SABMiller: The battle for Latin America

Abstract

SABMiller plc., which was started in 1895, is a South African based brewery giant. Since then it has expanded from its original South African base into a global company with operations in Africa, Asia, Australia, Europe, Latin America and North America. Today, it is multinational company and its headquarters are in London. The company marketed over 200 brands across 75 countries and it was the world's second-largest brewing company measured by revenues and was also a major bottler of Coca-Cola. Through their "Building locally, winning globally" philosophy, they have made their presence felt in both developed markets and emerging economies such as Latin America, Africa, China and India. The Latin America segment covered SABMiller's primary brewing and beverage operations in Colombia, Ecuador, El Salvador, Honduras, Panama and Peru. In each country SABMiller was the leader of the market. The segment also bottled soft drinks for The Coca-Cola Company in El Salvador and Honduras, and for PepsiCo International in Panama. In Latin America, the company operated 17 breweries and 15 bottling plants. However, the global competition for Latin America was aggressive, there were other three multinationals trying to compete actively and conquer new territories globally. The Belgium-based Anheuser-Busch InBev, Dutch brewer Heineken, and Denmark's Carlsberg, the four of them, including SABMiller, they brewed more than 50 per cent of the world's beer and three of them were having a battle for the countries of Latin America, due the constant growth and profitability of the region. The case paper intends to discuss and highlight the entry strategy of SABMiller in the Latin America market, the overall strategy of conquering emerging markets of SABMiller by fast local adaptation to individual markets, SABMiller's responsiveness to local business focusing on Latin America and the dynamics of the global players of the brewery industry in Latin America.

Introduction

In July 2012, Graham Mackay leaned back in his chair during his private flight from London to Bogota, where he was going to attend the SABMiller quarterly divisional seminar series of Latin America and discuss the future opportunities of growth with Mr. Karl Lipper, new President SABMiller Latin America since 2011[1]. Mr. Mackay has been the Chief Executive Officer at SABMiller since 1999. He joined The South African1 Breweries (SAB), the predecessor organization of SABMiller, in 1978 and has held a number of senior positions in the company, including the Executive Chairman of the beer business in South Africa. He became the Group Managing Director in 1997. As the Meyer Kahn, the previous Chairman retired on 26 July 2012, Graham Mackay took over as Executive Chairman for an interim period of one year and at the end of the interim period, the intention was that Graham would become Non-Executive Chairman.

The board of directors agreed that the new Chairman (Mr. Mackay) must be able to provide stability and continuity, must understand both the global brewing industry and the particular challenges of the emerging markets in which SABMiller operated, must be familiar with the ways of working and able to enhance the corporate culture and operational performance and must be competent to oversee the completion of the business capability programme currently under way[2]. For all these high expectations about him, Mackay felt the pressure to make concrete actions, he was wondering what is the best strategy for expansion? In which emerging market is appropriate to enter now? There is a tradeoff between profitability and risk; there are regions with high profitability but with fierce competition, especially Latin America.

Mr. Mackay was thinking what should be the next strategic move for SABMiller. He knew that the company had a strong presence in the developing regions such as Latin America and Central and Eastern Europe, where the focus was on volume and value growth, achieved by providing high-quality, aspirational brands at a range of prices to cater for all income levels. At 76%, the proportion of the group EBITA coming from developing or emerging economies remained the highest in the brewing sector. Hence his meeting in Bogota was going to be fundamental to get a deeper understanding of the opportunities and risks for growth in Latin America, since the others global players also have been trying to conquer the same region during the last years.

History: African roots and heritage

SABMiller began its operations as South African Breweries (SAB) in 1895. SAB evolved over time and launched Castle Lager in 1898. In 1911, SAB stimulated the local barley industry, supplying imported seed free of charge and contracting to buy the crop at market prices.[3]

The company acquired a stake in Schweppes carbonated soft drinks in 1925. A decade later, the company established extensive hop fields through a joint venture with Ohlsson's. In the early 1950s, the company acquired a number of breweries, small hotels and pubs. During 1960s, SAB extended its involvement in the liquor industry by acquiring control of Stellenbosch Farmers' Winery. In 1975, the company replaced its Pepsi franchise with Coca-Cola. The company established operations in Botswana in the early 1980s, securing a controlling interest in Lesotho Brewing and Maluti Mountain Brewery. It

1 Source: SABMiller plc Quarterly divisional seminar series Latin America presentation, 05 July 2011.

2 Source: Chairman’s statement, Meyer Kahn, Chairman, 2012 Annual Report.

3 Source: Company Profile_SABMiller, published by market line on 06 Jul 2012

also made acquisitions in diversified consumer goods segment such as the Scotts Stores retail apparel group and Edgar's fashion group. During the same period, the company ceded control of Appletiser to Coca-Cola and made its first investment away from the southern African subcontinent in the US. The company acquired Plate Glass group, a manufacturer and distributor of glass and board products, in 1992. In 1995, SAB entered the beer markets of Tanzania, Mozambique and Angola when it took control of the second largest brewery in mainland China. In the late 1990s, the company entered new markets including Poland and Romania.

In 2001, SAB became the first international brewer to enter Central America when it acquired Honduran brewer, "Cervecería Hondureña"; also, formed a joint venture with El Salvador Beverages Business, a brewery and sparkling beverage distributor[4]. SAB acquired the Miller Brewing Company (Miller), America's second largest brewer, in 2002. The merged company changed its name to SABMiller.

In early 2003, the company expanded its international operations when SABMiller acquired a 29.6% stake in the Chinese brewer, Harbin Brewery Group, from China Enterprise Development Fund. In the following year, SABMiller announced the establishment of two separate joint ventures with its pan-African partner, Castel Group. In the following year, China Resources Breweries, an associate of SABMiller and a subsidiary of China Resources Enterprise, announced that it would invest $82.2 million in the construction of a new brewery in the city of Dongguan, in the south-east Chinese province of Guangdong.

In 2005, SABMiller took over Bavaria, South America's second largest brewer, by acquiring stake of 71.8%, and by the end of the year the company increased its stake in Bavaria to 96.8%. The following year, SABMiller entered into a joint venture with Vietnam Dairy Products Joint Stock (Vinamilk), to establish a greenfield brewery in the Binh Duong province in southern Vietnam. Under the terms of the agreement, SABMiller and Vinamilk each hold 50% interest in the joint venture.

In 2007, SABMiller and Molson Coors Brewing Company signed a letter of intent to combine the US and Puerto Rico operations of their respective subsidiaries – Miller Brewing Company and Coors Brewing Company – to form a new venture, Miller Coors. SABMiller's Russian operation invests US$170 million in the construction of a new brewery east of Moscow.

In 2009, SABMiller's Romanian subsidiary, Ursus Breweries, acquired a 71% interest in the Romanian brewer Bere Azuga. CR Snow SABMiller's joint venture in China continued to expand with the acquisition of further breweries in Anhui, Liaoning and Zhejiang provinces and it's first in Shandong province.

In 2010, SABMiller acquired Cerveceria Argentina Isenbeck, the third largest brewer in Argentina, from the Warsteiner Group. In 2011 SABMiller announced the building of a new brewery in Nigeria and further invests in its Southern Sudan operations. The same year, SABMiller announced US$295 million investment programme in Peru and a US$260m investment programme to fund capacity expansion in its subsidiaries in Uganda, Ghana, Zambia and Tanzania.

Finally, in 2012 SABMiller announced to double capacity in Uganda with construction of new US$80m brewery in Mbarara in western Uganda, the fastest-growing regional beer market in the country. SABMiller, Anadolu Group and Anadolu Efes announced completion of a strategic alliance for Turkey, Russia, the CIS, Central Asia and the Middle East, with our Russian beer business, and Ukrainian beer business, contributed to Anadolu Efes in exchange for a 24% equity stake in the enlarged Anadolu Efes group.

4 Source: Heritage of SABMiller. http://www.sabmiller.com/index.asp?pageid=27

Global Beer Industry and Emerging Markets

Beer is the world's oldest alcoholic beverage. Early origins can be dated back to 6 million BC in written history of Ancient Egypt and Mesopotamia. It was largely considered a home activity until the 14th century when the world's oldest operating commercial brewery was established in Bavaria[5]. This was the catalyst that broke the mold from family oriented practice, to an entrepreneur's dream. For example in the US, most of the major players in the market were established in the mid to late 1800's. With an industry that has been around as long as the beer brewing industry has, it was no secret that it has reached a pinnacle. At the same time it are showing no signs of decline, therefore maturity was the proper life cycle stage for this industry[6]. There were four big players in the industry, the Belgium-based Anheuser-Busch InBev, Dutch brewer Heineken, and Denmark's Carlsberg, the four of them, including SABMiller, they brewed more than 50 per cent of the world's beer.

The brewing industry is measured by the number of hectoliters produced by year. The global beer industry represented approximately 1.85 billion hectoliters in 2010, up approximately 1.5% from 2009. North America represented 18% of global beer volume but an estimated 32% of global beer profits, driven by ABI's high profitability in the United States. Central and South America (C&S America) was 13% of global beer volume but 21% of global beer profit, due to favorable oligopolistic market structure. Western Europe was 15% of global beer volume but 18% of global value, driven by high unit pricing. But relatively low margins resulted in the region accounting for an estimated 12% of global profit. Intense local competitive dynamics and low selling prices led to C&E Europe representing only 10% of global beer profit (versus 14% of volumes). Asia Pacific was the largest regional beer market by volume due to its population size and accounted for 35% of the world's total beer consumption (see **Exhibit 1**). However, the region only accounted for 17% of the global beer profit pool (largely due to a very fragmented, low-price, low-margin Chinese market). Africa/Middle East was a fast growing region but was still relatively small, largely due to low levels of income per capita. Beer typically constituted a first affordable luxury and there were still many people in early and mid-stage emerging markets drinking "cheap local alternatives" (see Exhibit 2). The Bernstein analysis argued that as the income rises, people will continue to increase total alcohol consumption and switch from cheap local alternatives to clear beer

The global beer market had EBIT of approximately $31.5 billion in 2010 (approximately 20% margin). Similar to revenue, this blended global weighted average hid a number of big differences between regions (from 30% in C&S America to 13% in Asia Pacific) and within regions (e.g., from 6% in China to 34% in Australia). Broadly speaking, individual market margins seemed to be driven by a combination of net price/hectoliter, market structure and brewer efficiency. Global growth continued to be driven by emerging markets, which accounted for virtually all the incremental volume consumption in the last decade.

If mature markets still represented approximately half of the global beer profit pool, it was the emerging markets that have been driving volume growth. Over the last decade, beer volume growth came primarily from emerging markets (see **Exhibit 3**), driven by robust growth in Latin America, C&E Europe and strong growth in Asia Pacific and Africa/Middle East. In North America, beer volume growth was in positive territory, largely driven by population growth. In contrast, in Western Europe, beer volumes declined over the past 10 years as a combination of low population growth, falling alcohol consumption per capita and beer's share of throats loss versus spirits and wine. However, North America and Western Europe still contributed significantly to global value growth in beer, due to relatively strong price mix (see **Exhibit 4**).

5 Source: http://www.beertown.org/ba/index.html

6 Source: Beer Brewer Industry Analysis, April 16, 2008.

Part of the difference in beer consumption per capita across regions, was driven by significant income disparities, as there was a broad "logarithmic" relation between GDP per capita and beer consumption per capita (see **Exhibit 5).** Another part was explained by very different local drinking cultures, although more country specific. For example, in France and in Italy, beer consumption was relatively low versus countries like the United Kingdom or Germany because of the strong wine culture. Similarly, in Japan, sake was a very important national alcoholic drink, as was "baijiu" in China.

Latin America accounts for 13% of global beer consumption, but 21% of EBIT. Beer volumes have grown rapidly over the last decade, driven by strong economic development and positive demography. Many markets across the region were organized as virtual monopolies or duopolies with strong dominant players such as ABInBev, and SABMiller. As a result, margins were very high across the region, despite relatively modest ratio of price/hectoliter.

Global Competitors and the battle for Latin America

The top four brewers (ABInBev, SAB Miller, Heineken and Carlsberg) collectively accounted for 45% of volume, 48% of revenue and 59% of EBIT, on a proportionate basis (i.e., adjusted for associates and minorities)[7]

ABInBev accounted for 18% of global beer volume but almost 30% of global EBIT. Its businesses are skewed to North America and Latin America, through AmBev. The group has best-in-class margins, benefiting from scale, top-cost management and favorable market structures in the Americas.

SABMiller accounted for 12% of global beer volume and 15% of EBIT. It was the global brewer with the highest exposure to fast-growing emerging markets (c.75% pro forma for Foster's), with strong positions in Africa and Latin America leading to robust pricing power and superior margins. In contrast, SAB's Asian operations were mainly in China and India, where operating margins are low.

Heineken accounted for 9% of global beer volume and 10% of EBIT (on a proforma basis). It now has a more balanced geographic mix of mature/emerging markets post FEMSA/CCM. However, the group was still heavily dependent upon low-growth, lower-margin Western Europe. Having said that, Heineken pure beer margins in Western Europe were not as low as they seem on a reported basis when we adjust for their very large wholesale business. In addition, the group led positions in many African markets, where it benefits from strong pricing power and superior margins.

Carlsberg accounted for 6% of global beer volume and 5% of EBIT. It primarily operated in Europe (N&W and C&E), which accounted for 90% of its beer profits. In Eastern Europe, Carlsberg was largely concentrated in Russia, where Baltika enjoys close to 40% market share. Given the scale of the Russian beer market, the group had high margins in Eastern Europe. In contrast, Carlsberg had relatively low margins in Western Europe, where markets were a lot more competitive.

Regarding the positioning of these brands in Latin America, two different competition dynamics were clearly identified in Mexico and C&S America. On one hand, Mexico accounted for 24% of the population, 19% of the beer volumes (64 mhl), 15% of beer net revenue ($6 billion, $94/hectoliter) and 17% of beer EBIT ($1.7 billion, 28% margin). Within Mexico, the beer market also worked as a duopoly, between Grupo Modelo (now owned by ABInBev) and Heineken (FEMSA/CCM). The two brewers combined virtually controlled the entire market (see **Exhibit 6**). Modelo's domestic Mexican business was already approximately 38% larger than CCM's. Furthermore, Modelo had a much larger export business

7 Source: The Bernstein Global Beer Guide, April 2012.

and its total volume and revenues were approximately 4x CCM's on a Crown Imports fully consolidated basis (slightly above 2x on a proportionate basis). Modelo's business was also more concentrated around Mexico City; whereas CCM was strong in the north and in the more rural south, where cost-to-serve was likely higher. CCM also had a marginally lower net revenue/hectoliter. Finally, there may well be inherent efficiency differences.

On the other hand, Central and South America was one of the largest profit contributors to three of the global brewers. BInBev, through its 62% stake in AmBev, had the highest relative (profit) exposure to C&S America, with an estimated 35% of group equity-adjusted EBIT (estimated 42% if including Mexico from its 50% stake in Modelo/Diblo). SABMiller (pro forma for Foster's acquisition) was the second-highest brewer exposed to Latin America, with approximately 29% of group EBIT derived from the region. Heineken (postFEMSA/CCM) was number three, with an estimated 17% of group pro forma EBIT stemming from Latin America (see **Exhibit 7**), largely from Mexico (excluding Mexico, Heineken's profit exposure to C&S America is approximately 3% of group proforma equity-adjusted EBIT). [8]. However, Carlsberg had almost no exposure to the region. The region was likely to continue to offer attractive growth opportunities, notably as real GDP continues to grow in the region and therefore, Latin America will continue to be one of the key growth drivers for the beer category, along with Asia and Africa. However, in profit terms, it was clear that both Latin America and Africa were far more profitable than Asia due to very different market structures (series of oligopolies versus heavy fragmentation, respectively).

At a company level, AmBev, SABMiller and Heineken combined accounted for an estimated 88% of the Latin American beer profit pool (see **Exhibit 8**). Tier 2 brewers of local or regional companies include Polar, Schincariol (now owned by Kirin), Petrópolis and CCU (33% owned by Heineken). Both AmBev and SABMiller had very high operating margins (see **Exhibit 9**), benefiting from superior scale and above all from their strong local leadership positions, particularly in Brazil and Argentina for AmBev, and Colombia and Peru for SABMiller.

In 2010, Heineken, the world's third largest brewer, announced the US$7.6 billion acquisition of the beer operations of the Latin American company FEMSA. Several other large brewers were interested in FEMSA's beer assets, including the global number two brewer SABMiller due to FEMSA's unique position in the Latin American market and its small but expanding export operations. On a global level this acquisition should increase Heineken's share of the beer market from 6.9 percent to 9.2 percent, thus closing the gap on second-placed SABMiller, which in 2009 held a share of 9.5 percent. The deal considerably strengthened Heineken's position in the Americas, significantly increasing its share in Mexico and Brazil as well as securing its joint venture with FEMSA in the US premium import market. Mexico and Brazil were the two leading markets in Latin America and, combined, accounted for just fewer than 63 percent of the region's beer volumes in 2009. Heineken may have paid a high price for FEMSA but this deal will transform the company, giving it access to the two largest markets in Latin America with a partner which retains a vested interest in these markets through an equity holding. It seems that Heineken wanted the deal more than its rivals, but had to pay for it [9].

In 2010, SABMiller plc. announced that it had acquired Cervecería Argentina S.A. Isenbeck ("CASA Isenbeck"), the third largest brewer in Argentina, from the Warsteiner Group. CASA Isenbeck's principal brands were Isenbeck and Warsteiner, with total sales volumes in 2009 of approximately 600,000hl. Its brewery was located in Zarate, near Buenos Aires, and had a total capacity of 1.2 million

8 N.B. Most of Heineken's Latin American profits come from Mexico.

9 Source: Latin America Beer: What Are Next Targets?.

hl. CASA Isenbeck was going to continue to produce and distribute the Warsteiner brand under a long-term license agreement.

In 2012, after years of partial ownership, Anheuser-Busch InBev, the world's largest brewer, had decided it was time to buy Corona. AB InBev announced that it had struck a deal to buy the remaining shares of Grupo Modelo for $20.1 billion. The purchase extended AB InBev's led over SABMiller as the largest brewing company in the world[10]. These confirmed the Mexican battle between AB InBev's and Heineken, Between them, the companies will control almost all of the country's beer market after Amsterdam- based Heineken bought the brewing business of FEMSA[11].

Outside the two major markets of Brazil and Mexico, Anheuser-Busch InBev was dominant in Argentina, Uruguay and Bolivia and had operations in other countries in the region. SABMiller had a stronghold in Central America, Peru, Ecuador and Columbia. This left several smaller brewers in the region that were focused mostly on one country but were nowhere near the size of FEMSA. The dominance of Anheuser-Busch InBev, Heineken, SABMiller and the instability of certain markets left little room for acquisitive growth in the region.

International strategy

"Building locally, winning globally, delighting consumers"[12]**.** SABMiller became a global leader by **excelling locally - nurturing strong, local brands and building brand portfolios that meet the needs of consumers in each of individual markets**. The portfolio of brands included premium international beers such as Pilsner Urquell, Peroni Nastro Azzurro, Miller Genuine Draft and Grolsch, as well as **leading local brands** such as Águila, Castle, Miller Lite, Snow, Tyskie and Victoria Bitter. SABMiller created leading positions in both emerging and developed markets across the world, growing through a culture of operational excellence, delivering high quality products, innovation and sustainable growth.

The company believed that the business was not separate from society, and that the success of SABMiller was inextricably linked to the well-being of the wider community. Everywhere it operated, they were working to build strong local businesses that contributed to their local economies. That's what made them global leaders in doing business locally.

"SABMiller's strategic focus was centered on four priorities"[13]:

(1) **Creating a balanced and attractive global spread of businesses:** The wide geographic spread of the operations allows us to benefit from growth in volumes and value in beer markets around the world. We continue to look for opportunities **to strengthen our geographic footprint in both developing and developed markets through greenfield entries, alliances, mergers and acquisitions**.

(2) **Developing strong, relevant brand portfolios that win in the local market:** We seek to develop **attractive brand portfolios that meet consumers' needs in each of our markets.** This includes expanding our offerings to address new consumer segments and drinking occasions, strengthening our mainstream brands, building a differentiated **portfolio of global and local premium brands** and channeling the right brands to the right outlets at the right time and price.

(3) **Constantly raising the profitability of local businesses, sustainably**: Our aim is to keep enhancing our operational performance through top-line growth and continuous improvement in costs and

10 Source: The King Of Beers Buys A $20 Billion Crown, June 2012 by FORBES.

11 AB InBev Seals $20 Billion Modelo Purchase to Gain Corona, Jun 29 2012 by Bloomberg.

12 Company Snapshot 2012, SABMiller.

13 Source: Strategic priorities of SABMiller. http://www.sabmiller.com/index.asp?pageid=18

productivity. It's also important that we maintain and advance our reputation, protect our license to trade and develop our businesses sustainably for the benefit of our stakeholders.

(4) **Leveraging our skills and global scale:** Our global spread presents increasing opportunities to gain value from the scale and skills of the group, not least by leveraging our scale and expertise in procurement, standardizing our back-office functions and integrating our front-office systems. We are also benefiting from ongoing collaboration and the sharing of skills between our businesses.

External studies concluded that SABMiller was the global brewer with the largest exposure to fast-growing emerging markets (see **Exhibit 10**). With the acquisition of Bavaria in 2005, **Latin America** was the largest profit pool for the group, representing close to 30% of the group beer profit (pro forma for Foster's). SAB's margins in Latin America were high by global standards. This was because SAB had dominant positions in almost all markets in which it operated (e.g., Columbia, Peru). **Africa** was also a good market for SAB as it had clear leadership positions in most local markets where it operated, leading to strong pricing power. SAB was also strong in **C&E Europe**, particularly in Czech Republic and Poland, while **Western Europe** was a relatively small region for the group. In **North America,** SAB was mostly operating through its MillerCoors JV with Molson Coors. The JV had significantly strengthened SAB's operations in the United States and brought significant cost savings. Finally, in **Asia**, SAB's main markets were Australia (post Foster's acquisition), China and India. In China and India, unit revenue and margins were low due to market fragmentation in China and regulation issues in India. This was offset by Australia, where unit revenue and margins were very high by international standards (see **Exhibit 11**)[14].

At the heart of the business was a passion for producing quality beers. In creating and building the brands, they drew on deep insights into local culture and consumers and sought to win with products that tap into local preferences. **The focus on local businesses with tailored brand portfolios made SABMiller, the most local of the global brewers**.

On the one hand, the **Local brands** typically brewed and consumed in the same community, beer was an inherently local business. SABMiller respected and nurtured the history and heritage of local brands and gave the businesses considerable freedom to meet local needs. They were also innovators – be it new, affordable brands made from locally grown ingredients, craft beers for the aficionado or the concept of the 'local premium' for consumers aspiring to affordable luxury. On the other hand, the four **global brands** had their own distinct provenance and characteristics. They comprised the stylishly Italian Peroni Nastro Azzurro; the world's original golden beer, the Czech-brewed Pilsner Urquell; the Northern European Grolsch; and the embodiment of American urban cool, Miller Genuine Draft.

In terms of the **"Premiumisation and Innovation strategy aimed at the emerging middle class in the emerging markets"**, SABMiller tried to respond to the market with the local premium brands and the global brands, trying to position itself in the premium and super premium segments. SABMiller hoped to find a kicker in Premiumisation in emerging markets such as Latin America, South Africa and India. The premium segment was constantly growing in the beer market and more consumers were willing to buy a premium product. The price sensitivity for alcohol beverages was the lowest among categories of "everyday life"[15]. Moreover the dynamics of Premiumisation were different across developed and emerging markets, mainly because in the emerging markets the new emerging middle class needed to display a status and this middle class would double in the next years[16].

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14 Source: The Bernstein Global Beer Guide.

15 Source: Booz & Company, Autumn 2009. Survey of Consumer Spending. Sample size n=2,010.

16 Source: Premiumisation Seminar, DIAGEO, April 2010.

This trading up was shown in countries such as Panama and Honduras, where not only the local pride brands were competing but also the international premium brands such Corona, Heineken, Miller Genuine Draft were trying to conquer the Super Premium Segment. It was because regardless of the average beer drinker's economic background, consumers were turning to premium brands[17]. Even low income consumers didn't want to be associated with cheap brands. In such countries as Honduras, there was an opportunity in the premium segment, where the consumers wanted to feel they were consuming a luxury product, for example an international well-known beer and even an exotic "European" beer. SABMiller had success in introducing Miller Genuine Draft, Miller Lite and other products that were marketed as premium beers, but there was not significant knowledge of the other global premium beers such as Peroni Nastro Azurro or Grolsch.

Originally, to build the global premium portfolio, SABMiller acquired Italian Peroni Nastro Azzurro beer, a European brand the company reintroduced as standing for all the things we loved about Italian brands: high-fashion, sexual allure, and premium price. This beer, together with Miller Genuine Draft and its Czech addition Pilsner Urquell (acquired in 2003), was another high-end brand that would seem to be out of reach for the average cash-strapped consumer. Nonetheless, in what seemed like a move contrary to common sense, SABMiller announced in March 2006 that it was set to launch a US$ 50 million global brand campaign built around the Peroni offering, proving that it was willing to spend the money in order to become a heavyweight contender in the premium beer game[18]. However it seemed that with too many global premium brands, there is not a singular image of the international premium brand such Heineken did. When you think about SABMiller, it was not clear for the local market which was the most premium brand, Peroni Nastro Azurro, Miller Genuine, Grolsch or Pilsener Urquel. It was the moment to decide which can be the most appropriate model for the premiumisation and innovation strategy in SABMiller, by creating a new premium brand within the portfolio of brands or by using the Nesspreso model (see **exhibit 12**), creating a separate entity as 100%-owned SABMiller affiliate.

Finally, another important factor of success was the innovation strategy, which was continuously stimulated by the Local premium brands. In Latin America, for instance, seasonal offerings such as the Negra, Dorada and Roja variations of Club Colombia and seasonal derivatives of Cusqueña in Peru had underpinned double-digit volume growth in the premium segment.

Regarding this innovation strategy in Latin America, Karl Lippert said: "At any given time, we have about 50 innovations such as new products, brand extensions and new packaging. We've achieved a 6% innovation rate for fiscal 2013 (revenue coming from new products etc.), compared to 2% in 2011. Heineken has set a goal of reaching 6% by 2020, but we're already there"[19]. For example in Honduras, SABMiller had an innovative packing and 360º brand building campaigns strengthening Port Royal brand, which was the local super premium brand in a green bottle[20].

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17 Source: http://www.brandchannel.com/features_effect.asp?pf_id=313

18Source :SAB Miller's Haute Aspirations.
http://www.brandchannel.com/features_effect.asp?pf_id=313

19 Source : http://finance.yahoo.com/news/beer-maker-sabmiller-courting-latin-192454486.html

20 Source: SABMiller plc Quarterly divisional seminar series Latin America presentation, 05 July 2011.

Focus on Latin America

In 2012, SABMiller continued to register strong growth in Latin America, where its volumes were up by 8% compared to the previous year[21]. Central and South American beer market represented 234 million hectoliters (13% of global beer volumes), $21.5 billion of net revenue ($92/hectoliter and 13% of global beer revenue) and $6.6 billion of EBIT (30.5% margin and 21% of global beer profits). Overall, the **C&S American beer market have very high operating margins by global standards** (approximately 30% versus global average of approximately 20%). This was primarily due to the oligopolistic nature of each market, where the dominant brewer typically enjoys very strong pricing power and significant economies of scale in branding, manufacturing, distribution and overhead absorption.

SABMiller first entered the Latin American Market with the acquisition of "Cerveceria Hondureña" in Honduras, making the company the first international brewer to enter Central America. Since then, the group has expanded its Latin American operations into six countries, including El Salvador, Colombia Ecuador, Panama, Peru and in 2010 the most recent moved in Argentina. In each of these countries (except Argentina), SABMiller was the number one brewer by market share and the company was also the third largest brewer in Argentina. SABMiller bottled soft drinks for The Coca-Cola Company in El Salvador and Honduras, and for Pepsico International in Panama. In 2012, the Latin American region contributed with the highest EBITA for the company (see **exhibit 13**).

In 2007, SABMiller announced that it was investing approximately US$1.8 billion in its South American operations over 5 years, responding to higher than expected sales volumes and the significant profit growth potential in the region. The investment would finance upgrades to the group's brewing capacity; point of sale improvements; the development of route to market networks; and new packaging which forms part of a brand renovation programme to enhance the appeal of the group's beers to a broader base of consumers and across a wider range of drinking occasions[22]. Further investment in capacity, point of sale development and route to market assets would continue during the investment period across the four markets in the region. Speaking at an investor seminar in London, Barry Smith, president of SABMiller South America, commented:

"This last quarter has seen another good performance from our businesses in South America, with volumes ahead some 12% on a pro forma basis, and up 11% year to date. This performance, and the smooth integration of the four new operations that has been achieved in the last year, gives me confidence that we will continue to make good progress towards developing our South American platform."

In 2012, Latin America delivered a strong performance with lager volume growth of 9% (8% on an organic basis) and soft drinks volumes improving by 10%. This was attributable of the focus on the affordability of lager in a number of the markets, differentiated brand portfolios and the expansion of the premium segment, in the context of economic growth across the region. Volume growth, combined with selective price increased and mixed benefits, increased group revenue by 13%. Higher commodity costs were partly offset by improved manufacturing efficiencies and continued distribution productivity gains. Increased investment behind our brands was funded through ongoing fixed cost productivity improvements. EBITA grew 15% and EBITA margin improved 50 bps (up 70 bps on an organic, constant

21 Source: Africa and Latin America Continue to Drive SABMiller's Growth in Fiscal 2012, Euromonitor International, 2012.

22 Source: SABMiller plc to invest US$1.8 billion in South America. Archive news 17 January 2007.

currency basis). After the positive results over the last past years, Karl Lippert, President of SABMiller Latin America said:

"Strong volume and EBITA, growth resulted from improving affordability of key lager brands, building our brand portfolios and expanding the premium segment"[23].

C&S/Latin America was key for SABMiller. The region was the largest contributor to SABMiller's profits, accounting for 29% of the group EBITA. The region has been very dynamic and has generated approximately 20% of total incremental organic revenue and c. 40% of total incremental organic EBITA for the group since the full integration of Bavaria into SABMiller's accounts. The region was likely to remain one of the key drivers for SABMiller along with Africa in the near term.

Honduras

In late November 2001, Honduran Brewery, SA became part of SAB Miller; the company acquired the shares Dole Fruit Company, Inc. had in Honduran Brewery, SA. As a subsidiary of SAB Miller, the company has upgraded and modernized its production and administrative processes and commitment was to achieve sustained commercial success, meeting the aspirations of consumers with quality products and services[24]. At the same time SAB entered to El Salvador. Graham Mackay, Chief Executive, commented:

"This acquisition is consistent with our stated strategy of investing in growth markets. This transaction will give us the leading position in the growing beer and soft drinks markets of El Salvador and Honduras and we believe we can achieve significant revenue growth and substantial cost savings while working closely with our strong local partner. The acquisition is expected to be earnings enhancing in its first financial year"[25].

Cervecería Hondureña S.A. (CHSA) was the leading producer and distributor of soft drinks and beer in the Republic of Honduras and was headquartered in San Pedro Sula. Through its exclusive bottling agreement with TCCC, which has been in place since 1928, and its own proprietary line of soft drinks and beer, CHSA had become the largest beverage company in Honduras. CHSA was the sole domestic brewer and the leading beer importer in Honduras, supplying 98% of the beer consumed in the country. The Beer division was headquartered in San Pedro Sula, where its main brewery was located. It also operated a second, smaller facility in Tegucigalpa. Sales volumes for the year ended 31 December 2000 were 941,179 hls in a market where per capita consumption was 14.8 liters versus the Central American average of 18.5 liters. The market has grown at an annual growth rate of 2.7% over the past 10 years. The company's lines of proprietary brands and imports accounted for approximately 96% and 2% respectively of the Honduran beer market volume. CHSA's strength relative to other importers and potential market entrants was a result of its long history of product quality, customer loyalty, its national distribution system and economies of scale. Its main proprietary domestic brands included Salva-Vida, Imperial and Port Royal.

In 2003, the company consolidated all beer production nationally plant in San Pedro Sula and redesigned logos and icons Salva Vida and Imperial Beer, presented in bottles with paper labels and new breaks regionalism of its distribution it remained for many years. Next year in 2004, SABMiller went to

23 Source: 2012 Annual report_SABMiller

24 Source: History of SABMiller in Honduras. http://www.cerveceriahondurena.com/

25 Source : SAB plc announces major investment in El Salvador and Honduras. Archive News 29 Nov 2004. http://www.sabmiller.com/index.asp?pageid=149&newsid=513

market a new flavor balanced pilsner, golden color in clear bottle: Barena, soon was having a broad consumer acceptance Honduras. In 2005, a Market launched of Coca Cola licensed Vital Water, pure water and natural. In 2008, the company acquired rights to distribute Miller Lite & MGD.

In Honduras lager volumes for 2012 were up 9% versus the prior year. Growth was underpinned by our affordability strategy, in the traditional trade with a larger multiservice bottle, and in the modern trade with affordable can pricing, for both mainstream brands, Imperial and Salva Vida. The super premium category saw healthy growth, with Miller Lite doubling its volumes. The alcohol market share continued to increase reaching a historic high of 53%. Soft drinks volumes grew by 7% boosted by further cooler penetration and brand activations and the success of multiservice packs. During the year SABMiller launched Actimalta in the non-alcoholic malt category with good acceptance from our target consumers. The juices and tea categories introduced last year saw volume growth of over 40%.

There were three main brands in Honduras, Barena, Salva Vida and Port Royal. The total size of the market was 1,207 (hl 000) and the beer consumption per capita was 15 litter[26]. SABMiller had 96% of market share of beers and 58% share of total soft drinks market.

El Salvador

In 2001 SAB entered to El Salvador. SAB formed BevCo with a prominent local family consortium which owned a leading conglomerate in El Salvador with wide ranging commercial interests in Central America. This family consortium, through a separate holding company (CAB), controlled the sole brewer and largest soft drinks bottler (Coca-Cola) and water business in El Salvador (together defined as "ESBB").

The markets of El Salvador and Honduras offered the potential for growth in both volumes and profits. Per capita consumption was relatively low in comparison with other Central American markets and together with favorable demographics this provides the basis for sustainable long-term volume growth in beer and soft drinks. These two countries had stable political environments, good economic growth prospects and benefit from a close trading and political relationship with the USA. In El Salvador, the full use of the US dollar as the local currency was introduced on 1 January 2001, and over the last few years the Honduran currency has been relatively stable, trading against the US dollar in line with inflation differentials.

El Salvador Beverages Business (ESBB) was El Salvador's leading producer and distributor of beer, carbonated and non-carbonated soft drinks, and bottled water as well as one of the largest packaging companies in Central America. Through its longstanding exclusive bottling agreement with The Coca-Cola Company (TCCC) and its proprietary beer, non-carbonated soft drinks and bottled water brands, it was the largest beverage business in El Salvador. Besides serving the El Salvadorian market, ESBB was also an exporter of beer, water and packaging products to countries including the USA, Guatemala, Honduras, Nicaragua, Costa Rica, and Panama.

La Constancia was a leading industrial company in El Salvador for 95 years. It was the first national company dedicated to the production of beer and was responsible for 99% of local beer sales - accounting for volumes of 805,000 hls during the year ended 31 December 2000 - and has its own national distribution system. The brand portfolio comprises six locally produced brands (including Regia, Pilsener lager, Suprema and Premier), a range of imported beers from Guinness, Modelo and Anheuser Busch, and Maltin, a malt-based carbonated soft drink. In addition La Constancia exported its own and private label brands (5.5% of beer production) to the USA.

26 Source: Forecast figures for 2011 from Plato Logic, March 2012.

In 2001, the beer market in El Salvador was an underdeveloped market, with consumption of some 12 liters per capita versus the Central American average of approximately 18.5 liters. The market grew at an annual compound growth rate of 3% over the past five years.

In 2012 El Salvador domestic lager volumes saw double digit volume growth, driven by the more affordable bulk pack of our flagship mainstream brand, Pilsener. The local premium brand, Suprema, also saw healthy volume growth of 30%, which together with the repositioning of Golden Light in the upper mainstream segment, significantly improved revenue mix. As a consequence, the alcohol market share increased to 32%. Soft drinks volumes grew by 7%, mainly due to the success of multiservice packs. In January 2012 SABMiller expanded into the non-alcoholic malt category with the brand Actimalta.

The brand portfolio include: Golden, Suprema and Pilsener. The total size of the market was 850 (hl 000) and the beer consumption per capita was 11 litter. SABMiller had 89% share of the total beer markets and 47% shares of total soft drinks market.

Major transaction in Latin America: Colombia, Panama, Ecuador and Peru.

In 2005, SABMiller plc. announced a major investment in Latin America through a transaction with the Santo Domingo Group (the "SDG") in which SABMiller obtained a controlling interest in Bavaria S.A.,

Bavaria was the second largest brewer in South America, as well as being the largest brewer in the Andean region. Bavaria operated 16 breweries, and enjoyed significant market shares in each of its countries of operation: Colombia (99%), Peru (99%), Ecuador (93%) and Panama (79%). The combined business would have annual beer volumes of approximately 175 million hectoliters, pro forma aggregated net revenues of approximately $12.5 billion and pro forma aggregated EBITDA of approximately $3.5 billion. It was highly complementary to SABMiller's existing operations and provided access to a major additional source of profitable growth in one of the global beer industry's most strategically important and fastest growing regions[27].

SABMiller outbid Heineken, to secure control of Bavaria, South America's second largest brewer. It got political backing after a meeting between Meyer Khan, Chairman of SABMiller and Colombian president Alvaro Uribe[28]. Commenting on the Transaction, Graham Mackay, Chief Executive of SABMiller, said:

"We are excited by the enhanced prospects for growth, in a strategically important market, which the combination with Bavaria brings. We are confident that together the business will generate considerable benefits for all stakeholders. We are delighted to welcome the Santo Domingo Group and the management and employees of Bavaria to the SABMiller group. I believe that they will provide a significant contribution to the future success of SABMiller. Through this transaction, we will be one of the largest international investors in the Andean region, and we look forward to playing an important role in the welfare of these local communities."

Following the Transaction, SABMiller had a leading position in South America, in addition to its existing strong positions in the USA, Europe, Africa and Asia, establishing SABMiller as a leading

27 Source: SABMiller and Bavaria announce a major transaction in Latin America, Archive News 19 July 2005. http://www.sabmiller.com/index.asp?pageid=149&newsid=493.

28 Source: SABMiller buys Grupo Bavaria for $7.8bn, Financial Times. http://www.ft.com/intl/cms/s/0/ea6bc492-f7b6-11d9-9f64-00000e2511c8.html#axzz2GDokLDtW

brewer across 5 continents. Bavaria would further diversify SABMiller's existing portfolio of businesses and brands in highly attractive growth markets.

Colombia

In 2012, Colombia lager volumes grew by 7% reflecting healthy consumer spending, the implementation of new marketing campaigns and the strategy of price restraint in mainstream brands. The share of the alcohol market improved in the last quarter, ending the year in line with the prior year, benefiting from increased marketing support and the narrowing of the relative prices between lager and spirits. The light beer category saw continued growth with Águila Light volumes up 44%. The premium brands also grew robustly, with the local premium brand franchise, Club Colombia, improving volumes by 30% and new variants attracting consumers to the category. The non-alcoholic malt products saw double digit volume growth following the successful introduction of a smaller pack for our brand, Pony Malta, and the addition of the new more refreshing malt brand, Maltizz.

The brand portfolio in Colombia included: Pony Malta, Aguila Light , Costeña, Pilsen, Poker Ligera, Club Colombia Roja, Redd's, Maltizz, Cola & Pola. The total size of the beer market was 18,980 (hl 000) and the beer consumption per capita was 41 litter. SABMiller had 99% of market share of beers .

Panama

In 1939 "Cervecería Nacional" was formed following the merger of Panama's three largest breweries. In December 2001, the owners of capital National Brewery ("Cervecería Nacional) Group SA closed a purchase and sale from the Grupo Empresarial Bavaria. Thus, as in the first days of 2002 the National Brewery became part of that brewer. In 2005 the National Brewery SA, took a new direction when the Grupo Empresarial Bavaria Group merges with SABMiller, the second global brewer by volume[29].

In 2012, the lager volume growth of 2% and revenue mix benefited from the performance of premium brands, with Miller Lite and Miller Genuine Draft (MGD) showing strong acceptance amongst targeted consumers. MGD had established itself as the leader in the super premium segment and Miller Lite the leader in the premium segment. Mainstream brands Atlas and Balboa benefited from investment behind new brand campaigns and improved in-outlet execution. Soft drinks volumes grew by 4% boosted by the milk category and a strong performance from sparkling soft drinks, through increased availability of cold products at the point of sale.

The brand portfolio in Panama included: Atlas, Balboa and large variety of soft drinks. The total size of the beer market was 2,711 (hl 000) and the beer consumption per capita was 82 litter. SABMiller had 67% of market share of beers.

Peru

In 1996, the company merged with Compañia Nacional de Cerveza, Cervecería del Norte and Sociedad Cervecería de Trujillo to form Unión de Cervecerías Peruanas Backus y Johnston. In 2002 the company was acquired by the Bavaria group, which was part of SABMiller in 2005. Backus and Johnston, was the most important brewing company in Peru. Its principal brands were: Cristal, Pilsen Callao and Cusqueña. It has production plants around the country.

29 Source: Our history cervecería nacional de Panama. http://www.cerveceria-nacional.com/Default.aspx?tabid=56

In 2006, SABMiller announced that its Peruvian subsidiary Backus and Johnston would invest US$102 million in infrastructural projects in Peru. The investment, included the expansion of the brewhouse at its Ate facility to the east of Lima; a new brewhouse at the brewery in Motupe in northern Peru; and a significant upgrade of packaging capability across the country. The investment would also include a further $12 million expenditure on fridges, coolers and trade equipment to improve the accessibility of cold product to all Peruvians[30]. Commenting on the new investment, Robert Priday, the president of Backus and Johnston, said:

"The investments will serve to extend the production capacity in the brewery plants in Lima as well as interior of the country, which will comply with the most modern technology in brewing, fermentation and packaging processes. The investment will ensure that we can sustain and improve on the high quality of beer we have become renowned for. It is also a reflection of our commitment and confidence in our operation in the country. The steady improvement in the local economy deserves to be rewarded with investments of this nature."

In 2012, Peru had another good year aided by healthy economic growth. Lager volumes rose 10% as consumers continued to trade up from the informal alcohol sector. The roll-out last year of our business capability programme enabled direct sales service model allowed us to capture growth opportunities while generating operational efficiencies and differentiated value propositions to the customers. As a consequence, lager market share grew in both volume and value share terms to 93% and 95% respectively. The flagship mainstream brand, Cristal, increased volumes by 22% reflecting the strong resonance of this brand underpinned by its support of national soccer. The premium portfolio also performed well with volume growth of 22%, and the Cusqueña brand extended its appeal through a number of seasonal variants and its association with Peruvian heritage and the centenary of the rediscovery of Machu Picchu. In the soft drinks category, there was a volume growth of 34%, as our non-alcoholic malt brand, Maltin Power, benefited from campaigns highlighting its nutritional attributes.

The brand portfolio included ilsen Trujillo, Barena, Arequipeña, San Juan, Malta Cusquena, Pilsen Polar, Peroni Nastro Azzurro, Miller Genuine Draft, Maltin Power, Guaraná Backus, Viva Backus, San Mateo, Cristalina. The total size of the beer market was 12,425 (hl 000) and the beer consumption per capita was 41 litter. SABMiller had 93% of market share of beers.

Ecuador

In 2005, "Cervecería Nacional" becomes part of SABMiller. It consolidated the National Brewery philosophy, based on a business model that includes commitments to the country, as the company was aware that its success was strongly linked to the welfare and prosperity of the communities in which it operated[31].

In 2012, Ecuador saw lager volume growth of 7% as the expanded direct service model assisted with the capture of new growth opportunities. Lager market share of alcohol rose to above 50%. In addition to cycling the Sunday trading ban of June 2010, growth was driven by improved product availability of cold beer at the point of sale and continuing expansion of our presence in festivals and events. The upper mainstream offering, Pilsener Light, saw volume growth of 87%, supported by the introduction of a larger pack. The local premium brand, Club, further strengthened its position as the leading premium lager brand in Ecuador with volume growth of 15% through new activations and

30 Source: SABMiller plc announces $102 million investment in Peru, Archive news 25 august 2006. http://www.sabmiller.com/index.asp?pageid=149&newsid=446

31 Source: Business Model, commitment of "Cerveceria Nacional". http://www.cervecerianacional.com.ec/nuestra-empresa/modelo-de-negocio.aspx

upsizing of the bottle. The non-alcoholic malt brand, Pony Malta, continued its success with its PET and smaller packs performing well, resulting in volume growth of 38%.

The main brands in Ecuador were: Pielsener, Club and Dorada. The total size of the beer market was 5,999 (hl 000) and the beer consumption per capita was 41 litter. SABMiller had 97% of market share of beers.

Future growth and outlook

Geographic mix was crucial to long-term growth. According to Euromonitor International in **Latin America**, the company's dominant position in Colombia, Peru, Ecuador, Honduras and El Salvador gave it a strong platform for future growth as the region was forecast a 4% volume CAGR over 2011-2016, although the company lacked a major presence in Brazil, which was expected to continue to drive the region's growth[32]. Additionally to the opportunities in Latin America, further recent trends in others geographical locations were happening in the global beer market (see **exhibit 14**).

Growth and development trends in the global beer market were generally unchanged in 2011. **Emerging markets were still the principal source of volume growth while developed markets faced weak consumer demand as a result of difficult economic conditions and shifting consumer trends.** The better performing markets, regardless of their stage of development, continued to be those in which industry leaders used brand development, innovation and partnerships to capture latent opportunities and stayed ahead of changing consumer trends.

In contrast to China's high growth in volumes but low profitability, **South America, impressively, saw growth in both volumes and profitability**. In the continent's biggest market, Brazil, beer sales were resilient in the face of softer consumer trends and the development of premium brands remains an opportunity – as it also does in Argentina. In Peru and Colombia, where the premium segment was better established, brewers continue to attract young adult consumers and to raise the image of the beer category as a whole. A trend from informal spirits to beer was evident in Peru which still offered sizeable growth opportunities for beer from adjacent categories. **Latin America as a whole continued to offer excellent growth and profitability opportunities** from an already strong and profitable base[33].

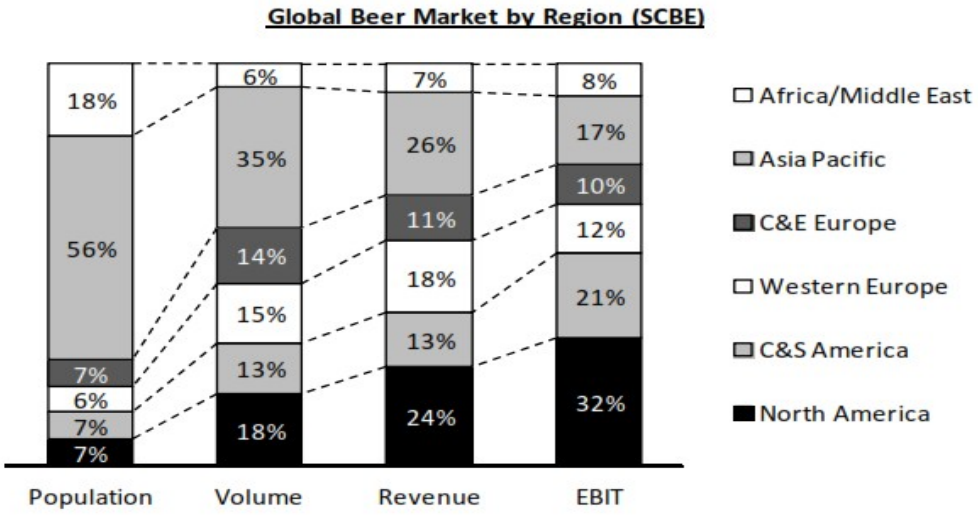
Graham Mackay knows that capturing the opportunity in both developed and emerging markets requires three key skills – brand development, innovation and the ability to forge successful partnerships in markets where joint ventures are necessary. Very few brewers excel at all three.

Now it's the moment when Mr. Mackay should decide to expand in other countries of Latin America, SABMiller most profitable region, or expand in new emerging markets or even consolidate in mature markets. He also needs to decide what could be the best Premiumisation and Innovation strategy aimed at the emerging middle and high class in Latin America. These were the dilemmas he needed to solve very soon.

32 Africa and Latin America Continue to Drive SABMiller's Growth in Fiscal 2012, Euromonitor International, 2012.

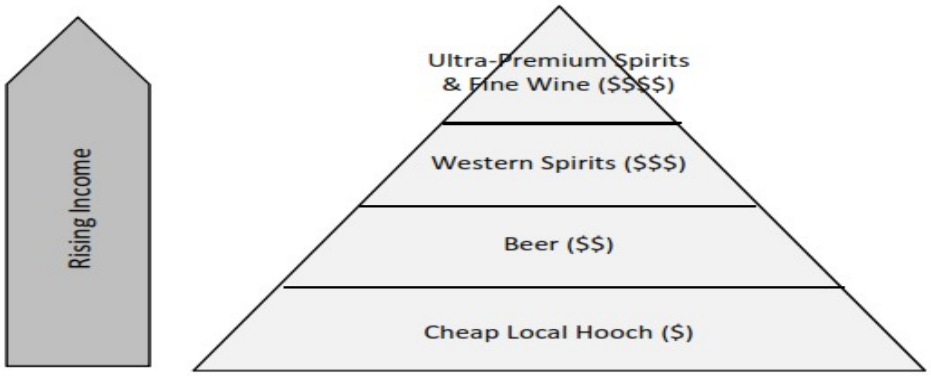
33 Source: Global beer market trends. Independent industry analyst, May 2012.

Exhibit 1: Significant disparities in regionals dynamics.



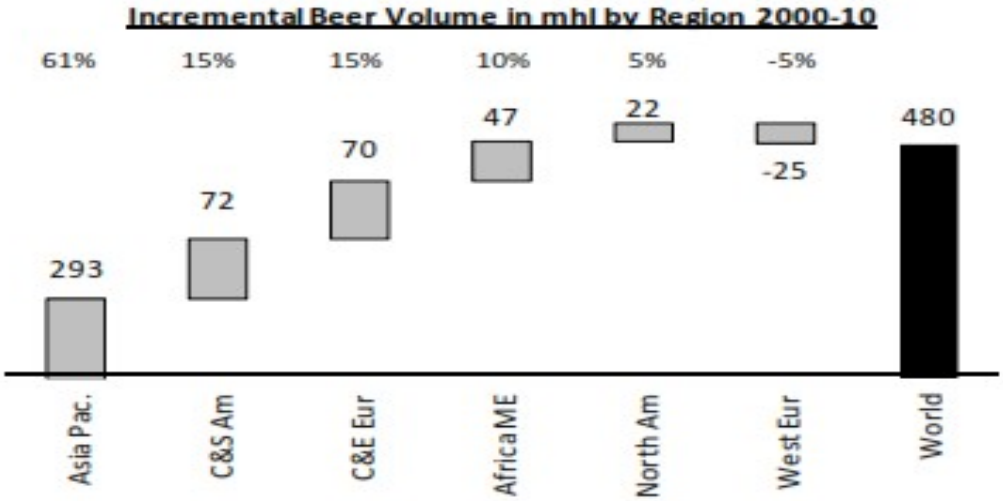
Source: Plato Logic, corporate reports and Bernstein estimates an analysis.

Exhibit 2: Hierarchy of Needs.



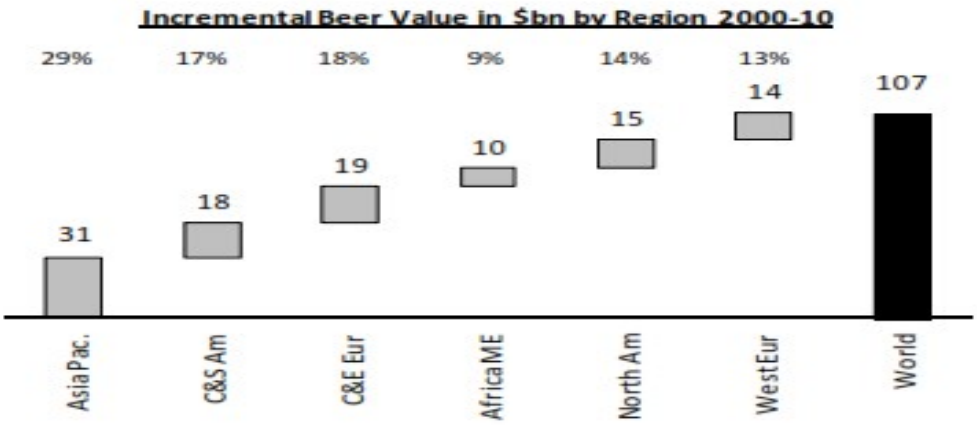
Source: Bernstein analysis.

Exhibit 3: Almost all beer volume growth is driven by emerging markets…



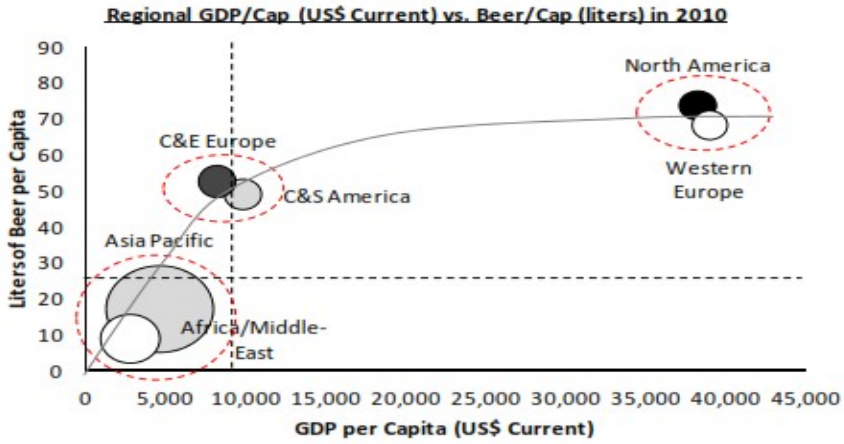
Source: Plato Logic, Euromonitor and Bernstein estimates and analysis.

Exhibit 4: ...Mature markets still contributed to value growth, but approximately 70% of value growth still came from emerging markets



Source: Plato Logic, Euromonitor and Bernstein estimates and analysis.

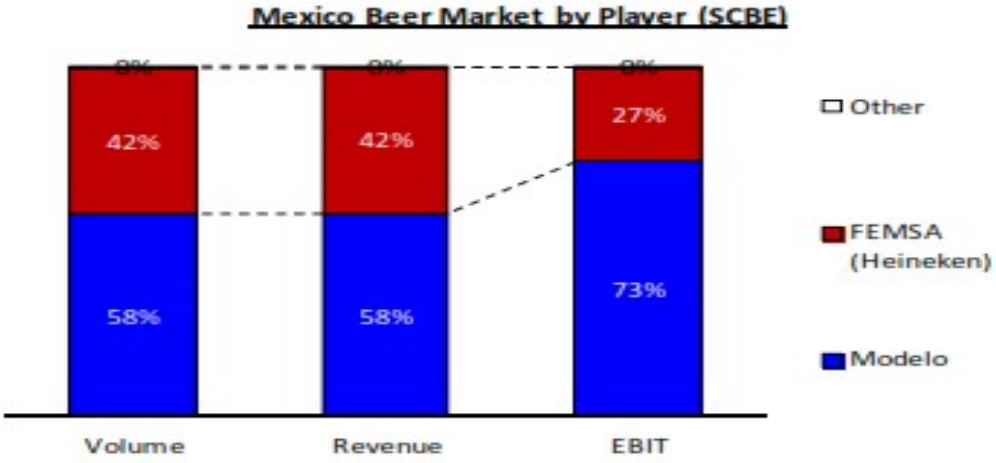
Exhibit 5: Strong relationship between GDP and beer consumption per capita



Note: Size of bubble denotes population.

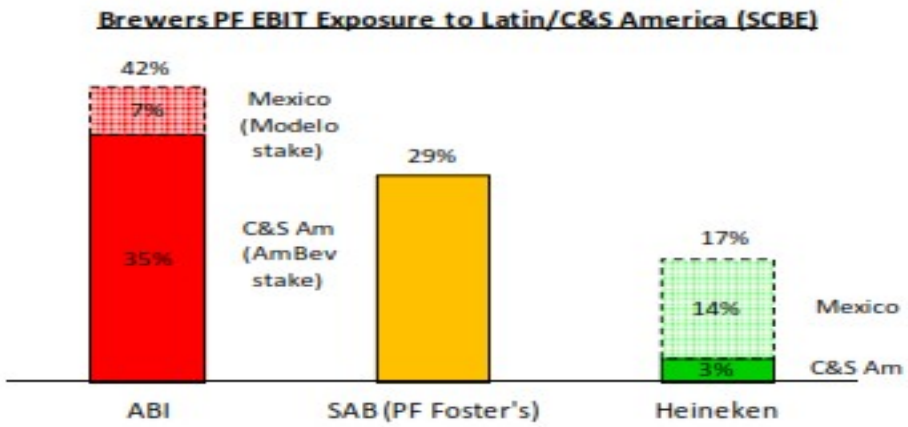
Source: Plato Logic, IMF, corporate reports and Bernstein estimates and analysis.

Exhibit 6: Modelo and Heineken control the Mexican beer market...



Source: Plato Logic, corporate reports and Bernstein estimates and analysis.

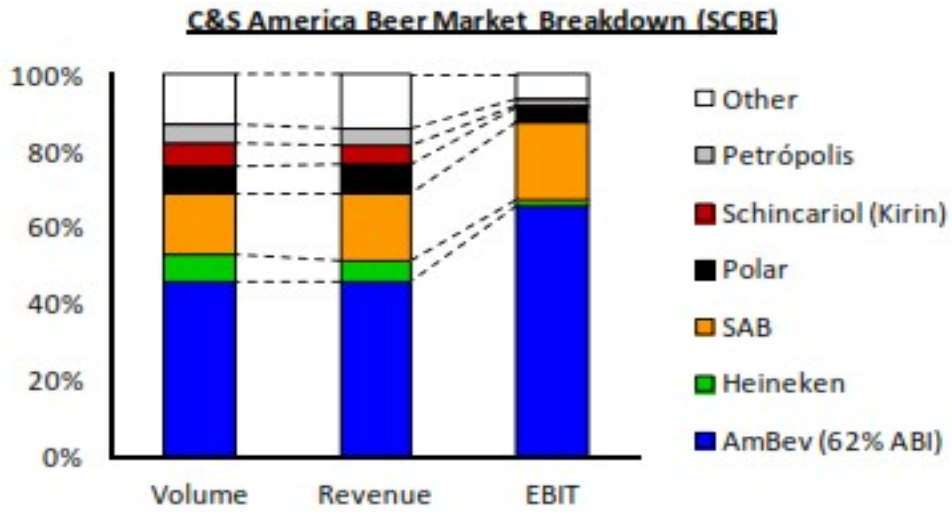
Exhibit 7: Of the big 4, ABInBev and SABMiller have the highest profit exposure to C&S/Latin America



Note: Equity-adjusted basis. SAB is pro forma for Foster's, based on FY 2013E.

Source: Corporate reports and Bernstein estimates and

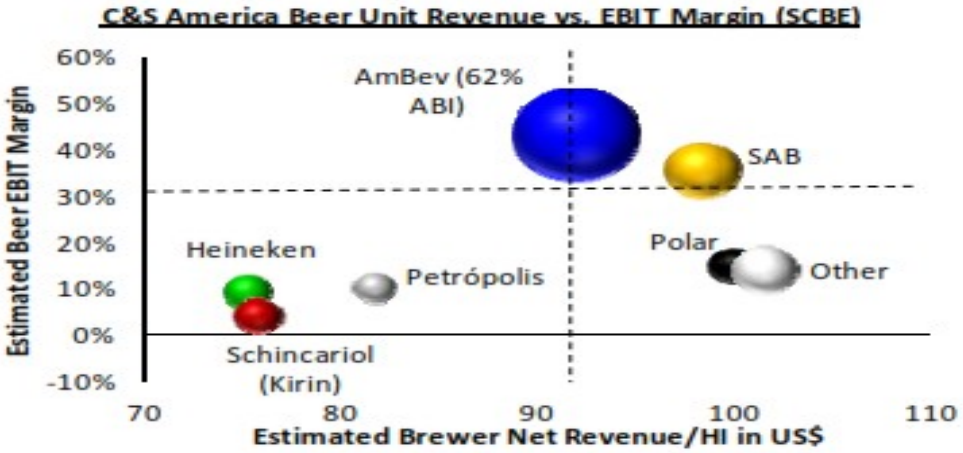
Exhibit 8: AmBev, SAB and Heineken account for an estimated 88% of Latam Beer Profits



Note: Heineken is proportionate for 33% stake in CCU.

Source: Plato Logic, corporate reports and Bernstein estimates and

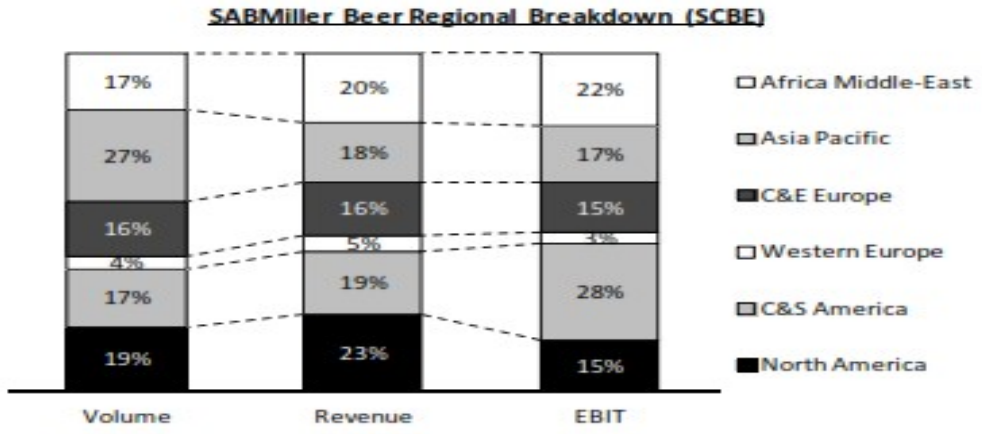
Exhibit 9: AmBev and SAB are the largest brewers in Latin America by Far… and the Most Profitable



Note: Size of bubble denotes beer volume. Heineken is proportionate for 33% stake in CCU.

Source: Plato Logic, corporate reports and Bernstein

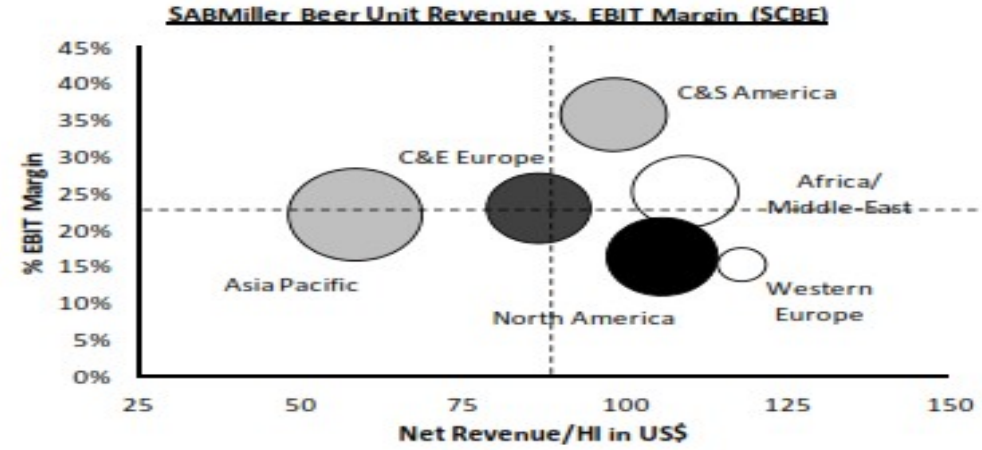
Exhibit 10: SABMiller is most exposed to Emerging Markets...



Note: Excludes holding.

Source: Plato Logic, corporate reports and Bernstein estimates and analysis

Exhibit 11: SABMiller with very little exposure to Western Europe



Note: Size of bubble denotes beer volume in mhl.

Source: Plato Logic, corporate reports and Bernstein estimates and analysis.

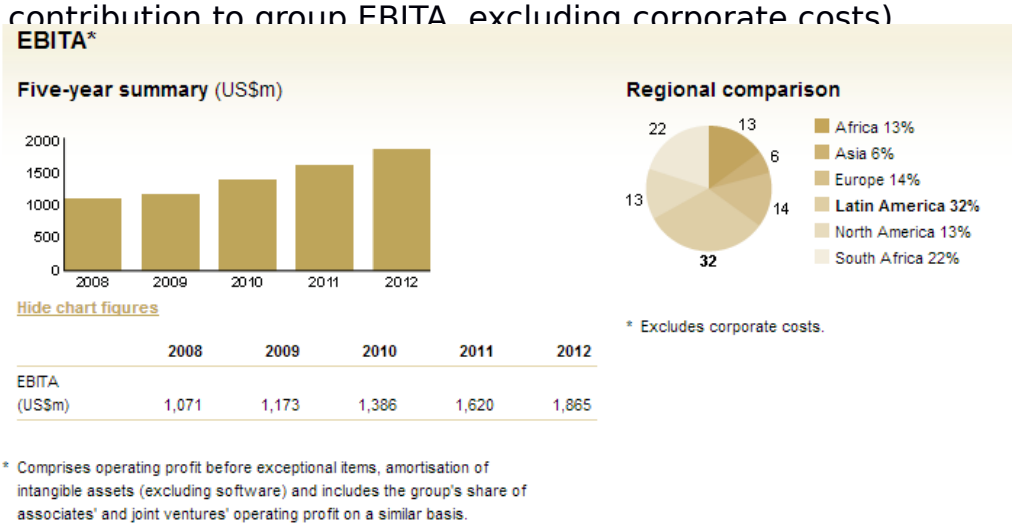
Exhibit 12: Innovation and Renovation: The Nespresso Model

"*The business has two - and only these two – basic functions: marketing and innovation. Marketing and innovation produce results, all the rest are costs* " --- Peter Drucker.

"*The just keep pace in this industry, you need to change at least as fast as consumer expectations. That's renovation. To maintain a leadership position, you also need to leapfrog, to move faster and go beyond what consumers will tell you. That's innovation*" --- Peter Brabeck-Letmathe, CEO, Nestle, S.A.

"*Individualization is a driving force in today's markets - in everything from the telephone to beer to tea to personal computers. The Nespresso system is an innovative concept that offers consumers individual portions of freshly ground coffee in a range of tastes that result in an exceptional cup of espresso everytime. We are convinced of the power of the idea and the technology behind it, and we are aiming to grow this business eightfold to SFr 1bn in the next decade*" --- Willem Pronk, CEO, Nestle Coffee Specialties.

Exhibit 13: Operating results (five-year summary of EBITA and the contribution to group EBITA, excluding corporate costs)



	2008	2009	2010	2011	2012
EBITA (US$m)	1,071	1,173	1,386	1,620	1,865

* Comprises operating profit before exceptional items, amortisation of intangible assets (excluding software) and includes the group's share of associates' and joint ventures' operating profit on a similar basis.

Source: http://www.sabmiller.com/index.asp?pageid=635

Exhibit 14: Recent Trends for future growth in another locations

In **Asia Pacific**, SABMiller's lager volumes grew by 4% on an organic basis in FY 2012 as the company continued to benefit from dynamic Chinese growth through its equity stake in the leading brewer China Resources, helped by solid growth in India. Asia Pacific is predicted to continue to lead global beer volume growth with a 5% CAGR over 2011-2016, driven by strong growth in the region's largest Chinese market. SABMiller, through its equity stake in the leader, should be able to capitalize on this but should also continue to build its presence in other markets in the region to enable it to fully exploit this forecast growth. In FY 2012, SABMiller reported 2% lager volume growth in its main **South African** market and continued to register a solid 13% volume gain in the rest of the **African continent**, with strong performances in Tanzania, Mozambique, Zambia, Uganda and Zimbabwe, while Castel Group, the company's partner in other countries in the region, delivered 11% organic growth in its volumes, with good performances in Cameroon, the Democratic Republic of Congo, Ethiopia and Tunisia. As economic development is expected to continue, Africa offers the company significant potential. The beer consumption in the Middle East and Africa is forecast to register a 5% CAGR over 2011-2016, and as per capita consumption is still low (10 liters in 2011 compared to 52 liters in Latin America) the region offers long-term potential.

The biggest beer market, China, accounted for 43% of the world's volume growth and nearly 37% of the volume growth from emerging markets. China's top five brewers accounted for 63% of total industry volumes. However, beer pricing remains low in China and profit margins are thin. Consolidation of the fragmented Chinese beer industry remains an important long-term trend and one that will lead eventually to greater industry profitability. In **South Africa**, brand development work among mainstream and premium brands solidified the leading brewer's share in 2011. Elsewhere in Africa, the ability to form effective partnerships continues to be an important component of growth for some companies and the opportunity to 'formalize ' informal beverages is a major factor in markets where affordability is critical. Industry leaders SABMiller, Castel and The Coca-Cola Company remain aligned in their pursuit of the opportunities provided by beverage volume growth in these low-scale markets. In the **USA, volumes declined 1.7% in 2011** as unemployment remained high, particularly among young, legal drinking age men. Newer craft beers and some imports continued to thrive at the upper end of the price spectrum at the expense of more seasonable and longer-established light beer brands. **Australia has new opportunities following SABMiller's acquisition of Foster's**. We expect to see renewed focus on innovation and the development of mainstream, premium and import brands. **European consumer trends remain challenging.** Difficult long-term demographic trends, a shift to home consumption in markets such as the UK and near-term

austerity measures all combine to limit growth. Mergers and acquisitions remain a factor in the Czech Republic while partnerships have played a role in markets such as Russia where beer is still only 25% of alcohol consumption and where premium brands remain promising.

SABMILLER: THE BATTLE FOR LATIN AMERICA

Case Objectives and Use

The case intends to discuss and highlight the following four issues (a) entry strategy of SABMiller in the Latin American market (b) their expansion strategy into Latin American emerging markets by fast local adaptation (c) the premiumization and innovation strategies to create value in the brewery industry and (d) launching innovations in the local market while introducing global brands to the local markets.

Case Synopsis

Source: Africa and Latin America Continue to Drive SABMiller's Growth in Fiscal 2012, Euromonitor International, 2012.

Australia, Europe, Latin America and North America. Today, it is multinational company and its headquarters are in London. Through their "Building locally, winning globally" philosophy, they have made their presence felt in both developed markets and emerging economies such as Latin America. The Latin America segment covered SABMiller's primary brewing and beverage operations in Colombia, Ecuador, El Salvador, Honduras, Panama and Peru. In each country SABMiller was the leader of the market. In Latin America, the company operated 17 breweries and 15 bottling plants.

However, the global competition for Latin America was aggressive, there were other three multinationals trying to compete actively and conquer new territories globally. The Belgium-based Anheuser-Busch InBev, Dutch brewer Heineken, and Denmark's Carlsberg, the four of them, including SABMiller, they brewed more than 50 per cent of the world's beer and three of them were having a battle for the countries of Latin America, due the constant growth and profitability of the region. SABMiller tried to respond to the market with the local premium brands and the global brands, trying to position itself in the premium and super premium segments. SABMiller hoped to find a kicker in Premiumisation in emerging markets such as Latin America. Therefore, the top-management dilemma was to find an appropriate model for the premiumisation and innovation strategy in SABMiller, by creating a new premium brand within the portfolio of brands or by creating a separate entity as 100%-owned SABMiller affiliate.

Having in mind these challenges, in July 2012, Graham Mackay, Chief Executive Officer at SABMiller since 1999, was going to attend the SABMiller quarterly divisional seminar series of Latin America and discuss the future opportunities of growth with Mr. Karl Lipper, new President SABMiller Latin America since 2011. Mr. Mackay aimed to provide stability and continuity in the region, he felt the pressure to make concrete actions, he was wondering what the best strategy for expansion is? In which emerging market is appropriate to enter now? There is a tradeoff between profitability and risk; there are regions with high profitability but with fierce competition, especially Latin America.

Now it's the moment when SABMiller should decide to expand in other countries of Latin America, SABMiller most profitable region, or expand in new emerging markets or even consolidate in mature markets. He also needs to decide what could be the best Premiumisation and Innovation strategy aimed at the emerging middle and high class in Latin America. These were the dilemmas the SABMiller executives needed to solve very soon.

1. Specific course the topics it covers, and specific learning objectives for that course.

The topics covered by the case is on International Strategy, International Business, International Marketing. Specific learning includes (a) analysis of brewer industry (b) entry strategy through acquisition (c) expansion strategy (d) local adaptation (e) innovation strategy (f) premiumization (g) adaptation of global brands to local markets.

2. Suggested Student Preparation Questions (questions that help guide student advance preparation before the case discussion in class).

a) What is your assessment of today's Beer Brewer Industry in Latin America?
b) What is the international strategy of SABMiller in Latin America?
c) What is your assessment of SABMiller international strategy in Latin America?
d) How the SABMiller's international strategy differs from its main global competitors?
e) What is the rationale for expansion in emerging markets rather than focus in the consolidation in mature markets?
f) What is your SWOT evaluation of SAB Miller in Latin America?
g) What would be you recommendation (Action Plan) for future expansion?

3. Reading to be assigned along with the case.

Background Reading:

Michael J. Silverstein, Neil Fiske, John Butman (2008). Trading Up: Why Consumers Want New Luxury Goods--and How Companies Create Them. Penguin Books, London.

4. Teaching plan, including key questions with responses, expected flow of discussion, and other guidance.

The case intends to discuss and highlight the entry strategy of SABMiller in the Latin America market, the overall strategy of conquering emerging markets of SABMiller by fast local adaptation to individual markets, SABMiller's responsiveness to local business focusing on Latin America and the Premiumisation and innovation strategies to create value in the brewery industry.

a) <u>What is your assessment of today's Beer Brewer Industry in Latin America?</u>

In order to assess the beer brewer industry in Latin America, each of the Michael Porter's Five Forces is analyzed:

1. Rivalry among exiting firms:

- **Global competitors fighting for Latin America:** The first three of the "four big players" (ABInBev, SABMiller and Heineken) are trying to enter to new countries in the last three years, therefore there is a battle of bits for each local or regional brewery in Latam.
- **Weak local competitors:** generally the strong local competitors already were acquired by the global players or are affected by the global competitors.
- **No Switching costs:** The consumer can purchase whichever beer he/she favors. However, consumers are very brand loyal, reason why the high advertising costs are high.

- **High advertising costs affecting smaller competitors:** As ABInBev**,** SAB and Heineken account for more than 80% of the profits in Latam, they are more flexible and advertise-wise against smaller competitors.
- **Non-price based rivalry:** The beer industry in Latam primarily competes with non-price based rivalry. There is a lot of product differentiation, e.g. local beers vs. foreign beers, lager or ale.

Conclusion: There is a HIGH competition among the main global players, which are in almost all Latam, due the attractiveness of Latin America in terms of high profitability and high growth expected.

2. Threat of New Entrants.

- **Economies of Scale:** The bigger brewers have achieved great economies of scale not only in production but also purchasing, distribution, and advertising, etc.
- **Capital Requirements:** The capital requirements necessary to compete on the national level against the big three firms are extremely high. These high costs of act as a barrier to entry for firms that are considering trying to compete in this industry on the highest level.
- **Access to Distribution Channels:** Alcoholic beverages are distributed through wholesale distributor, which are highly consolidating in Latam.

Conclusion: There is a LOW threat of New Entrant in Latam beer brewing industry due the high amount of entry barriers.

3. Threat of Substitutes Products:

- **Other alcoholic beverages such as liquors and wines:** In contrast, of North America and Western Europe, In these markets, the beer category is typically losing share of throat to wine and spirits, in most of the countries of Latin America the threat fort wine is low.
- However In countries such as **Chile and Argentina there is HIGH threat**, because there is a **"wine culture"** and there is less consumption per capital (1).
- **Switching costs:** The switching cost of changing to a substitute good is practically non-existent.

Conclusion: There is a MODERATE threat of substitutes (wine and other liquors) in Latam.

4. Bargaining power of Suppliers:

- **Agricultural suppliers:** There is no product differentiation, allowing the brewer company to pick and choose those they wish to do business with.
- **Availability of Local suppliers:** Most of the brewer companies can choose from local suppliers.
- **High amount of suppliers, locally and regionally**: There are more than 175 manufactures and suppliers who provide brewing equipment to small-scale breweries.
- Brewers can also purchase **used or refurbished equipment.**
- As far as supplier substitutes, **the ingredients** that go into the brewing of beer **cannot be replaced**. Those ingredients are necessary for the production.

Conclusion: Suppliers have LOW bargaining power in the industry, which works in craft brewers' favor.

5. Bargaining power of Buyers:

- **Number of distributors or wholesaler in the market:** It depend of each country of Latam, if there is a large amount of wholesalers it dilutes the power of buyers, if there is a few wholesalers, they have more power. In Latam there is a trend, the distributors are consolidating and increasing in power.
- **Exclusive contracts:** Once the wholesaler entire exclusive contracts with brewer, the brewers can not go to other wholesaler.

Conclusion: Finally there is a MODERATE bargaining power of Buyers.

b) <u>What is the international strategy of SABMiller in Latin America?</u>

Analysis:

1) The company **recognize that beer is essentially a local business** and that **local managers are in the best position to identify and exploit local opportunities in Latin America**. SABMiller's International Strategy in Latin America focus in generating maximum value and advantage from the size without becoming over-centralised and losing the relevance and the **local responsiveness** in each country of Latin America where it operates.

2) SAB's margins in Latin America are high by global standards. This is because the company has a **CLEAR LEADER positions in all markets in which it operates** (e.g., Honduras, Colombia, Peru), with the exception of Argentina, where the company just entered two years ago. SABMiller aim to be the leader of each market in which it operates[(2)].

3) SABMiller is expanding in Latin America by **excelling locally – building local brand portfolios** that meet the needs of consumers in each of individual markets of LATAM. It includes building a **differentiated portfolio of global and local premium brands** and channeling the right brands to the right outlets at the right time and price.
4) SABMiller aims to expand the wide geographic spread of the operations because allows it to benefit from growth in volumes and value in beer markets around the world. SAB continue to **look for opportunities to strengthen the geographic footprint in both EMERGIN MARKETS (such Latin America) and developed markets through alliances, mergers and mainly acquisitions in Latam (e.g. Cervecería Hondureña in 2001, Bavaria -Colombian in 2005).**

5) **Local businesses** contribute their experience and insights and are then **responsible for applying the Ways** in their own marketplace. With the same approach the innovation is managed, **effective innovation must be an answer to known needs in Latin America and be rooted in a of the Latin American marketplace.**

6) SABMiller keep enhancing the operational performance through top-line growth and continuous **improvement in costs and productivity in each country of Latin America.** It's also important that to maintain and advance the reputation, protect the license to trade and **develop the businesses sustainably.**

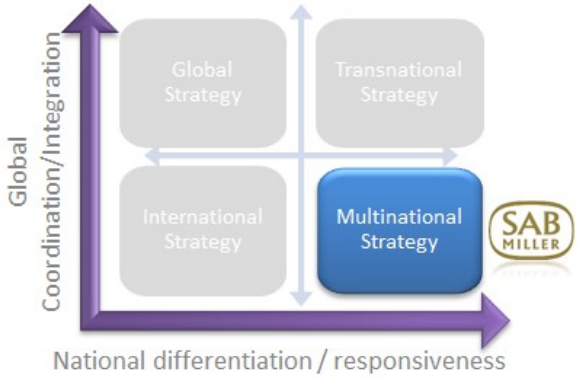
7) **A large presence in Latin America** would presents increasing opportunities to gain value from the economies of scale and skills of the group, not least by leveraging the scale and expertise in procurement, standardizing the back-office functions and integrating the front-office systems. SABMiller is also benefiting from ongoing collaboration and the sharing of skills between the businesses.

8) SABMiller believes that **the business is not separate from society**, and that the success of the company is inextricably linked to the well-being of the wider community. Everywhere it operates, they're working **to build strong local businesses that contribute to their local economies.**

Conclusion:

1) Based in the global coordination/integration-national differentiation framework, SABMiller follows a **Multinational Strategy (National differentiated Strategy in the integration-**

responsiveness framework) in Latin America, due the high responsiveness to local markets and the high need for global integration.



2) **SABMiller's strategy is nationally responsive in each Latin America country** and the company has the willingness to invest in the growth of these markets while learning to be self-sufficient and independent from their mother company.

3) As a multinational corporation, **SABMiller understood and recognized that there are differences across national markets**, and differentiation is required to be successful in Latin America.

c) <u>What is your assessment of SABMiller international strategy in Latin America?</u>

Analysis:

1) SABMiller concentrate on building local brands and make acquisitions only where they have the potential to add value, building flexibility through national differentiation and local response mechanism with a decentralized, self-sufficient, entrepreneurial national organizations.

2) In some countries such as Honduras, El Salvador and Panama, most of the consumers do not know details about SABMiller, but everyone knows "Cerveceria Hondureña, "Cerveceria Nacional", or the local brands such as "Port Royal", "Balboa", "Golden" etc. It is interesting to know how a multinational company such as SABMiller has managed to give a real local image to their products, and even most of the Honduran, Salvadorean or Panaman customers feel proud of their "local brands".

3) As we can notice in the 2012's reports, **Latin America produced EBITA growth of 15%.** Strong revenue growth reflected a combination of higher volumes, selective price increases, favorable mix and manufacturing efficiencies. Due this trend of **constant growth in the last decade and being the most profitable region**, is clear that the international strategy in Latin America has been successful.

Conclusion:

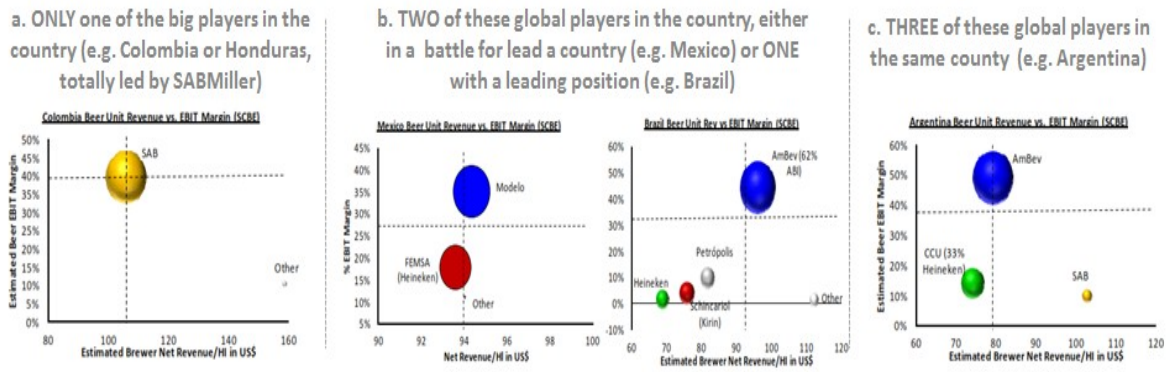
SABMiller has become a global leader by doing business locally in emerging markets, including each country of Latin America. **The company was flexible, ready to adapt and modify** their offerings, strategy, management styles in their respective national market, allowing them to have a **successful international strategy in each country of Latin America where they operate**.

d) <u>How the SABMiller's international strategy differs from its main global competitors?</u>

Analysis:

1) Latin America Beer Market Is highly dominated by the Big 3 (**ABInBev, SAB and Heineken), which account for an Estimated 88% of Latin America Beer Profits.** ABInBev and SAB Are the Largest Brewers in LATAM by far, and the most profitable.

2) The overall strategies in Latin America has been similar, by acquiring local brewer companies to gain access to those markets. There are different kind of competitors dynamics in each country, for example:



There are other local players with good positions in some specific countries , such as Shincariol (Brazil) &Petropolis (Brazil) or Polar (Venezuela, where there is no global competitor).

Conclusion:

Global Competitors	SAB MILLER	ABInBev	Heineken
Global Strategies[6]	• It is the global **brewer with the highest exposure to fast-growing emerging markets,** with strong positions in Africa and Latin America. • SAB's Asian operations are mainly in **China and India**, where operating margins are low. It is also in Eastern Europe.	• Its businesses are skewed to **North America and Latin America**, through AmBev. • The group has best-in-class margins, benefiting from scale, top-cost management and favorable market structures in **the Americas.**	• Recently has a more balanced geographic mix of m mature/emerging markets post acquisition of FEMSA/CCM. • **It is still heavily dependent upon low-growth, lower-margin Western Europe.** • It has leading positions in many African markets.
Latin America Strategies	• In 2010, SABMiller plc announced that it has acquired Cervecería Argentina S.A. • The region is the largest contributor to SABMiller's profits, is likely to remain one of the key drivers for SABMiller in the near term. • **Main Countries: Colombia, Peru, Honduras, El Salvador, Panama, Ecuador and Argentina.**	• In 2012, total acquisition of group modelo in Mexico, owning the brand "Corona" • LATAM represents approximately 42% of group equity-adjusted pro forma EBIT. • Since the formation of ABInBev, AmBev was virtually the engine of growth of the group's organic top line, Brazil is a giant market. • **Main Countries: Brazil, Mexico, Argentina, Bolivia, Uruguay.**	• In 2010, acquisitions of FEMSA/CCM (Mexico, Chile), declaring a battle for Mexico against group Modelo (just acquired by ABInBev) • LATAM represents approximately 17% of group equity-adjusted pro forma EBIT, largely from Mexico • **Countries: Mexico, Chile, Brazil, Argentina, Peru.**

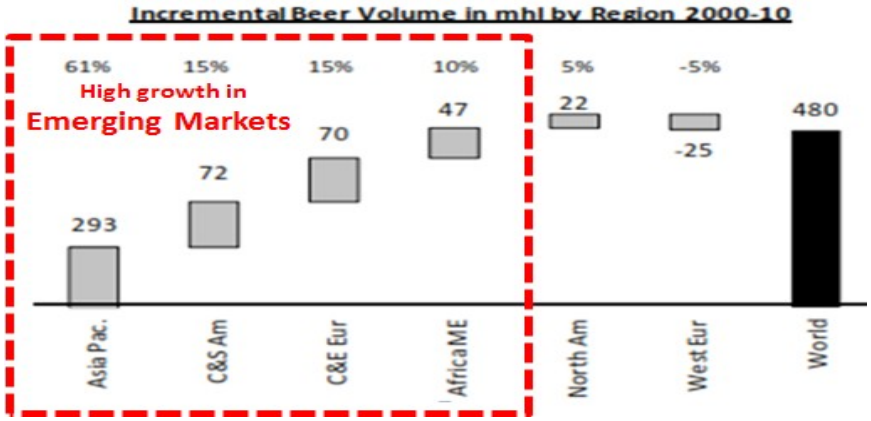
e) <u>What is the rationale for expansion in emerging markets rather than focus in the consolidation in mature markets?</u>

Analysis:

1) It is the **emerging markets that have been driving volume growth**. Over the last decade, **beer volume growth came primarily from emerging markets, driven by robust growth in Latin America, C&E Europe and strong growth in Asia Pacific and Africa/Middle East**.

2) In contrast, in **Western Europe, beer volumes declined over the past 10 years** as a combination of low population growth, falling alcohol consumption per capita and beer's share of throats loss versus spirits and wine.

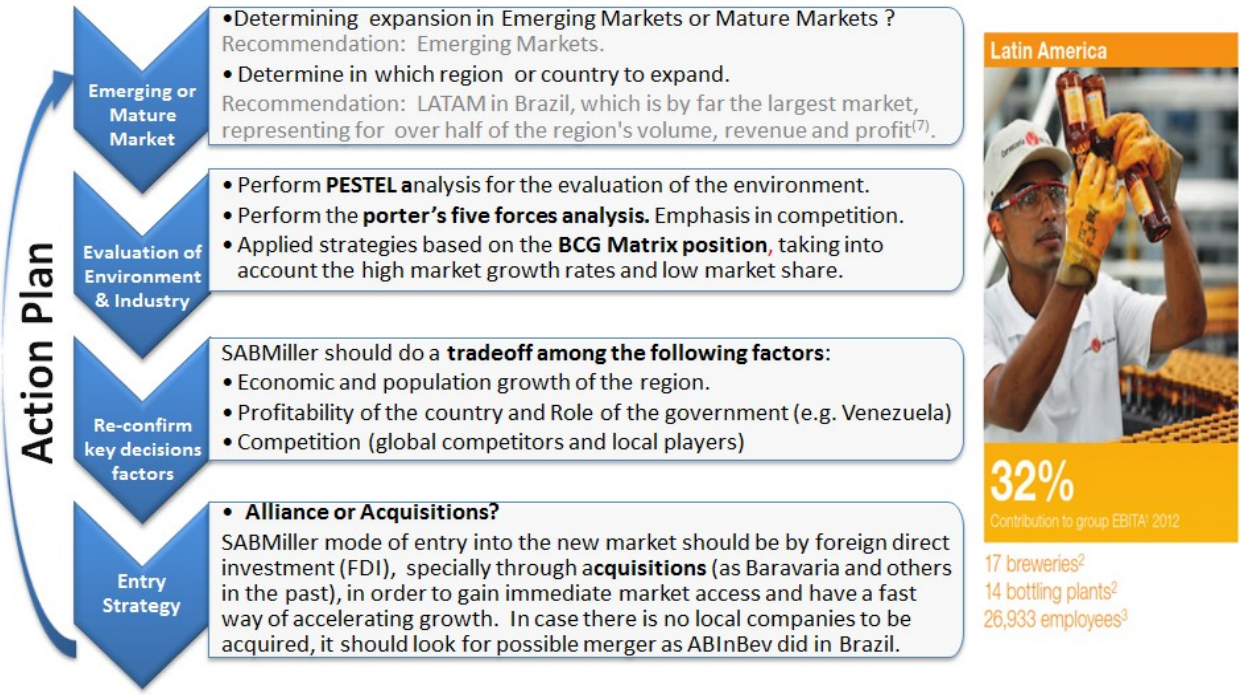
3) SABMiller performance in 2012 was **driven by strong beer consumption growth in its key African and Latin American markets**, while in **Europe and North America weak consumer demand continued to hinder sales.**



Conclusion: As the company delivered a strong performance in emerging markets and it continued to face difficult conditions in mature beer markets, **the expansion in Emerging Markets is totally rational** since there is a first mover advantage for the global competitors.

f) <u>What is your SWOT evaluation of SAB Miller in Latin America?</u>

g) <u>What would be you recommendation (Action Plan) for future expansion?.</u>



h) <u>Suggest a Premiumisation and Innovation strategy to conquer the Latin American market?</u>

Analysis:

1) The **"Premiumisation"** strategy should upscale the brand portfolio and develop brands of high quality and high-margin (e.g. limited edition) supported by increased marketing investment. Contrary to the practice of the global competitors with a singular international premium brand (e.g. Heineken, Corona, etc.), SABMiller has more than one global premium brands, hence there is not a singular image of the international premium brand, it is not clear for the local markets which is the most premium brand, Peroni Nastro Azurro, Miller Genuine, Grolsch or Pilsener Urquel.

2) **Innovation strategy** should be a priority to accelerates growth and create as yet unexplored areas for encounters between the brands and consumers, be they new moments, occasions or experiences. Innovation should not be just a priority in supporting the brands, but it also should applies to all areas of the business: Sales, Human Resources, Production, Legal, Finance and Communications.

Conclusion: SABMiller should invest in the Premiumisation and innovation strategy aimed at the emerging middle class in the emerging markets. It is necessary to create a singular **GLOBAL ICON** with a global advertisement campaign to gain premium recognition worldwide as **"International Premium Brand"** and/or even differentiated innovative second-tier products such as **"affordable premium".**

The dilemma of SABMiller is whether to create (1) one or two premium global iconic brands *within the portfolio of Brands* **OR** (2) create one or two premium global iconic brands *as a separate entity to manage the new brand*. Both strategies can be analyzed **using the McKinsey 7S Framework**.

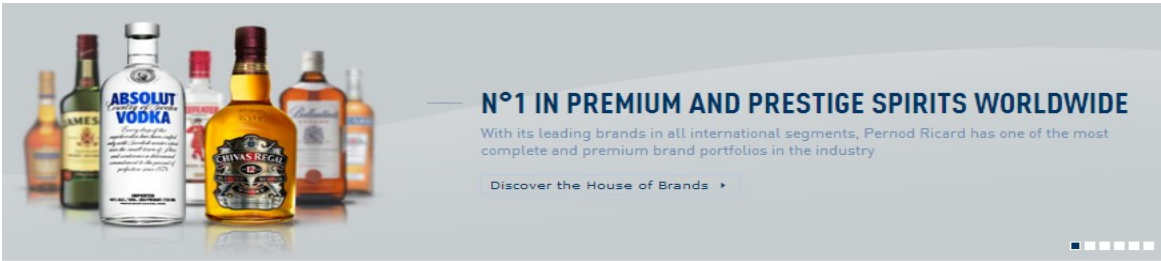
1. **Create one or two global inconic brands *within the portfolio of Brands*.**

The McKinsey 7S Model for this approach is the following:

1) **Strategy:** create a global inconic brand within the portfolio of Brands.
2) **Structure:** Create a Premium Brand department to mange all the activities related to the one or two global iconic brands. A central office in HQ and in each of the subsidiaries.
3) **System:** A bonus system which supports innovation and the new ways of working, a pay grade structure that is aligned to the new team structure. An appropriate system to monitor the success of the new Global Premium Brand.
4) **Shared Values:** Think Creative and Innovate, Promote Entrepreneurial Spirit, Built World's Class brands, Aim for the market leadership.
5) **Style:** Leadership strongly believes in Premiumisation and innovation as the two major focuses for value creation. Long-term vision based on strong and on-going investment in support of the Group's International Premium Brand.
6) **Staff:** An innovative and entrepreneurial outlook team, with goal sharing and commercial aptitude, acting as change agents and driving improvements on an individual level.
7) **Skills:** Develop new team skills, segmentation and go to market imagination, thinking outside the box and ability to bring new premium solutions to customers.

Benchmark of premiumisation and Innovation strategies:

1) **Pernod Ricard:** #1 in Premium and prestige spirits worldwide.



Take away for SABMiller:

- Create GLOBAL ICON brands, which are the super premium brands of the portfolio of brands.
- The Premiumisation strategy should responds to consumers' desire to "drink less, but drink better".
- It acknowledges the development in emerging markets of middle and upper classes in search of brands that convey status.
- From line extensions to new digital media and events, but innovation involves more than just marketing; it touches on all fields in the company including Sales, Human Resources, Strongly linked to premiumisation.

2) **Heineken:** The Heineken brand is a key strategic asset and is the undisputed leader in the international premium segment, being twice the size of the nearest competitor brand. Heineken has consistently outperformed the overall beer market and the international premium segment over the past several years.

Take away for SABMiller:

- Develop a unique brand available in as premium brand all over the world.

- Develop the growth and promotion of a unique premium brand with evidently premium brand differentiation in the portfolio of brands.

2. **Create one or two global inconic brands brands *and manage it as a separate entity*.**

The McKinsey 7S Model for this approach is the following:

1) **Strategy:** create a separate entity to manage the global icon brand and innovation strategy.
2) **Structure:** 100%-owned SABMiller Affiliate with its own CEO, R&D and Marketing deparments. All the department report only to the CEO of this separate entity.
3) **System:** A bonus system which supports innovation and the new ways of working, a pay grade structure that is aligned to the new team structure. An appropriate system to monitor the success of the new Global Premium Brand.
4) **Shared Values, Style, Staff and Skills:** The soft elements of the 7S model are the same of the GLOBAL ICON brand strategy described previously.

Benchmark of premiumisation and Innovation strategies:

1) **Nespresso:** it has become one of the most successful global food and beverage brands in the world.

Take away for SABMiller: The revolution is not to sell a premium beer but to make luxury the coherent key entry point for the SABMiller global premium brand around the world.

- SABMiller should establish uniqueness and superiority, developing a global brand universe to showcase luxury codes from product and packaging design to retail experience and loyalty.
- A SABMiller Club might be central to this strategy, building on the insight that consumers want to be part of luxury brands, not just use them.
- A boutique concept could promotes the right balance between the art of beer experiences and retail.

2) **VOSS:** LUXURY BRAND OF "WATER", with the bottled water market, being one that is flooded with brands struggling for recognition, you wouldn't dare think that an ultra-premium, luxury brand of water could hold its position, never mind capture a target audience……VOSS Water has proved otherwise.

Take away for SABMiller: Luxury in water, why not in beer?

- Innovation in bottle design is key for the luxury impression. The design is the seduction tool to attract their wealthiest customers.
- As Voss water does, SABMiller should aim to be the beer of choice when people visiting selected hotels, bars, clubs, spas and retailers.

3) **RedBull:** Red Bull´s real product benefits justified a premium price. It is by far the most expensive non-alcoholic drink on the market.

Take away for SABMiller: One brand, One product.

- In order to put the entire focus on this one product, this one brand, SABMiller should said: No diversifications, No licensing, No brand-merchandising, No umbrella brand.

- As Red Bull does, SABMiller should rethink about: Category, Packaging, Price, Distribution strategy and Communication strategy vis-à-vis its premiumization strategy.