PZENA Investment Management

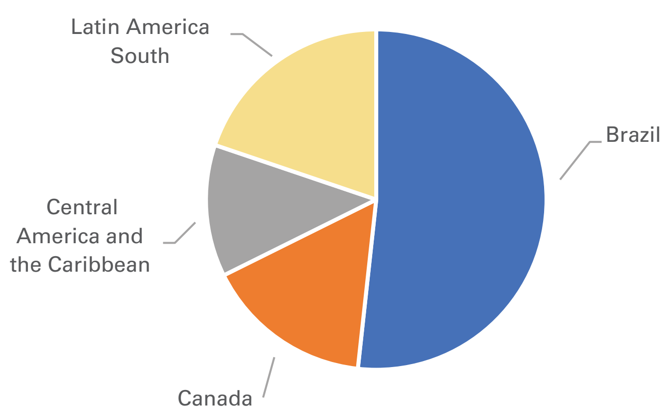
FOURTH QUARTER 2021 HIGHLIGHTED HOLDING: AMBEV

Favorable market structure, best-in-class margins, strong brands, and sustainably high returns on capital describe Ambev, Latin America and Canada's leading brewer. Short-term margin pressures have created a long-term opportunity.

AMBEV: THE BEER HEAVYWEIGHT

Headquartered in Brazil, Ambev (formally "Americas' Beverage Company" in Portuguese) produces, distributes, and sells beer in 18 countries across the Americas (Figure 1). Ambev was created in 1999 through the merger of Brazil's two largest breweries, Brahma and Antarctica. In 2004, Ambev merged with Belgium's Interbrew to create InBev, becoming the world's largest brewer, and it became larger after acquiring Anheuser-Busch in 2008, creating AB InBev. It grew even larger after acquiring Grupo Modelo in 2013 and SABMiller in 2016. Having consolidated the fragmented beer industry with well over 500 brands in its portfolio, AB InBev is arguably the greatest roll-up in history and today makes one out of every four beers sold worldwide. Its closest competitor, Heineken, is only half as big.

Figure 1: Ambev's 2020 Revenue by Geography



Source: Company filings

Through the consolidation of the beer industry, Ambev has remained a publicly traded subsidiary of AB InBev, which holds a 62% stake. Ambev owns two of the world's largest beer brands by volume, Skol and Brahma, and has exclusive distribution rights to AB InBev's global brands (Budweiser, Corona, and Stella Artois) within its markets. By design, Ambev does not compete with its parent company, as AB InBev has consolidated any overlap that resulted from M&A activity. The result has been extremely favorable market structures in Ambev's 18 countries of operation, which have manifested in best-in-class margins and sustainably high returns on tangible capital, supported by strong brands, economies of scale, and vertical integration.

		Earning Per Share			Price/Earnings		
	Price	FY22E	FY23E	Normal*	FY22E	FY23E	Normal*
AmBev S.A. (BOVESPA:ABEV3)	R$15.42	R$0.77	R$0.93	R$1.90	20.0x	16.6x	10.7x**

Fiscal Year-End December 31
*Pzena estimate of normalized earnings
**Globally adjusted price-to-normal based on Brazilian discount rate
Source: Bloomberg, Pzena analysis
Data as of December 31, 2021

BIG BEER IS A GOOD BUSINESS

There's nothing intrinsic to beer that makes it a good business. All beer has four essential ingredients: water, barley, hops, and yeast. So, whether you're enjoying a Bud Light, Corona, or the latest craft beer at your local pub, you're drinking a brewed mix of ingredients that are more or less the same. Yet, nearly all beer drinkers have their preferences and are often loyal to just one — a testament to the power of branding. It's this brand loyalty that leads to high share of throat for mega-brewers, who pour billions of dollars each year into strengthening their brands.

Pricing premiums based on brand explain the excess returns earned by the largest brewers, however AB InBev is in a league of its own, with the highest margins and returns on capital of any brewer. The reason is market structure. While AB InBev is the largest brewer in the world, with a 25% share by volume, its true dominance in beer is seen on a country-by-country basis, especially in Latin America and Canada where Ambev operates. Ambev boasts a dominant position, or is part of an effective duopoly, in each of its 18 countries of operation. For example, in Brazil — Ambev's largest market — it has an estimated 65% market share by volume, ahead of Heineken's 19%. In Bolivia, Paraguay, Uruguay, Cuba, and the Dominican Republic, Ambev is the standalone market leader. Such favorable market structures allow Ambev to consistently earn returns on tangible capital well above 50%.

Ambev has maintained its market dominance through vertical integration, from manufacturing to distribution, creating a barrier to entry large enough to deter would-be competitors. Often overlooked, Ambev's vast distribution network, spread strategically across the Americas, is its most significant source of competitive advantage. In

Brazil, Ambev delivers to over one million points of sale, while Heineken and Coca-Cola FEMSA (a beer distributor in Brazil) reach just half as many points. Distribution is particularly complex in Latin America because most beer is sold in returnable glass bottles that must be delivered to bars and picked up after each use to be sanitized and relabeled at the plant.

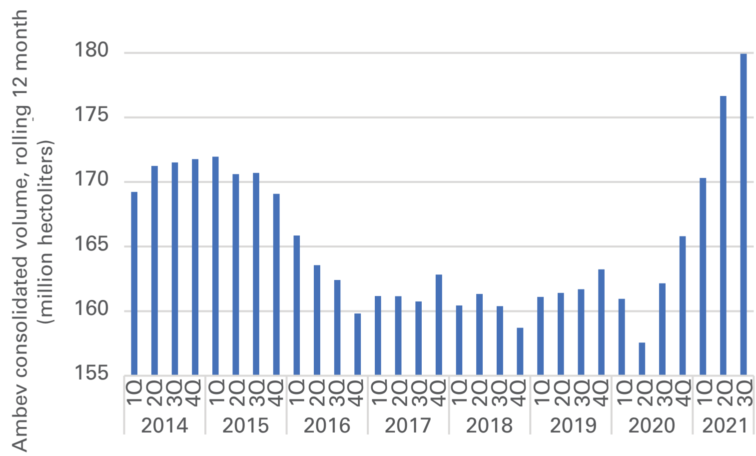
CONSUMPTION BOUNCES BACK

The opportunity to invest in Ambev arose in the second quarter of 2020 when the impact of COVID-19-related restrictions began to weigh on the stock's market valuation. As bars and restaurants shut down, Ambev's quarterly volume sales declined, hitting its lowest point in over a decade, and empty pubs led to pint-sized profits (relative to normal). Our concern at the time was not whether volumes would eventually rebound to pre-pandemic levels — that was likely — but whether they would ultimately revert to record levels achieved just before Brazil's severe 2015-16 recession. When Jean Jereissati took over as CEO in January 2020, his stated goal was to get volumes back to their peak levels. Despite the COVID-19-related setbacks, we believed his target was achievable within five years.

Surprisingly, Ambev not only surpassed CEO Jereissati's volume goal but also achieved it in record time (Figure 2). Just one quarter after reporting its lowest volume in over a decade, Ambev reported record third quarter volume in 2020 — and has posted record volumes each quarter since. The debate now is whether Ambev's record volumes can be sustained. While a portion of the volume gains can be attributed to one-off factors such as Brazil's coronavouchers, we don't believe the strong sales dynamic is likely to substantially weaken anytime soon, for three reasons: (1) 20% of Ambev's volumes today are from new products introduced in past three years; (2) Ambev acquired more than three million new customers since 2019, attributable to the company's increased distribution penetration, where it has maintained a crucial advantage; (3) intuitively, beer consumption per capita is highly correlated to a country's GDP per capita, which for Brazil, is currently depressed, setting up a viable growth avenue by way of an economic rebound from the country's recession.

It seems illogical then, given the exceptional snap-back in volumes to record levels, that Ambev is trading well below its 2018 high despite the brewer posting both better sales and profit numbers. Much of the reasoning, we surmise, has to do with the factors outlined in our Commentary section — that Ambev, simply by virtue of being an EM stock, is falling victim to negative investor sentiment surrounding the Brazilian economy. Over the long run, however, we believe that Ambev's strong financial performance is what will garner a higher multiple on the stock regardless of short-term macroeconomic noise, presenting the current share price as an attractive entry point.

Figure 2: Ambev Rolling 12-month Consolidated Sales Volume

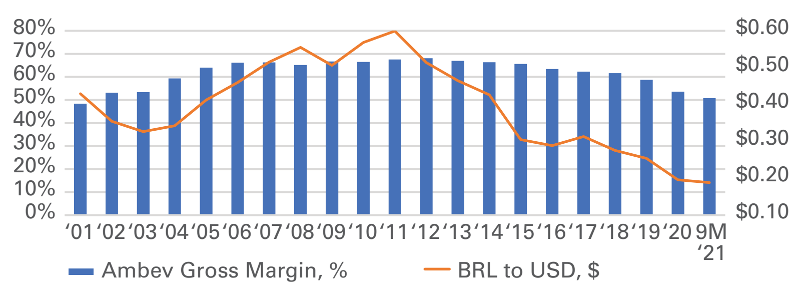


Source: Company filings, Pzena analysis

A MARGIN STORY

Despite setting records on the top line, declining margins have put a damper on Ambev's stock price, with the primary driver being foreign exchange headwinds on cost of goods sold (COGS). In short, Ambev's sales in Brazil are generated entirely in local currency, while half of its COGS are international trading commodities (aluminum, glass, sugar, hops, malt, corn, wheat, etc. are all COGS for Ambev) denominated in US dollars. This mismatch squeezes the company's gross margin when the Brazilian real depreciates against the greenback (Figure 3).

Figure 3: Ambev Gross Margin vs. Strength of Brazilian Real



Source: Company filings, Pzena analysis

We know the future path of macroeconomic conditions and currency moves in Brazil will continue to be a wild card. But as long as the real remains relatively stable, we expect margins to steadily increase from 2022 onward due to Ambev's continued premiumization efforts of enticing consumers to move beyond mainstream brands and toward higher-priced beers. This is a particularly compelling trend for Ambev, as premium beers sell at higher prices, but don't cost much more to make. Interestingly, the premium category is underpenetrated in Brazil, representing just 16% of total beer volumes, whereas in other emerging markets like Russia and Chile, it's 42% and 32%, respectively.[1] Ambev's portfolio of local premium brands, as well as its access to AB InBev's global portfolio, positions it to grow margins over the medium term via a strong mix effect.

[1]Source: GlobalData (all data) and Bernstein analysis

LOOKING AHEAD

From a macro perspective, the bull case is, although less foreseeable, relatively straightforward: Latin America experiences a post-pandemic economic revitalization, people have more discretionary income, and Ambev regains pricing power accordingly, while the Brazilian real at least stabilizes against the dollar, and commodity prices somewhat normalize from their current sky-high levels. The fundamental, company-specific picture driven by Ambev's premiumization efforts, however, is more visible, and we believe that management has the right strategy and the means to execute on it, providing asymmetric upside to the company's market valuation.

FURTHER INFORMATION

These materials are intended solely for informational purposes. The views expressed reflect the current views of Pzena Investment Management ("PIM") as of the date hereof and are subject to change. PIM is a registered investment adviser registered with the United States Securities and Exchange Commission. PIM does not undertake to advise you of any changes in the views expressed herein. There is no guarantee that any projection, forecast, or opinion in this material will be realized. Past performance is not indicative of future results. All investments involve risk, including risk of total loss.

This document does not constitute a current or past recommendation, an offer, or solicitation of an offer to purchase any securities or provide investment advisory services and should not be construed as such. The information contained herein is general in nature and does not constitute legal, tax, or investment advice. PIM does not make any warranty, express or implied, as to the information's accuracy or completeness. Prospective investors are encouraged to consult their own professional advisers as to the implications of making an investment in any securities or investment advisory services.

The specific portfolio securities discussed in this presentation are included for illustrative purposes only and were selected based on their ability to help you better understand our investment process. They were selected from securities in one or more of our strategies and were not selected based on performance. They do not represent all of the securities purchased or sold for our client accounts during any particular period, and it should not be assumed that investments in such securities were or will be profitable. PIM is a discretionary investment manager and does not make "recommendations" to buy or sell any securities. There is no assurance that any securities discussed herein remain in our portfolios at the time you receive this presentation or that securities sold have not been repurchased.

Ambev was held in our Emerging Markets Focused Value, Emerging Markets Select Value, Global Focused Value, Global Value, International Focused Value, International Value, and other strategies during the fourth quarter of 2021.

For U.K. Investors Only:

This financial promotion is issued by Pzena Investment Management, Ltd. ("PIM UK"). PIM UK is a limited company registered in England and Wales with registered number 09380422, and its registered office is at 34-37 Liverpool Street, London EC2M 7PP, United Kingdom. PIM UK is an appointed representative of Mirabella Advisers LLP, which is authorised and regulated by the Financial Conduct Authority. The Pzena documents are only made available to professional clients and eligible counterparties as defined by the FCA. Past performance is not indicative of future results. The value of your investment may go down as well as up, and you may not receive upon redemption the full amount of your original investment. The views and statements contained herein are those of Pzena Investment Management and are based on internal research.

For EU Investors Only:

This financial promotion is issued by Pzena Investment Management Europe Limited ("PIM Europe"). PIM Europe (No. C457984) is authorised and regulated by the Central Bank of Ireland as a UCITS management company (pursuant to the European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations, 2011, as amended). PIM Europe is registered in Ireland with the Companies Registration Office (No. 699811), with its registered office at Riverside One, Sir John Rogerson's Quay, Dublin, 2, Ireland. Past performance is not indicative of future results. The value of your investment may go down as well as up, and you may not receive upon redemption the full amount of your original investment. The views and statements contained herein are those of Pzena Investment Management and are based on internal research.

For Australia and New Zealand Investors Only:

This document has been prepared and issued by Pzena Investment Management, LLC (ARBN 108 743 415), a limited liability company ("Pzena"). Pzena is regulated by the Securities and Exchange Commission (SEC) under U.S. laws, which differ from Australian laws. Pzena is exempt from the requirement to hold an Australian financial services license in Australia in accordance with ASIC Corporations (Repeal and Transitional) Instrument 2016/396. Pzena offers financial services in Australia to 'wholesale clients' only pursuant to that exemption. This document is not intended to be distributed or passed on, directly or indirectly, to any other class of persons in Australia.

In New Zealand, any offer is limited to 'wholesale investors' within the meaning of clause 3(2) of Schedule 1 of the Financial Markets Conduct Act 2013 ('FMCA'). This document is not to be treated as an offer, and is not capable of acceptance by, any person in New Zealand who is not a Wholesale Investor.

For Jersey Investors Only:

Consent under the Control of Borrowing (Jersey) Order 1958 (the "COBO" Order) has not been obtained for the circulation of this document. Accordingly, the offer that is the subject of this document may only be made in Jersey where the offer is valid in the United Kingdom or Guernsey and is circulated in Jersey only to persons similar to those to whom, and in a manner similar to that in which, it is for the time being circulated in the United Kingdom, or Guernsey, as the case may be. The directors may, but are not obliged to, apply for such consent in the future. The services and/or products discussed herein are only suitable for sophisticated investors who understand the risks involved. Neither Pzena Investment Management, Ltd. nor Pzena Investment Management, LLC nor the activities of any functionary with regard to either Pzena Investment Management, Ltd. or Pzena Investment Management, LLC are subject to the provisions of the Financial Services (Jersey) Law 1998.

For South African Investors Only:

Pzena Investment Management, LLC is an authorised financial services provider licensed by the South African Financial Sector Conduct Authority (licence nr: 49029).