Report
DYNAMO 67
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Budding

In Dynamo Report n. 65 we updated the fundamentals of our investment in Ambev, explaining the reasons why we decided to increase the Fund's exposure to Inbev upon the acquisition of Bud. In the previous report we looked at the past and focused on an economic analysis of the Inbev/Bud transaction. The exercise now is prospective. The idea here is to describe the map of opportunities that we believe to be present on Anheuser-Busch Inbev's (ABI) radar.

Before we begin, listed below are some of the company's numbers so that we can get a sense of the size of the opportunities. ABI today is a company with a market value of US$97 billion and an estimated net debt for the end of the year of US$39 billion. In 2010 ABI should generate sales of US$36 billion and an EBITDA of almost US$14 billion, after achieving synergies of approximately US$2 billion since the fourth quarter of 2008. North America, with the outsized predominance of the United States (US), became the most important geography to the company, representing an estimated 42% of sales and 51% of operational profits for this year. Next is Northern Latin America, with Brazil as a highlight, with 28% of sales and 36% of operational profits, assuming the consolidation of 100% of Ambev. It is not hard to realize how important these two regions have become for the company, in such a way that Southern Latin America, Western Europe, Eastern Europe and Asia represent as a whole only 30% and 13% of sales and operational profits, respectively. Expected free cash flow for ABI for 2010, after required adjustments, is of the magnitude of US$6 billion. With additional synergies being extracted from the North American operations and an increase in volumes in Brazil and other emerging markets, we expect a 20% growth in adjusted free cash flow in 2011 to a level of US$7 billion.

US Distribution

As we pointed out in Report n. 65, an important component of Ambev's growth in Brazil was the successful penetration further down the distribution chain, with a greater percentage of sales made directly to retailers and to the on-premise channel, eliminating the presence of an intermediary. Some might wonder if the American market, where most of the distribution is done via third parties, would present the same opportunities. This is not the case as the law in 29 of the 50 US states[1] establishes that beer can only be sold through a so called "three-tier distribution system" and prevents consolidation between brewers and distributors. Hence, ABI's challenge in most US states is to make its distributors more efficient, creating incentives for them to modernize their operational systems and better serve retailers. Moreover, part of the challenge is an improved alignment in terms of sales performance and the identification of consumer trends.

Many distributors in the US work with old back office systems and operate in a highly inefficient way. The system as a whole is estimated to make around 7% EBIT margins [2] in the US. This is partially explained by the enormous fragmentation of the distribution market. While consolidation amongst American beer producers has happened in an intense fashion over the last two decades, the same is not true for the distribution chain. Brands owned by ABI and MillerCoors have an aggregate 80% market share of beer sales in the US, while the 10 largest distributors account for only 12% of the total beer distribution[3]. Given the high investment required for warehousing, transportation and sales support, it looks like returns on invested capital are meager. With a low incentive to reinvest, the quality of the service offering is weak. Furthermore, in many areas distributors operate within a few miles from each other. Synergy opportunities in combining systems, fleet, fixed assets, and administrative expenses are obvious and therefore ABI should encourage distributors to merge, which would eliminate a series of duplicities and inefficiencies that exist in the current system. In fact, this had already been happening, albeit at a slow pace, even before the acquisition of Anheuser-Busch by Inbev: between 2003 and 2009 the number of distributors in the AB system dropped from 650 to 525[4].

For ABI it would be much better to work with fewer and more efficient distributors. The dialogue would be more fluid, sales strategies would be better coordinated,

1 US Beer Wholesaler Consolidation: A Tantalizing Prize But Slow And Difficult to Capture, *Stirling, December 9, 2009.*
2 M.J.Mazzoni, Global Beer Forum, *London, June 16, 2009, supported by information extracted from a report by* Sanford Bernstein *published on December 9, 2009.*
3 US Beer Wholesaler Consolidation: A Tantalizing Prize But Slow And Difficult to Capture, *Stirling, December 9, 2009.*
4 *M.J.Mazzoni, UBS client presentation, July 8, 2010.*

improving revenue management, with gains for both ends. Additionally, it would be easier to establish the incentive structures of the distributors, results accountability, and measure comparable performance.

The distribution system's profit pool is close to US$3 billion, or roughly US$1 per case of beer sold. Estimates suggest the existence of at least US$0.75 per case of beer of inefficiencies in the distribution system[5]. In the case of ABI, with a 50% market share, that would imply something like US$1.1 billion. An interesting opportunity, though in practice getting there will be very challenging. Even after the disappearance of some and the consolidation of others, there still are 1,850 distributors in the US[6], many of which family owned, having survived many generations, with strong local political connections and no strong motivation to sell. This is a delicate subject for ABI, and understandably one they do not like to talk about in public. Moreover, discussions regarding a potential increase in excise taxes have been recurring over the last two years to cover budget deficits, both on the state and federal level. In this case, the high degree of influence distributors have with local politicians turns them into important allies. Lastly, more pressing issues, such as deleveraging the balance sheet and integration with Bud in the US, still dominate the company's agenda.

ABI already owns many distributors in the states where it is allowed to and is trying to make further inroads where possible. This year the company tried to buy a controlling stake in a major distributor in Chicago, in which it already owned 30%, but the move was blocked by the Illinois Liquor Control Commission. This only comes to show that any consolidation efforts will not be straightforward. Still, we believe that when the time comes this opportunity will be addressed. It won't be easy and the US$1.1 billion figure is probably a dream. However, even a third of this amount would already be relevant.

Besides distribution, which is the most apparent and promising opportunity in the US, this market also offers other action items that can generate interesting results for the company. Improving the quality of pricing/revenue management is one of them.

Ambev has always been seen as doing a very good job at recognizing consumer profiles and identifying social-economic, demographic and geographic differences which enabled them to manage pricing in a very effective way. This has been done via different packaging propositions, products, promotions, marketing and was supported by a focused and highly incentivized team and internally developed state of the art systems.

In the US they found there was not a coherent strategy in place. Price increases were generally taken across the board, without allowing for differences between the economic environment, demographics or end-market organization in each region. This is exactly what the current US management team is addressing, with the caveat that it would be much easier to implement if the distribution system was more efficient as previously discussed.

Another interesting point is that beer is still affordable to the US consumer when compared to other countries with a high income per capita. A bottle of beer is 26% more expensive in the UK, 125% in Canada, 137% in Japan and 262% in Australia[7]. Beer prices increased by less than the CPI[8] over the last decade, what the company sees as an opportunity. ABI is the leader in most American states and has used its pricing power to implement increases above inflation, first in October 2009 and again in September 2010. MillerCoors (MC), the main competitor with a 30% share in the US, has followed ABI's footsteps and also increased prices. The most recent increase was focused on the sub-premium segment of the market, which both ABI and MC see as excessively discounted when compared to premium brands due to continued discounts granted by the former AB to its clients. The intention here is to close this gap, which is too high in comparison to other consumer goods in the US.

Grupo Modelo

ABI has an economic interest of 50.2% in Grupo Modelo, the largest Mexican brewer. Modelo is controlled by five local families that have been involved with the company since it was founded in 1925 and today own, in aggregate, 56% of the voting capital. The Mexican market is the fifth largest profit pool for beer in the world[9]. However, consumption per capita at 59 liters is much lower than North American and European levels. The market can be considered a duopoly in which Modelo holds a 56% share, Femsa 41% and imports 3%. It is a very hard market to penetrate, where 70% of the volume is sold through small local chains and "mom-and-pop" stores, 20% to on-premise channels and only 10% via traditional supermarkets. Throughout its history Modelo developed important exclusivity contracts with small neighborhood stores, supporting these establishments with marketing initiatives at the point of sale and supplying coolers to many of them. The market is structured in such a way that brewers have huge bargaining power over retail outlets and more than 80%

5 *Jim Koch speech. Founder, President and Chairman of the Board of Directors of The Boston Beer Company, Inc. at the* National Brewers Wholesale Association (NBWA) *conference, September 2009.*

6 *M.J.Mazzoni, ibidem note n.4.*

7 *Luiz Fernando Edmond, president of AB-Inbev North America,* Investor Event *presentation in Saint Louis, Missouri, on June 2nd and 3rd 2010.*

8 *Dave Peacock, president of AB-Inbev US, presentation at the same* Investor Event.

9 *Carlos Brito, president of AB-Inbev, presentation at the same* Investor Event.

of the products are sold directly, eliminating the middlemen and helping to keep a significant part of the profits with the brewers.

When we look at Mexico by region, the two main players have a significant share in their area of influence. Modelo clearly dominates the more affluent central part of the country while Femsa dominates the north. In the south, they enjoy very similar positions, but there is no evidence of price wars in recent history. In other words, instead of a duopoly, the Mexican market is essentially comprised of two monopolies with very similar characteristics to Brazil's Southeast region, largely dominated by Ambev. The pricing environment has been very favorable over the last few decades and there are no signs that this will change. Last January, Femsa was acquired by Heineken, which has a reputation in the global beer arena of prioritizing profits over market share.

Despite such benign conditions, Modelo's operating margin of its beer business has been hovering around 36% on average over the last 5 years[10], roughly 6 percentage points below Ambev's operating margin during the same period. It is reasonable to argue that margins should be even higher in Mexico than in Brazil, given that Modelo has a higher share of the wealthiest region in the country and that an even higher percentage of its sales are done through direct distribution to retailers. There is certainly room for improvement.

As we discussed in previous reports, ABI's track record in extracting improvements at companies it acquired is very favorable. After the acquisition by Inbev, Bud's operating margin in the US increased from 23% in 2007 to 34.5% in the twelve months ended on Q3'2010. Also, Labatt in Canada – a tough, highly controlled market – saw its margin jump from 26% to 34% in the four years following the acquisition by Inbev. We believe that under a dedicated and focused management team Modelo's margins could be much better than they are today.

We see opportunities in four other fronts: first, on capex, since Modelo has been investing in Mexico close to two times depreciation over the last seven years. The last large-scale project is the construction of a state of the art plant in Coahuila, close to the border with the US. Due to the economic crisis, volumes in the last two years were lower than the company had forecasted so that after the project is completed in 2011, we estimate Modelo will be running with an average spare capacity higher than 20%. This might give management the opportunity to rationalize the industrial footprint and reduce investments to levels below depreciation for the coming years. If ABI buys Modelo, the efficiency gains with optimizing industrial assets can be even higher, involving plants in both countries. Second, we believe that working capital can also improve. We estimate Modelo's cash conversion cycle at approximately 80 days, while ABI and other global beer companies operate in negative territory. Supplier days look particularly low. This is understandable since until very recently, each plant sourced separately, with reduced bargaining power. The company is implementing a more modern enterprise management system (ERP), allowing for some of these issues to be addressed.

The third opportunity comes from an improvement in the capital structure. Modelo has been operating with net cash in the balance sheet for quite some time. We understand the defensive strategy since the company underwent very tough times during the 1990s, but it still looks overly conservative and the company could easily operate with a leverage level of at least 1.5x net debt/ebitda. In that case, shareholder returns would improve without compromising the company's risk profile. The fourth opportunity we see is that Modelo is a very asset rich company, some of them underutilized and that could be monetized, such as the beer plant in one of the prime areas of Mexico City.

A company with such traits hardly appears as a bargain and valuation, in this case, is always a critical aspect. Given the synergies and opportunities offered by Modelo and Inbev's track record in managing acquisitions, we believe Modelo could deliver a compelling return to ABI shareholders over time.

Modelo is worth US$25 billion on the Mexican Stock Exchange, implying that the part not owned by ABI is worth US$12.5 billion. On one hand, ABI would have to pay a premium to acquire control, on the other hand, Modelo has US$1.8 billion in cash. Moreover, because they own only 44% of the voting capital, ABI doesn't consolidate Modelo's results into its own. If it did have control, both net cash and ebitda of US$2 billion would be entirely consolidated. As a result, even considering the control premium to be paid, the acquisition of Modelo wouldn't significantly increase ABI's leverage. According to our estimates, which assume margin increase, capex and working capital reduction, sale of non-core assets and increased leverage, we believe ABI could pay a control premium higher than 20% of Modelo's current market price and still generate a return to shareholders above its cost of capital.

The greatest challenge here would be the reluctance of controlling families to sell. The founders and their heirs built a company that is a national pride, pays generous dividends and offers them a prominent social standing as one of the largest employers in the country. The five families may have different interests, which would increase

10 Modelo doesn't disclose operating margins by segment, which are: domestic market beer, beer to be exported and retail/sale of other products. We arrived at the 36% estimate assuming: i) the margins of the export business are similar to Crown's, a joint-venture between Modelo and Constellation Brands, responsible for the distribution of Modelo's brands in the US; ii) a 5% margin of the remaining businesses, which includes more than 1,000 retail convenience stores in Mexico.

the time and the patience required in a negotiation process. The sale rationale is far from obvious. When ABI acquired control of Bud, the Mexican families resorted to arbitration, claiming a possible right to purchase Bud's stake in Modelo. Despite the favorable ruling to Inbev, this episode illustrates the behavior of the families. On the other hand, with global beer market increasingly consolidated, even more so after the Heineken acquisition of Femsa, Modelo runs the risk of being encroached by more capitalized players. In this context, it would be a better option to realize value now or to join forces with a larger brewer. Three other aspects should be considered in a potential transaction. First: the change of control of Modelo could trigger a tag along for minorities of the company, which depending on the premium paid, can reach up to US$5 billion. Second, as Modelo has a 5% share of the US market, the acquisition could attract the attention of competition regulators in some states. Lastly, all of Modelo's exports to the US, accounting for 20% of the group's sales, are made through a joint-venture with Constellation Brands, a North American company with which Modelo has an ongoing agreement until 2016. Should ABI acquire control of Modelo and decide to use its own distribution channels to sell the Mexican company's brands, it would have to pay Constellation a break-up fee.

Brazil

The enviable position of Ambev in Brazil is widely known and was discussed in previous reports. Around 70% of all the beer sold in Brazil comes from one of the company's plants. Because of its strong presence in the affluent Southeast of the country, its market share in the profit pool is even higher. The country is doing well and, as mentioned above, consumption per capita is still low when compared to more developed nations. The other 30% of the market is dominated by three players, one of which was recently acquired by Heineken as a result of the Femsa transaction. The pricing environment has been rational and the two strongest competitors, Petropolis and Schincariol, with much lower margins, have been following every price increase implemented by Ambev.

There are still some valuable opportunities for Ambev in Brazil other than natural market growth. In Report 65 we discussed the recent social mobility the country has been experiencing with the impressive growth of the middle class. Ambev is focusing on doing a better job at understanding the market, segmenting demand and providing products suitable to the preferences, tastes, and aspirations of those new consumers. This translates into innovation. The recent change in mindset is clear, one can notice a sense of urgency to bring new products to the market, of which Antartica Subzero and the 1 liter bottle of Skol are worthy examples.

Another opportunity lies in the Northeast of the country, where beer per capita consumption is 46 liters, compared to 73 in the Southeast, 64 in the South, 62 in the Midwest and 59 for the whole country[11]. The Northeast has particularly benefited from real increases in wages and federal income transfer programs. As a consequence, the northeastern economy has grown at rates above the country average. Ambev is under-represented in the region, with a market share slightly below 60%. The Northeast is where Schincariol is stronger, with 36% of the market, well above its national share of 12%. Ambev doesn't have sufficient industrial capacity in the region and recent volume growth was so strong that the company had to transport beer produced in other parts of the country to supply local demand. This partly explains the lack of operational leverage in the company's results in the first half of the year. To address this issue the company has increased its capex budget in 2010 for the region (to R$550 million), to accommodate an increase in production capacity in the region.

The premium segment is also something that management speaks about with high enthusiasm. Clearly this is an undeveloped niche in Brazil and should benefit as Brazilians aspire for better beer. As a comparison basis, 43% of powder juice sold in Brazil is classified as premium; the same happens for 42% of powder soap, 32% of yogurt, 23% of cigars and 22% of snacks[12]. On the other side of the spectrum, premium beer represents only 5% of the beer market. Russia has the same level as the world average of 13% and in Argentina – where Stella Artois is a huge success – the premium segment represents 16% of the market[13]. Ambev intends to focus on this opportunity as it believes that it must step up to the challenge of developing this segment of the market.

Earlier this year, some issues prevented the company of fully benefiting from a double digit volume growth in the first half of the year. Operational leverage was lower than expected for the reasons mentioned above and in Report 65: lack of footprint in the Northeast, imports of cans at expensive prices due to a shortage in Brazil, higher marketing expenses with the World Cup, and negative results from currency and sugar hedges. Most of these issues will dissipate in the next 12 months, which leads us to believe in a trend of more virtuous results ahead.

Last but not least, ABI owns 62% of Ambev. This has been increasing constantly since 2004 through a series of buybacks by Ambev. After the acquisition of Bud in 2008, ABI prioritized the deleveraging process, and buybacks came to a halt. Since ABI fully consolidates Ambev's results, keeping the subsidiary in a comfort-

11 *Joao Castro Neves, president of AB-Inbev Northern Latin America,* Investor Event *presentation.*

12 *Joao Castro Neves, ibidem.*

13 *Joao Castro Neves, ibidem.*

able cash position was important to rating agencies. We expect a net debt / ebitda ratio close to 2x by the end of 2011, which would allow greater flexibility for the company to deploy its free cash flow. ABI has absolute discretionary power to restart the buyback program, which implies a use of cash easily executable, with practically non-existent transaction costs, won't demand additional management attention, and high returns. This would be accretive to shareholders and therefore, a natural move for the company.

China

China is today, by far, the largest beer market in the world. 397 million hectoliters were consumed in 2009, more than the US and Brazil combined. Still, beer consumption in China is only 32 liters per capita, compared to 59 in Brazil and Mexico and 74 in Russia. Beer consumption is expected to grow 5% per year between 2009 and 2020, with an incremental volume of 160 million hectoliters until 2015, which is equivalent to the projected figures for the Brazilian and Mexican markets combined. The company expects that China will account for 46% of global growth in the period 2010-2015[14].

Similar to other business sectors in the country, huge volumes do not imply big profits. The market in China is still somewhat fragmented, awash with companies that survive only because of government subsidies as the industry is an important employer in many regions. The regulatory environment is weak and informality abounds. Building capacity can cost six times less than in the western world so there still is a lot of capacity coming on stream. A bottle of 640ml can be found in retail shops for US$0.40. In this context, it doesn't come as a surprise that operating margins are amongst the lowest in the world[15].

It is worth remembering that China is a huge country with different climates, tastes and mountains in the middle. Building a national brand is far from a trivial task. The market is segmented, with local peculiarities. ABI has an 11% share, though its strength lies in the Northeast and Southeast of the country.

Before the acquisition of Bud, Inbev had a presence in China through many vehicles: ownership of Fujian Sedrin and stakes in joint ventures they controlled or in which they had a minority interest. Brands lacked recognition and in the company's own words, it was hard to attract talented individuals since few people knew who they were. With the acquisition of Bud, things changed. Budweiser is the leading premium brand in China with a 35% market share in this segment. Harbin is the 5th largest brand in the country with a leading position in the sub-premium segment. Inbev executives like to say they found a talented and motivated group of local executives in the Chinese AB business. The company also sent some managers from New York, Brazil and Belgium to China, such as the current CEO for the region, who was previously in Canada. Aside from a stronger team of executives, joining forces in the country should allow for the extraction of operational synergies by eliminating many functions that were duplicated and with a better rationalization of the portfolio of brands.

Even with overcapacity in the market and the presence of state-owned companies, the market is slowly consolidating, partly because of M&A transactions and partly because many small companies disappeared after credit became scarcer. Snow, Tsingtao, ABI and Yanjing have between themselves 57% of the total market[16]. Each company is stronger in a certain region. The average consumer in China views beer as a premium liquid so consumption is expected to increase as disposable income improves.

ABI executives recognize that it will be a long and winding road, but they are excited with the opportunity. China represents 13% of the company's total volume but only 2% of ebitda. There are US$3.5 billion of assets there that generated only US$65 million of operating profit in 2009. ABI's revenues per hectoliter in China are half the amount in Eastern Europe and operating margins are below 4%. The opportunities are clear and we believe ABI is better equipped now than it has ever been in the past. It is possible that acquisitions happen along the way that can accelerate market rationalization and increase profitability per case sold. Experience in other countries show that consolidation of brewers leads to higher margins. The gains in scale of combined industrial, commercial and logistics operations are usually relevant. Things may take a while to unravel, but the prospects look good.

Synergies

After the acquisition of Bud, Inbev announced a target to achieve US$1.5 billion in cost synergies from the combination. US$1 billion of that was already planned under the Blue Ocean program, described by the Inbev executives as a detailed and very elaborate program. Hence, the combination would bring an additional US$500 million above the existing program. A few months later, ABI increased the target to US$2.25 billion, which is equivalent to 6.5% of total combined sales.

We learned over time that cost efficiency is a never ending process at ABI. Be it in Brazil, Canada, Argentina or Western Europe, all targets have been surpassed. We wouldn't be surprised if the synergies effectively captured

14 *Miguel Patrício, president of AB-Inbev Asia-Pacific,* Investor Event *presentation.*

15 SEEMA International, *2009.*

16 *Miguel Patrício, president of AB-Inbev Asia-Pacific,* Investor Event *presentation..*

surpass the target again. In previous mergers between consumer companies, synergies can reach up to 10% of combined sales. If this is the case here, an additional US$1 billion could be saved. We recognize that when the target was revised upward in the beginning of the year, the company was pressured to reduce debt and by making a public statement regarding the target synergy level, investors and creditors got a sense of management's commitment to do so. Now, with the debt issue largely resolved, it is unlikely that we will hear anything new, while cost reductions are taking place silently. Up to September they had realized U$1.81 billion in synergies. We believe that the remaining US$440 million can be easily achieved until the end of next year.

Another opportunity that management doesn't talk about very much when speaking publicly is revenue synergies. Budweiser is a traditional and globally recognized beer brand. In some places, the brand recall compares to Coca-Cola, illustrating the potential to be tested in events with a global reach. However, until recently, Bud was only sold in the US, UK, Ireland and China. Now ABI can use Inbev's distribution and sales channels in places like Latin America, Europe and Russia. The company started doing so without much fanfare and it is hard to quantify the size of this opportunity for the time being. Though if they are successful, avoiding the mistakes made when they tried to globalize Brahma and Leffe without cannibalizing its own brands, it could prove to be meaningful for the company.

Russia

Russia is the third largest beer profit pool in the world. Consumption per capita is higher than in Brazil and Mexico but beer represents only around 25% of total alcohol consumption against 50-60% in most Western European countries. This is explained by the huge level of alcohol Russians drink every year, nearly 70% more than in the US, 20% more than in Germany and 35% more than in the UK[17]. A huge part of that goes to vodka, easily accessible to the population, especially in the informal market.

The Russian government has demonstrated that it is worried about the health effects on the population caused by the consumption of low quality vodka. On the other hand, excise taxes on beer has been increasing significantly, though still at lower levels than Western Europe. The beer market looks promising in the country and Carlsberg, through Baltika, leader with 40% share, projects volume growth of 3 to 5% per year over the long run.

Although some improvements have been made, ABI still lacks a significant presence, despite having the second largest market share with 16%. It has worked hard over the last few years to improve its industrial footprint and rationalize its portfolio towards premium brands, but it still is at a substantial disadvantage to Carlsberg, whatever the basis of comparison. Operating margins (including Ukraine, where ABI is the market leader) hovers around 10%, compared to 30% at Carlsberg. While Carlsberg makes €15 of profit per hectoliter, ABI makes less than €5.

The fact that they did not put Russia up for sale during the deleveraging process is testament to their belief in the long term prospects of the market and that they can do a better job there. After all, the market has the same size as Brazil and it is hard not to be there. The jury is still out whether they are able to do it themselves or if they need to acquire another company. Carlsberg would obviously be the best choice, even though the foundation that controls it and the anti-trust body could give ABI a hard time. SAB Miller and Heineken, with low 20's market share between them, do not look like sellers. Efes Brewery International, controlled by Turkish Anadolu Efes and with a 10% share in the country could also be an interesting target.

Working Capital

Even before buying Bud, Inbev had been increasing its focus on reducing working capital needs. After the acquisition, the effort was intensified in light of the need to generate cash to pay down debt. Due largely to an increase in the term it pays its suppliers, working capital has been reduced to negative levels. By the end of 2009 it stood at minus 8% of sales. This means that every year sales grow, the company generates cash by releasing working capital. Obviously this is a one-off impact, but having negative working capital gives some comfort, aside from helping return on invested capital.

There is no publicly announced target for working capital, but senior management takes every opportunity they have to say that Reckitt Benckiser's[18] working capital is minus 16% of sales. There is also evidence that, even though they are not disclosed, there are internal targets for the procurement team. If ABI could get to Reckitt Benckiser's level it could represent a significant release of cash over time.

The next big thing?

ABI has turned into a behemoth in the global consumer space. Total enterprise value is U$136 billion

17 Carlsberg: From Russia, With Love, *Stirling, April 23, 2009.*

18 *Reckitt Benckiser (RB) is a company headquartered in the UK with a focus on cleaning products, health and personal hygiene. Peter Harf, ABI's Chairman of the Board of Directors is a member of RB's Board since 1999 as a representative of Joh A. Benckiser SE, of which he is the president. Joh A. Benckiser SE is RB's main shareholder.*

as we write. The company is still behind giants such as Procter & Gamble at U$205 billion, Nestle at U$195 billion, close to firms like Johnson & Johnson at U$162 billion and Coke at U$156 billion and is ahead of Pepsi at U$118 billion and Unilever at U$101 billion. The other largest global beer companies are way behind ABI. SAB Miller, Heineken and Carlsberg have enterprise values of U$65 billion, U$41 billion and U$14 billion, respectively[19].

This was built with craftsmanship work over the years, and for which entrepreneurial owners and incentive schemes designed to attract and retain the best pool of talent available were essential. Looking back in history, this company took decisive, large steps that were essential to take it to where it is today. The acquisition of Brahma in 1989, the merger between Brahma and Antarctica ten years later giving birth to what is today known as Ambev, the acquisition of Quinsa in 2002, the merger with Interbrew in 2004 involving the Canadian Labatt, until, finally, the acquisition of Anheuser-Busch in 2008, forming ABI as it is today. We estimate that ABI will generate about U$8 billion of cash in 2012 and debt will most certainly no longer be an issue.

With all that in mind we wonder what the next big step might be for ABI when we look a few years down the road. The opportunities discussed until now, like buying control of Grupo Modelo, increasing the stake in Ambev or making acquisitions to improve its footprint in Asia and Russia would be very welcomed, but would not be transformational. In the beer arena, we believe that an acquisition of SAB Miller is something that could make sense. The company has two relevant shareholders: Altria Group with 27% and the Santo Domingo Group with 14%. Most of the profits come from South Africa and Latin America (mostly Colombia and Peru), two markets with high potential of growing consumption per capita, with a relevant profit pool and where SAB has dominant positions. Their position in China is also strong and very complementary to ABI's. These are attributes that ABI executives usually hold in high regard. With the exception of the US, where ABI and SAB have an 80% share of the market, the geographic footprint is almost perfectly complementary. The US issue could be resolved with the involvement of Molson Coors, SAB's partner in its joint venture in the country, or any of the other global players.

Something that has been speculated on a recurring basis is a possible tie up with a global soft drink maker. The soft drinks market has obvious overlaps with beer: common consumers, logistics, brand value, and relationship with sales channels. ABI has never hidden its sympathy for the segment. Ambev already bottles and distributes Pepsi products in Brazil and recently ABI engaged in a joint sourcing agreement with Pepsi in the US. Soft drinks are consumer goods with a series of similar characteristics to beer. Lately ABI has been very outspoken about the need to learn from global consumer giants in regards to marketing, relationship with retailers, focus on power brands, development of global and local brands, as well as pricing strategies. All of this suggests a wider M&A horizon.

Our objective was to demonstrate the map of opportunities available to the company in this post-Bud phase. We purposely focused on the potential of the businesses. Naturally, there are risks associated with each initiative, including the following: i) tax increase in the US; ii) challenge of reviving the Budweiser brand, which has been declining in the US since 1988, aside from stopping the loss of share of its main premium brands to imported beer, craft beer, wine and spirits; iii) historically low growth of beers in this market, which raises a question regarding the potential of this consumption category in the country; iv) issues intrinsic to M&A activities – expensive acquisitions, defensive or badly executed; v) a natural limitation in the process of acculturation, of dissemination of this culture of excellence, given the size the company has reached.

This next big step, if it happens, is something still a few years away. As we discussed, ABI's corporate agenda seems to be largely booked in the short term. But we will follow this very closely. Without exception, all of the big steps in the past – some of them largely criticized by investors and the financial community when they were announced – proved to be highly value accretive to shareholders. We realize that the black swan may be waiting to come out, but in this case it is hard to shed the confidence in the success of the next chapter.

Rio de Janeiro, November 29, 2010

19 Source: Bloomberg.

DYNAMO COUGAR x IBX x IBOVESPA
Performance up to September/2010 (in R$)

Period	Dynamo Cougar	IBX average	Ibovespa average
60 months	187,9%	120,1%	121,1%
36 months	48,0%	9,6%	14,6%
24 months	76,9%	36,6%	44,6%
12 months	36,5%	11,5%	12,7%
3 months	13,7%	12,4%	11,5%

NAV/Share on December 30th = R$ 285,157122726

DYNAMO COUGAR x FGV-100 x IBOVESPA
(Performance – Percentage Change in US$ dollars)

Period	DYNAMO COUGAR* Quarter	DYNAMO COUGAR* Year to Date	DYNAMO COUGAR* Since 01/09/93	FGV-100** Quarter	FGV-100** Year to Date	FGV-100** Since 01/09/93	IBOVESPA*** Quarter	IBOVESPA*** Year to Date	IBOVESPA*** Since 01/09/93
1993	-	38,8%	38,8%	-	9,1%	9,1%	-	11,1%	11,1%
1994	-	245,6%	379,5%	-	165,3%	189,3%	-	58,6%	76,2%
1995	-	-3,6%	362,2%	-	-35,1%	87,9%	-	-13,5%	52,5%
1996	-	53,6%	609,8%	-	6,6%	100,3%	-	53,2%	133,6%
1997	-	-6,2%	565,5%	-	-4,1%	92,0%	-	34,4%	213,8%
1998	-	-19,1%	438,1%	-	-31,5%	31,5%	-	-38,4%	93,3%
1999	-	104,6%	1.001,2%	-	116,5%	184,7%	-	69,5%	227,6%
2000	-	3,0%	1.034,5%	-	-2,6%	177,2%	-	-18,1%	168,3%
2001	-	-6,4%	962,4%	-	-8,8%	152,7%	-	-24,0%	104,0%
2002	-	-7,9%	878,9%	-	-24,2%	91,7%	-	-46,0%	10,1%
2003	-	93,9%	1.798,5%	-	145,2%	369,9%	-	141,0%	165,4%
2004	-	64,4%	3.020,2%	-	45,0%	581,2%	-	28,2%	240,2%
1stQuar/05	-1,7%	-1,7%	2.967,4%	-1,7%	-1,7%	569,9%	1,1%	1,1%	243,8%
2ndQuar/05	5,4%	3,6%	3.133,2%	3,0%	1,3%	589,8%	7,5%	8,7%	269,6%
3rdQuar/05	32,3%	37,1%	4.178,3%	25,2%	26,8%	763,7%	31,6%	43,0%	386,5%
4thQuar/05	3,0%	41,2%	4.305,5%	3,1%	30,8%	790,7%	0,8%	44,1%	390,2%
1stQuar/06	23,3%	23,3%	5.332,9%	18,9%	18,9%	959,0%	22,5%	22,5%	500,5%
2ndQuar/06	-3,9%	18,5%	5.122,2%	-4,6%	13,4%	910,5%	-2,7%	19,2%	484,4%
3rdQuar/06	5,7%	25,3%	5.418,6%	2,6%	16,4%	937,2%	-1,0%	18,0%	478,4%
4thQuar/06	19,6%	49,8%	6.498,3%	23,0%	43,2%	1.175,8%	24,1%	46,4%	617,7%
1stQuar/07	9,7%	9,7%	7.136,3%	10,1%	10,1%	1.304,3%	6,7%	6,7%	665,8%
2ndQuar/07	29,3%	41,9%	9.259,4%	28,8%	41,8%	1.709,3%	27,2%	35,7%	874,1%
3rdQuar/07	7,5%	52,4%	9.957,6%	15,7%	64,1%	1.993,7%	16,4%	58,0%	1.033,7%
4thQuar/07	4,8%	59,7%	10.436,6%	2,6%	68,4%	2.048,7%	9,8%	73,4%	1.144,6%
1stQuar/08	-1,7%	-1,7%	10.253,1%	4,1%	4,1%	2.136,6%	-4,1%	-4,1%	1.094,1%
2ndQuar/08	16,4%	14,4%	11.950,7%	11,6%	16,1%	2.395,0%	17,9%	13,2%	1.308,3%
3rdQuar/08	-32,9%	-23,3%	7.983,4%	-36,3%	-26,0%	1.480,9%	-38,7%	-30,7%	763,2%
4thQuar/08	-31,1%	-47,1%	5.470,1%	-32,5%	-50,1%	973,3%	-35,9%	-55,5%	453,7%
1stQuar/09	8,1%	8,1%	5.919,9%	5,1%	5,1%	1.027,5%	10,6%	10,6%	512,5%
2ndQuar/09	44,7%	56,41%	8.612,4%	52,0%	59,6%	1.613,5%	48,8%	64,6%	811,6%
3rdQuar/09	29,4%	102,4%	11.175,9%	34,8%	115,2%	2.210,2%	30,9%	115,5%	1.093,2%
4thQuar/09	20,4%	143,7%	13.472,6%	17,0%	151,9%	2.603,3%	13,2%	144,0%	1.250,7%
1stQuar/10	-1,1%	-1,1%	13.318,6%	0,8%	0,8%	2.625,8%	-0,3%	-0,3%	1.255,7%
2ºQuar/10	-0,4%	-1,5%	13.263,4%	-10,7%	-9,9%	2.355,3%	-12,3%	-11,9%	1.089,6%
3ºQuar/10	20,9%	19,0%	16.054,8%	20,2%	8,3%	2.828,3%	18,6%	4,4%	1.310,7%

Average Net Asset Value for Dynamo Cougar (Last 36 months): R$ 988.521.534,00

(*) The Dynamo Cougar Fund figures are audited by Price Waterhouse and Coopers and returns net of all costs and fees, except for Adjustment of Performance Fee, if due.
(**) Index that includes 100 companies, but excludes banks and state-owned companies. (***) Ibovespa average.

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www.dynamo.com.br

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