Let it Snow, let it Snow, let it Snow, says SAB

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No small beer: The second part of our series from Mark Kleinman on how British companies are turning to Asia for their future growth

It is 7 on a bitterly cold December evening. On the roads of Hexi, a district in the Chinese city of Tianjin, pedestrians are vying for space with cyclists and motorists, eager to escape the chill. There are few obvious places to seek refuge - the handful of bars which occasionally dot the streets will not open their doors for another two hours.

It seems an unlikely place for one of the world's biggest brewers to be demonstrating its growth potential. But for SABMiller, the £16bn Anglo-South African producer of Miller Lite and Peroni, Hexi - and towns like it across China - is primed for a bigger role. For in the thousands of restaurants and small shops across this province, SABMiller's Chinese joint venture is engaged in a furious landgrab for the exclusive right to sell Snow, its flagship brand.

"Their presence here is very big and it is good to deal with a company of this size," explained Xhang Xhi, the owner of a small convenience store in Hexi. "I am very satisfied with Snow."

Through its 49 per cent stake in China Resources Snow Breweries (CRSB), acquired 12 years ago, SABMiller has emerged as the largest brewer by volume in the world's most populous country. That landmark was reached earlier this year and it is, at first glance, an enviable position. Soaring demand has catapulted Snow into the world's top ten beer brands, rubbing shoulders with the likes of Budweiser and Heineken.

And as foreign beer-producers (among them, Anheuser-Busch, InBev and Scottish & Newcastle) have piled into China, the thirst for market share has resulted in a flurry of takeovers of local breweries. So far, eight of the country's ten leading brewers have attracted overseas investment. On Friday, CRSB unveiled two further deals to snap up brewing assets in the country, including the first move by an international brewer into the autonomous region of Inner Mongolia.

The rush looks timely. Per capita beer consumption in China, while low by the standards of markets such as Britain and Germany, has quadrupled since 1988, according to the international beer industry consultant, Seema.

But the deluge of corporate activity has yet to produce the kind of tonic that shareholders most want to taste: a profit which reflects the size of one of the world's fastest-growing markets.

"Our margins are still too low," admitted Andre Parker, SABMiller's managing director for Africa and Asia. In the regions he manages, Asia accounts for 80 per cent of volume sales but only 20 per cent of profit. On a group-wide basis, Asia is worth about 10 per cent of annual sales, but just 2 per cent of earnings. Parker insisted that need not be the case in the long term.

"Once you have a recognised brand, you can ask the consumer to pay a little more for the product," he said. As China's economy booms, and its middle class swells in size, demand for branded consumer products from beer to luxury goods is mushrooming.

These trends have propelled building nationwide awareness of Snow, along with tidying up China's labyrinthine beer distribution networks, to the top of SABMiller's list of priorities. More than 40 regional variants of Snow have been standardised, a process which the company said is helping it squeeze out economies of scale in areas such as advertising, production and the listing fees paid to retailers. In a market where a 640ml bottle of "premium" beer is sold for the equivalent of 40 US cents, the need to keep a tight lid on costs is obvious.

Not that SABMiller's partner, majority-owned by the Hong Kong-listed conglomerate, China Resources Enterprise, has found that straightforward. Humor Wang, general manager of CRSB, said it was "impossible" to know how many outlets the company's products were sold in.

"There are simply too many," he said.

Problems also occur with unscrupulous distributors, and have led CRSB to set up what it calls a "supervision task force" to monitor its supply chain more carefully. But the company admits it cannot put a value on the amount of beer that goes missing or is sold illegally.

If that serves as a reminder of the difficulties of doing business in such a vast - and sometimes corrupt - market, then the growth opportunities remain sufficient to whet executives' appetites. Snow has only this year gone on sale in Beijing, and it has still to make an entrance in Shanghai - and yet its parent company can still boast a near-15 per cent national market share.

The scale of the growth opportunity has led City analysts to take a relaxed stance on SABMiller's investment in China.

"The advantage for the major players is that they have the management and financial resources to invest for the long term in what is at the moment a pretty irrelevant market from a profit standpoint," said Nick Bevan, a drinks analyst at Deutsche Bank. "China clearly has tremendous growth prospects from a per capita perspective, and as the market consolidates into a handful of players both pricing and margins should improve."

While SABMiller's early strategy of building volume in the rust-belt of north-east China has allowed it to gain scale more cheaply than competitors, it has left the company with a formidable challenge: turning to more affluent regions where its multinational rivals have a head-start.

"Sooner or later, we have to be in Shanghai," admits Parker. In 2004, SABMiller threw in the towel in a fierce battle for control of Harbin, another Chinese brewer, selling its 29 per cent stake to Anheuser-Busch, the Budweiser-maker. Although SABMiller could toast a handsome one-off profit from the disposal, it cost the company a chance to gain an immediate foothold in China's biggest cities.

To reduce its dependence on Snow's domestic sales, SABMiller has since drawn up plans to take some of its biggest-selling lagers, including Miller Genuine Draught and Pilsner, on to the mainland. And the company's Asian growth ambitions stretch beyond China. In India, SABMiller is committed to a $100m (£51m) annual investment programme over the next few years; and in Vietnam, the company has secured a deal with Vinamilk, the country's biggest dairy producer, to open a brewery in Ho Chi Minh next month.

"None of these investments are short-term plays," said Parker.

It is a view often-repeated by foreign investors in China. Seema president Glen Steinman believes it will be "somewhere between several and many years" before international brewers reap significant profits in China.

The board of SABMiller has other pressing issues to consider, including the future of a 28 per cent stake held by Philip Morris's parent company, Altria, and a share price which has seen SABMiller underperform the FTSE100 by five percentage points this year (unfairly, in the view of many analysts). But if shareholders can stick around that long, SABMiller's investment in Asia may just help provide the kind of hangover cure they have been looking for.