

A mixed forecast for beer

Importers and crafters bask in the sunny uplands of the high-end, but the big brewers brace for more rough weather.

U.S. Beer Sales 2005 vs. 2004

	2005 Barrelage	2004 Barrelage	% Change
Domestic	178,800,000*	180,950,000	-1.2%
Imports	25,565,709	23,849,826	7.2%
Exports	4,151,303	3,843,049	8.0%

*Estimate.

Note: Figures do not include non-alcohol products.

Export figure includes sales to U.S. military abroad and Puerto Rico.

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U.S. Beer Sales Domestic and Imported 2004/2003

	31-Gal. Barrels (in millions)		Percent of Total		Percent Gain or Loss	
	2005	2004	2005	2004	2005	2004
Domestic Beer	178,800,000	180,950,000	87.5	88.4	-1.2	+0.6%
Imported Beer	25,565,709	23,849,826	12.5	11.6	7.2	+1.4%
Total Sales	204,365,709	204,799,826	100	100	-0.2	+0.9%

*Estimate.

Note: Does not include exports. Totals are tax-paid shipments.

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Barrelage of Top 10 U.S. Brewers, 2005 vs. 2004

	2005 Sales 31-Gal. Barrels	2004 Sales 31-Gal. Barrels	Barrelage Gain or Loss	Gain or Loss Percent
1. Anheuser-Busch	101,100,000	103,000,000	-1,900,000	-1.8%
2. Miller Brewing Co.*	38,300,000	38,600,000	-300,000	-0.8%
3. Molson-Coors Brewing(1)	22,645,000	22,068,000	+577,000	+2.6%
4. Pabst Brewing Co.(2)*	6,900,000	7,300,000	-400,000	-5.5%
5. D.G. Yuengling & Son*	1,570,000	1,380,691	+189,309	+13.7%
6. Boston Beer Co.	1,400,000	1,306,000	+94,000	+7.2%
7. City Brewery	1,005,793	1,340,388	-334,595	-25%
8. Latrobe Brewing Co.*	990,000	1,050,000	-60,000	-5.7%
9. High Falls Brewing Co.*	705,000	720,000	-15,000	-2.1%
10. Sierra Nevada Brewing Co.	612,640	589,937	+22,703	+3.9%

KEY: *=Estimate; (1) The Molson-Coors Brewing Co. now includes Molson volume in their USA sales (2) The Pabst Brewing Co. has closed all of its breweries, and now operates as a contract brewer, producing beer at Miller breweries. Copyright 2006 Modern Brewery Age.

This is a strange time for the beer industry. For the past two decades, the industry has advanced in a reasonably predictable manner, backed by a clear narrative. The size of the overall market remained basically static, but the pie was constantly being redivided. Certain big brewers got bigger, while others declined. Regional brewers dropped out, and craft brewers came in. For statisticians, the most unpredictable development was the rise of the imports, which came up from nothing, to take 12% of the market.

That old and comfortable beer industry equation has now been turned on its ear due to factors largely beyond the control of brewers. Distillers and vintners are taking volume share from the brewers, and the analysts see this trend continuing in the coming year. In 2005, wine was up 4.8% and spirits up 2.9%.

Beer shipments were down 1.2% in 2005, but this was not a reflection on every domestic player. Yuengling, Boston Beer and Sierra Nevada sold more beer, A-B, Miller and Coors sold less (Note: Molson Coors now reports volume for the combined companies. We estimate Coors slightly down without volume effects of the merger).

Indeed, high-end beer thrived in 2005. Craft brewers were up 9%, according to the Brewers Association, and imports climbed 7.2%.

As industry vet and *Modern Brewery Age* columnist Bob Wilson noted last year, "Many of today's consumers are drinking something other than lagers. The major brewers are selling just vanilla, while the 21-34 year-olds are looking for 28 flavors. This is one of the reasons the craft brewers are doing well again."

In a speech in Cape Town, South Africa, in June, 1966, Robert F. Kennedy said, "There is a Chinese curse which says, 'May he live in interesting times.' Like it or not, we live in interesting times..."

Robert S. Weinberg, principal of the Office of R.S. Weinberg, St. Louis, MO, characterized the contemporary brewing industry in exactly the same way. "These are interesting times," he said.

"The nature of competition in the industry has changed radically in the last two years," Mr. Weinberg added. "And the big brewers don't know how to cope. There is nothing surprising about distilled spirits picking up and malt beverages dropping down. If you look at the last four or five years, you see this embedded in the data. It is cyclic. Distilled spirits and wine have an advantage over beer in that they can build up huge inventories, and live off them."

Like Mr. Wilson, Mr. Weinberg notes that consumer paradigms are shifting. "The young people of today are different than the young people of ten or twenty years ago," he says.

This is certainly reflected in the products that consumers are drinking. Of the 30 brands doing best in supermarkets (*IRI Top 30 Beer Brand Performers in 2005, page 19*), only 12 are offerings from the major brewers.

For brewers, the most terrifying table in this edition of *Modern Brewery Age* may be another IRI table, the "Top 10 New Beer Brands" supermarket sales data chart on page 19. Of these top 10 "beer" brands, only three are recognizable as conventional beers.

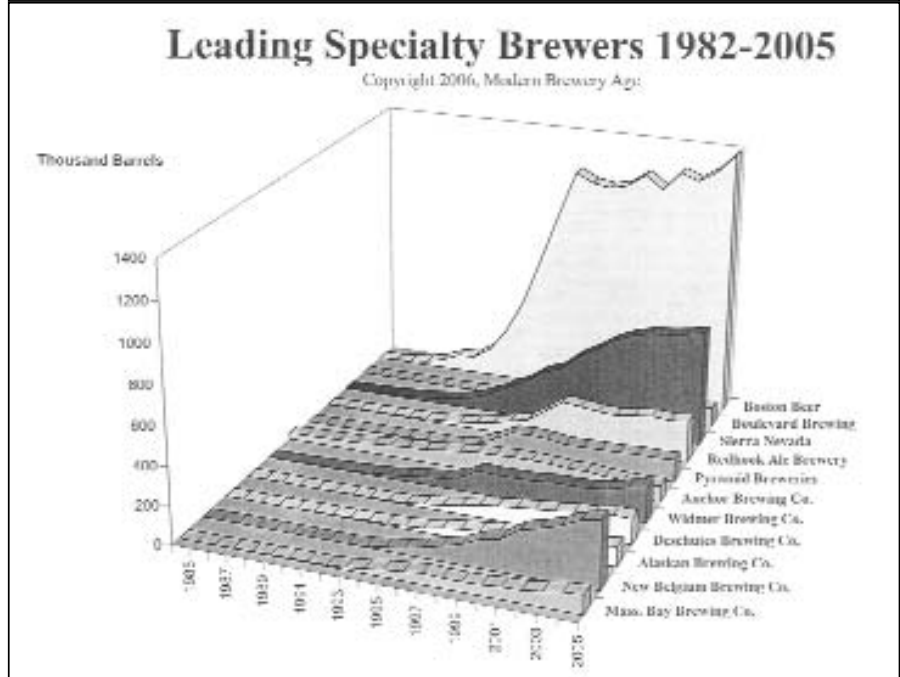
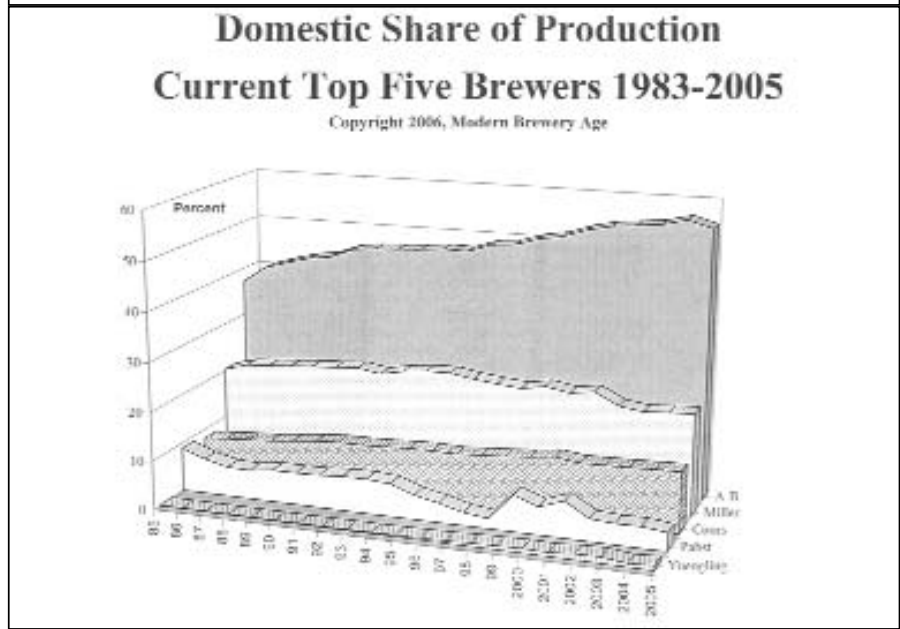
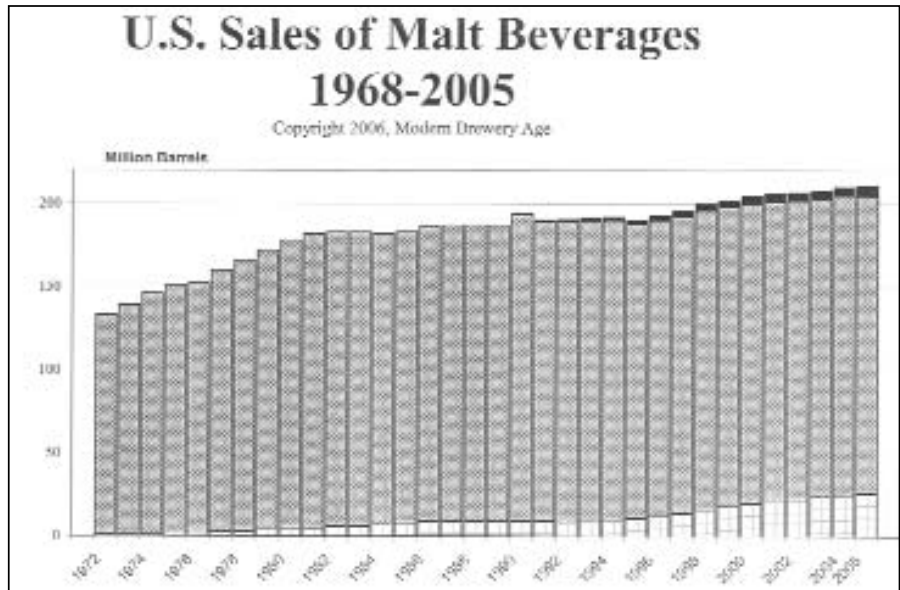
Budweiser Select is number one, followed by Smirnoff Twisted V Watermelon, Smirnoff Twisted V Black Cherry, Mike's Hard Berry, Beck's Premier Light, Bacardi Silver Watermelon, Bacardi Silver Low Carb Green Apple, B to the E, Smirnoff Twisted V Wild Grape, and Heineken Premium Light.

Anheuser-Busch is to be congratulated for getting Budweiser Select to the top of that list, but Adolphus Busch wouldn't recognize the other A-B entrants on that list as any kin to beer—Bacardi Silver Watermelon? Bacardi Silver Low Carb Green Apple? B to the E?

Some years ago, malternatives looked like a Trojan horse come to slay the beer industry. That didn't happen, but malternatives have certainly stolen a share of younger and female consumers. Beyond that, these high-profile malternatives have brought distilled spirits brands to the forefront of these consumer's brand sets.

This may be one factor in the growing per cap for spirits. Indeed, per capita alcohol consumption is rebounding in the U.S. market, but not for beer. According to Beer Institute figures, per capita consumption for beer was at 30.6 gallons per person in 2003, and now stands at 30.4.

"Beer per capitas are not growing," ana-



Production Draught and Package Sales & Total Taxpaid Removals of Malt Beverages

For Calendar Years 1946-2003 (Quantities in 31 Gallon Barrels). Beer Institute figures.

Calendar Year	Package		% of Draught		Total Taxpaid Removals
	Production	Removals	Total	Removals	
1946	83,312,516	53,010,253	66.6	26,530,243	79,540,496
1947	91,742,212	58,899,477	67.6	28,272,887	87,172,334
1948	88,125,320	58,699,355	69.0	26,367,959	85,067,314
1949	88,618,322	59,443,805	70.3	25,113,802	84,557,607
1950	88,178,356	59,487,512	71.8	23,342,616	82,830,137
1951	89,742,138	61,706,743	73.6	22,116,893	83,823,636
1952	90,489,824	63,359,469	74.7	21,477,011	84,836,480
1953	92,104,063	65,830,505	76.5	20,214,611	86,045,116
1954	88,940,268	63,927,035	76.7	19,377,986	83,305,021
1955	90,285,488	66,179,019	77.9	18,789,255	84,977,274
1956	90,338,445	67,087,002	78.9	17,921,154	85,008,156
1957	89,465,986	66,982,200	79.4	17,388,825	84,371,025
1958	90,120,512	67,168,341	79.6	17,256,368	84,424,709
1959	93,127,427	70,308,462	80.2	17,313,897	87,622,359
1960	93,415,363	70,955,595	80.7	16,957,244	87,912,839
1961	95,030,031	71,910,757	80.0	17,117,674	89,028,431
1962	96,831,989	74,128,498	81.3	17,068,659	91,197,157
1963	100,631,563	76,343,134	81.4	17,446,808	93,789,942
1964	105,897,968	80,685,951	81.8	17,958,041	98,643,992
1965	108,221,725	82,624,078	82.3	17,796,839	100,420,917
1966	113,037,193	86,531,831	83.0	17,730,210	104,262,041
1967	116,550,659	89,579,475	83.7	17,394,922	106,974,397
1968	122,407,762	94,007,957	84.4	17,407,741	111,415,698
1969	127,311,042	98,991,915	85.1	17,279,482	116,271,397
1970	133,123,267	104,619,875	85.9	17,240,131	121,860,006
1971	137,479,910	110,026,703	86.4	17,370,566	127,397,269
1972	141,336,930	114,219,578	86.7	17,589,085	131,808,663
1973	148,601,510	120,340,835	86.9	18,127,596	138,468,431
1974	156,147,443	127,227,705	87.5	18,236,377	145,464,082
1975	160,598,916	130,229,488	87.6	18,414,297	148,643,785
1976	163,656,955	132,125,154	87.9	18,262,233	150,387,387
1977	170,507,857	138,673,342	88.4	18,240,789	156,914,131
1978	179,656,544	144,585,652	88.9	18,120,235	162,705,887
1979	184,187,771	148,684,013	88.4	19,431,684	168,115,697
1980	194,086,267	152,346,481	87.9	21,020,539	173,367,020
1981	193,687,085	154,545,763	87.5	22,150,730	176,696,493
1982	194,349,406	153,606,164	87.0	22,968,671	176,574,835
1983	195,123,375	154,186,944	86.9	23,307,984	177,494,928
1984	193,021,392	152,640,123	86.9	22,839,376	175,479,499
1985	193,307,822	153,362,068	87.6	21,769,542	175,131,610
1986	196,498,984	157,422,686	88.1	21,298,341	178,721,027
1987	195,420,205	156,872,204	88.2	20,976,382	177,848,586
1988	198,024,766	157,934,409	88.6	20,299,638	178,234,047
1989	200,124,365	159,433,057	88.9	19,963,928	179,396,985
1990	203,658,410	163,998,656	88.9	20,475,177	184,473,833
1991	202,370,518	160,930,740	88.7	20,518,639	181,449,379
1992	202,107,862	159,809,506	88.4	20,559,366	180,874,804
1993	202,638,596	160,337,440	88.6	20,563,370	180,900,810
1994	202,039,109	160,122,576	89.1	19,564,706	179,687,282
1995	199,215,197	157,947,168	89.3	18,955,400	176,902,568
1996	201,050,049	159,213,737	89.5	18,746,053	177,959,790
1997	198,904,373	159,359,238	89.8	18,093,839	177,453,077
1998	198,130,339	159,935,547	90.2	17,383,919	177,319,466
1999	198,251,742	162,582,242	90.5	17,046,914	179,629,156
2000	199,173,709	162,644,340	90.7	16,710,730	179,355,070
2001	199,332,251	163,550,113	90.6	16,494,110	180,422,561
2002	200,406,545	165,599,785	90.7	16,628,422	182,596,473
2003	196,722,477	163,319,190	90.6	16,621,931	180,279,439
2004*	198,111,040	163,792,642	90.5	16,825,604	180,950,000
2005*	194,347,826	161,846,501	90.5	16,625,686	178,800,000

Data collected by the Beer Institute, Washington, D.C. Note: *2004 & 2005 domestic production estimates are subject to revision. Tax-paid removals may differ from official Beer Institute estimates published in the Statistical Update Memorandum. This table printed in Modern Brewery Age, April, 2006.

lysts Mark Swartzberg and Mark Astrachan of Stifel Nicolaus note in their recent beer report. "Imports and other high-priced beers are growing in a fashion analogous to the above average growth of higher-priced spirits and higher priced wines. We consider two factors especially notable—excess growth in marketing spending on all alcohol relative to inflation, and faster spending growth for wine and spirits than for beer."

The Stifel Nicolaus analysts do not see the beer trend turning around. "Our projections of per capita consumption by segment imply a continued decline in beer's share of alcohol mix in favor of wine and spirits," Swartzberg and Astrachan write. "We expect beer's share to decline from approximately 57% in 1995, to approximately 52% in 2005 and 49% in 2010. We consider this the most likely outcome because beer has a lot to lose as the distantly largest alcohol segment, and, on balance, the noted drivers of total consumption are weighted towards of exclusive to wine and spirits."

The bright side for beer, as the analysts note, has been in the high-end. There, growth rates have met or exceeded growth by wine and spirits.

"Craft beer volume growth far exceeded that of large brewers, wine and spirits in 2005," said Paul Gatzka, Director of the Brewers Association of Boulder, CO. "And even though imported beer grew nicely in 2005, craft beer grew at a faster rate."

The Brewers Association estimates 2005 sales by craft brewers at 7,112,886 31-gallon barrels up from an adjusted total of 6,526,809 barrels in 2004, an increase of 586,077 barrels or 8.1 million case-equivalents.

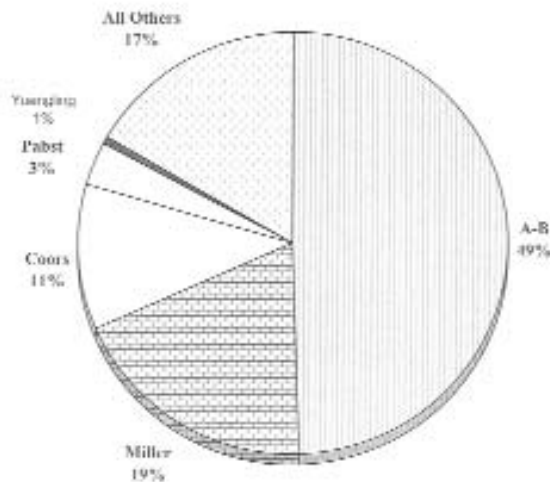
Those numbers are borne out in our annual brewery ranking, which turns past convention on its head. In years past, A-B would add a couple of million barrels without breathing hard, but this time they dropped 1.9 million. The entire top tier is down (Coors is an anomaly, as noted) and in 2005, it was the brewers of the third tier that chalked up volume.

The increased craft barrelage is startling given the capacity constraints on small brewers. Every added 20,000 barrels must be planned years in advance. Many of the upper echelon crafters felt a freshening wind behind craft beer years ago, and began adding capacity. Some brewers maintained excess capacity from the previous micro boom. The existence of this capacity, whenever it was built, is helping fuel renewed craft growth.

Analyst Bob Weinberg applauds this craft growth, but puts it in perspective. "In the domestic specialty market," he says, "we see

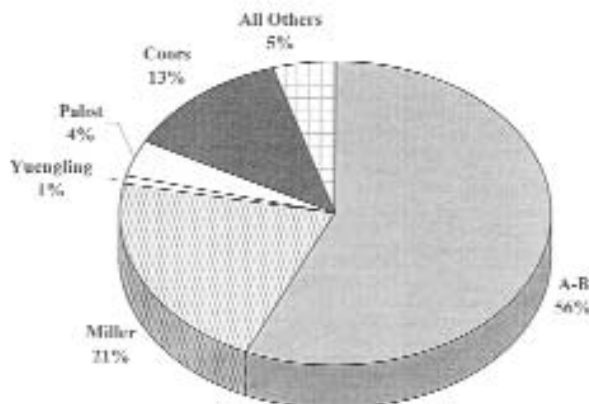
2005 Market Share-Top U.S. Brewers

(includes import volume in "all others")
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2005 U.S. Share of Production

(U.S. production, not including imports) Copyright 2006, Modern Brewery Age



large percentage growth, but relatively few barrels. It is hard to know what this means, but there are obviously more adventurous consumers out there willing to try new things. The numeric results show that. As for the imports, I think they continue to benefit from the lack of a definable super premium segment in the domestic market.”

Ephemeral or not, craft and import growth has put the big brewers in the shade. (Fortunately for the big brewers, domestic numbers only reflect part of the picture. Anheuser-Busch dropped 1.8% in the U.S. market, but is up 50.8% percent internationally. International volume jumped from 13,800,000 barrels to 20,800,00 barrels, and volume from A-B’s “international equity partners” now stands at 26,400,000 barrels, an increase of 36%).

And, no matter how many barrels A-B sells in Shanghai, a primary mission must

be the stabilization and growth of beer in the profitable U.S. market.

For the analysts, the prescription for future U.S. beer growth is simple—new products and increased marketing spending by brewers.

Analyst Weinberg has been a proponent of new products for years, nay, decades. “The answer is new products,” he says. “No question. But it is important to play off old and new products against each other in a fashion to reinforce each other in a brand portfolio. You have to examine interactions of new and existing products. There are subtle and important distinctions and you have to be careful when you do this. You don’t want the consumer getting the notion that the old products were bad; it has to be part of an evolution of the whole portfolio.”

New products in the high end may sell themselves to an extent, but marketing spe-

cialists suggest that mainstream beer will need to substantially increase their spend.

Messrs Swartzberg and Astrachan at Stifel Nicolaus say the future depends on “a virtuous cycle in marketing spending, with alcohol producers and marketers acting on the realization that spending in excess of inflation is key to maintaining favorable per capita trends.”

They say distillers and vintners are following this prescription, but brewers are lagging. “We are less convinced that brewers are prepared to keep up the marketing pressure,” they write. “If, indeed, the brewers are entering a phase of slowing marketing spending, we would expect beer to lose share to wine and spirits at a faster rate than that which we have projected.”

The bellweather for the U.S. beer market is always Anheuser-Busch. A-B will be the leader in marketing spend, and the primary contributor in the new products arena. So far this year, the company has come on strong. St. Louis has delivered a flood of new A-B products, a balance of craft-type beers and alternative beverages. In addition, A-B is building itself into a full-service importer. It has Grosch to take on Heineken, and an Asian brand for those niche restaurants. Now it just needs a good Mexican brand, a Canadian brand, and a European or two...

Some analysts are watching for future merger and acquisition activity, which could dramatically alter the landscape. A-B has been making new international arrangements with Heineken, sparking one waggish analyst to comment, “They are dating, and who knows, maybe they end up getting married.”

The past year was a tough one for the mainstream beer business, and distillers and vintners will be keeping the pressure on. Price war continues to lurk, but anecdotal evidence shows beer sales picking up and pricing conditions more favorable.

“Beer is not dead,” says analyst Robert Weinberg. “There is a slowdown in demand for malt beverages that is structural, and this has a demographic basis. The nature of the market has not changed, but there have been changes in the competitive structure, and this is worth examining.”

Mr. Weinberg promises to share the results of that examination with us. But in the interim, brewers can take solace—beer is demonstrably not dead, but, in the form of craft beer and imports, is in fact vibrant and growing. For brewers that make interesting, differentiated, high-quality beers, the sky