

FEMSA to Sell Beer Business to Heinekin

Case Type: merger and acquisition (M&A).

Consulting Firm: McKinsey & Company first round full time job interview.

Industry Coverage: food & beverages; tobacco & alcohol.

Case Interview Question #00741: The client Fomento Económico Mexicano, S.A.B. de C.V., doing business as FEMSA (BMV: FEMSA, NYSE: FMX), is the largest beverage company in Mexico and in Latin America. Headquartered in Monterrey, Mexico, FEMSA is also the largest independent Coca Cola bottler in the world as of September 2011.

For this case, FEMSA is interested in selling its beer business to Heinekin or SAB Miller. FEMSA is based mostly in Mexico. Should FEMSA go ahead to sell its beer business? Why or why not? Don't focus on the price of the transaction, but focus on the strategic view of the case.

Additional Information: (Provide the following information if requested by the interviewee.)

FEMSA is consumer goods centric with three major business units:

The first division is Beer with \$3 B in annual revenue. Its beer division has 7 – 8 brands. 75% of the total revenue is produced in Mexico and the other 25% is in US. They have famous brands such as Dos Equis, Tecate, and Sol. They've seen 3% – 5% growth, which is in line with their mature market. Their biggest competitor is Modelo who has been more profitable. Modelo (manufacturer of Corona beer) has a 55% market share and FEMSA has 45%. 50% of Modelo's revenues comes from Corona. FEMSA has 20% operating margins. Although this market is a duopoly, the two players FEMSA and Modelo have tried to avoid price wars, so they are cooperating to a degree, but not a ton.

The second division is CocaCola FEMSA. This is the bottling facility for Coca Cola. It's the largest in Latin America and the second largest in the world with \$7 B in annual revenue. This division is the fastest growing business within FEMSA. CocaCola FEMSA has made lots of acquisitions and has had strong organic growth. Needless to say, this division is highly profitable.

The third business is FEMSA Retail (\$4 B in revenue), which consists of a chain of convenience stores similar to 7-11. FEMSA Retail is the most dominate player in the market, and it has very fast growth, ~30% a year. As it typical of the retail world, FEMSA Retail's margins are slim. They've managed to obtain a 6% margin, which is above industry average.

In the last 10 – 15 years, there have been lots of mergers and acquisitions in the beer industry. The three major players in the beer industry are SAB Miller, Imbev, and Heinekin. Local brands tend to dominate only in local markets. There is strong emotional aspect to local brands, but most brands are moving toward a global reach. Typically this is because there's sourcing, manufacturing, and distribution synergies that help. At this point you are free to choose the side of FEMSA or Heinekin. Let me know what you choose and what you would advise the client.

Possible Answer:

I chose FEMSA, based only on the fact that the interviewer had tons of information regarding FEMSA.

I asked whether FEMSA is public or private. It turns out FEMSA is publicly traded. That changes the equation and how the CEO can approach this case.

Five buckets that will have an impact on share price:

- competition
- strategic
- operational
- investment options
- diversification premium

Within Competition, I talked about Modelo being a faster growing company, being squeezed out of industry, and new entrants coming in.

Within Strategy, I talked about duopoly currently in place and possible expansion plans.

Within Operational, there is certainly more value in a large brand. Any synergies that could be sold. Any profit sharing or results sharing opportunities.

Investment options – When the money does come in, what to do with that money. Dividends, another acquisition, grow current businesses, improve current operations.

Diversification premium: when you're in 3 different business, you're dinged in share price. The value of the firm is worth more separately. Transaction itself: the CEO needs to know what the right selling price is. Don't get into numbers, but talk about it.

Transaction price. How the transaction would change the industry's beta and company's beta.

Once you get out of the beer business, FEMSA is no longer in the same industry as a company. FEMSA was originally a consumer goods company. Once the beer business is sold, it's more a distribution company. The profile of the company changes. There will be a change in shareholder. This will also change the company's beta. As a CEO, you will need to understand these issues. Institutions that would previously fit in their beverage portfolio would no longer fit. FEMSA is facing the risk of getting squeezed out of industry because we're growing slower than our competitor.

Given the trends, we will be squeezed out. If a third competitor comes into the equation, competition becomes harder to maintain and the company could be squeezed out further.

Based on all these considerations the final recommendation to FEMSA is to sell the beer division.