.

On the other hand, Geckil says InBev is not afraid to spend money where it needs to, and its financial flexibility is one of the potential benefits of the proposed acquisition. “The financial strength of the company is really unbelievable,” he says. “InBev can do anything. They don’t need to get a quick return … They make investments for two or three years, spending money, and they don’t need to see the return right away.”

Moving to the Windy City

If MillerCoors’ merger news was overshadowed by the A-B InBev deal, it can take comfort in the widely held belief that it is better positioned than ever to compete against the giant brewer. The companies have had months to develop an action plan and will be set to implement those moves just as the competition is starting the process.

“In essence, it gives them an opportunity because people at A-B are going to be distracted until they know exactly what is going to transpire with them in their future as employees,” Sudano says. “So I don’t see a huge impact for MillerCoors. Actually, I see a potential opportunity in the short term.”

Steinman adds, “The rationale for MillerCoors getting together are still very much there and they’re going to look to capitalize on them. You have a much bigger, stronger competitor.”

But, he points out, MillerCoors has cost-savings goals of its own, to the tune of $500 million in stated cost synergies that it hopes to wring out of the combined businesses.

“There are going to be cutbacks,” Steinman says. “They are going to be creating a better organization over time, but it will probably be a somewhat bumpy road getting there.”

The new joint venture, which holds a little less than 30 percent of the U.S. market, has combined annual sales of $6.6 billion. Cost savings are expected to come in the areas of overhead reduction, brewing and packaging synergies and supply chain savings, and will be phased in over three years, the companies say.

Leadership at the joint venture brings together five directors from each company, and the group announced it will make its headquarters in Chicago, basing management between Miller Brewing’s Milwaukee brewery and Coors’ Golden,

Colo., facility. Both breweries are expected to remain open, as are six additional breweries between the two companies. It also plans to invest $50 million in the Milwaukee location and $100 million in the Golden facility.

On the wholesaler front, the MillerCoors merger is shaping up as another intense wave of consolidation. In many markets, Miller and Coors products are handled by the same distributors, but the company is in the process of identifying its preferred distributors in markets that have not been consolidated, Beer Marketer's Insights' Steinman says. "What we already see in response to MillerCoors, I do believe, [is] a stepped up pace of consolidation," he says.

Further distributor consolidation could force out smaller brands, particularly craft brewers, which already have a tough time getting distribution. The craft segment is the one part of the U.S. beer industry that is growing by double-digit rates and high margins make crafts valuable to wholesalers. But new distribution agreements could make it difficult for wholesalers to take on smaller brands.

In July, Brewers Association Chairman Rich Doyle, chief executive officer of Boston-based Harpoon Brewery, told *The Patriot Ledger* in Quincy, Mass., "The small brewers are concerned that these contracts will be even more constraining on the somewhat independent wholesalers to be able to handle products like ours. Ultimately, this is about the consumer having access to the brands they want and the choice they want."

International concerns

In the United States, the double set of mergers might simply make big competitors that much bigger. It's on a global basis that the potential A-B InBev stands to gain the most — and where it poses questions for other global brewers, and other beverage companies overall, some have said.

"In a global market, you're going to gain your profit not by sitting tight in the United States in a flat and declining market," Pirko says. "You're going to make your money in China and Russia and India and Brazil."

During the conference call to analysts, Brito said the acquisition will make it the most diversified player in the industry, giving it a balance between high-growth developing markets and more stable mature markets such as the United States.

The companies already work together in Canada, where Budweiser is the top-selling beer, and South Korea. A-B's presence in China, as well as its 50 percent stake in Mexico's Grupo Modelo made it even more attractive to InBev.

"InBev is likely coveting the opportunity to fully and seamlessly integrate the Modelo and A-B portfolios in the United States," wrote Credit Suisse's Laboy in his analysis of the sale.

Laboy even indicates that non-brewers may need to rethink their consolidation strategies based on the potential sale, saying beer and soft drink integration may become a more global and strategic issue.

"Next-frontier thinking requires every major beverage company to ask itself: what will InBev look like five years from now once it has fully digested [A-B], and possibly Modelo?" he wrote in his analysis. "Will it go down the unlikely path of spirits or will it pursue M&A in soft drinks?"

Those and other questions will be pondered during the coming months as both of the big U.S. brewing entities take over their new roles.

Sarah Theodore
Sarah Theodore is Editor of Beverage Industry magazine.