A case for buying

By Stafford Thomas

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SABMiller's AUS$9,5bn cash bid for Australian brewer Foster's Group was greeted in classic knee-jerk fashion by investors already spooked by general market weakness. Within three days of the announcement SABMiller's share price had been hammered by over 6%, creating an equally classic buying opportunity for investors taking a more measured view.

SABMiller's stance with Foster's is that you buy a company not when it's firing on all cylinders, but when it is in serious need of remedial action. "Foster's is a tired old company in need of a new lease of life, which SABMiller can give it," says Absa Asset Management analyst Christopher Gilmour. "They [SABMiller] have done their homework."

If SABMiller's bid eventually succeeds - Foster's has rejected it - it will take action in two key areas: reverse its flagging performance in the beer market and slash costs.

Foster's market share is sliding, having fallen from 53% in 2007 to 49% in 2010. Its beer volume fell about 6% year on year in October 2010 compared with a 4% growth rate a year earlier.

The main reason for the decline, says Sanford C Bernstein analyst Trevor Stirling, is Foster's under-representation in the fast-growing premium segment, where it is losing market share to smaller players, including Pacific Beverages, in which SABMiller has a 50% stake.

Anyone doubting SABMiller's ability in the premium beer market need look no further than SA, where it has used its marketing skills to transform an ordinary beer, Castle Lite, into the leading premium brand.

There is plenty of scope to cut costs at Foster's. SABMiller's beer volume is 21 times greater than the Australian brewer's while its total costs are only a little more than six times higher.

SABMiller's ability to extract costs from a business is also in no doubt. In the US, for example, SABMiller's 58%owned MillerCoors has sliced US684m off costs over the past three years and a further $66m is targeted by the end of 2012. Since 2009 in SA, R1bn in costs have been cut off what was already an efficient business. (See Cover Story June 10.)

Even in its current poor state of repair Foster's would add about 10% to SABMiller's sales (US18bn in 2010/2011) and, estimates Citigroup analyst Adam Spielman, add 6%-7% to its EPS in its year to March 2013. Foster's is also "highly cash generative", he notes.

A concern of many analysts is that Foster's will reduce SABMiller's attraction as an emerging-market play. Stirling estimates that the contribution of emerging markets would fall from 84% of SABMiller's profit at the interest, tax, depreciation and amortisation level at present and a projected 86% in 2013/2014 to 74% in 2013/2014.

Putting a different slant on it, rating agency Moody's believes a rebalancing of SABMiller's earnings base away from developing and emerging markets to assets generating strong cash flow in a mature beer market will enhance its credit rating. This would be important to SABMiller, which would have to fund the deal in part with debt.

How much SABMiller will have to fork out to secure the deal is unclear. Spielman believes it will have to raise its offer by at least 12%. A rival bid for Foster's is also possible, with US brewer Molson Coors tipped as a possible contender. Reassuringly, SABMiller has stated that it will not jeopardise its investment-grade credit rating to fund the deal.

For investors prepared to back SABMiller management's belief that it can extract value from Foster's, the current dithering over the pros and cons of the deal appears to be presenting them with a great buying opportunity.

Source: Financial Mail