Alternative Research Services, Inc.

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SAM -- $206

Market Cap.	$2.7 b
Shares Out.	13.5 m
Float	9.4 m
Short Interest	1.6 m
Days short	13.6
Avg. Vol.	137k
St. eps est. '15	$7.23
St. eps est. '16	$8.26
Px/book	5.43x
Px/sales	2.77x
Px/EBITDA	13x

Source: Nasdaq.com/Schwab

- SAM saw best days--trapped in the middle--industry gurus
- SAM exposed to weak cider sales; Q4 should be disaster
- Craft brewers now 4,144 v. 3,464; adding another 2000
- Increased SKU's from craft brewers creates margin risk
- Competitive new root beer; Pabst
- BREW lowers guidance to LSD citing higher SGA
- Risk: Heineken acquires SAM @ 10x EBITDA in 2017

The beer industry is split between a handful of national brewers and several thousand craft brewers. The national brewers are slowing to low single digits. As such, all of the companies bigger than SAM are digesting sizable acquisitions; including Anheuser-Bush/InBev, MillerCoors, Constellation, Heineken, and Pabst (product launch). Given those trends; Sam Adams could see its organic sales growth of 6% go negative in 2016 due to fundamentals. However, as we discussed in our prior report, sales for microbrewers have accelerated greatly both in the volume of beer sold, and the number of establishments, now 4,100 and growing. This partly explains the consolidation we've seen over the past two years—get big and hurry up. There is also a concerted effort on the part of beer drinkers to go local. This cultural shift by American beer drinkers is leaving the Anheuser-Bush-type companies out in the cold. SAM is in no man's land a national craft brewer. So there are roll-ups above them and competition below them.

We have to look at recent acquisitions of the bigger companies in the industry. We assume that there is already some takeover speculation in SAM's stock and there could be more to come that would increase the price of the stock, generating a better entry for the short. As we send out surveys seeking opinions within the industry, we expect that our ability to make a call on the valuation will improve. We have already interviewed several senior industry participants that largely reaffirmed our thoughts on SAM. It would be very unlikely in the next year or two that the bigger players would acquire SAM because they are digesting current acquisitions. In fact, one source indicated that due to anti-trust issues A/B could go many years before making another acquisition, if ever. We think the list of potential suitors is quite limited as they are integrating recent acquisitions.

We ran a few EBITDA scenarios (below) that allow us to modulate the risk of a takeover. In the green, we think it is a likely price for a takeover, yellow covers the middle ground. In red, we think it's very unlikely that SAM could be bought at 17x or 20x EBITDA. We spoke to the CFO of a meaningful brewing company that told us SAM has its best growth rates behind it. There is a "cap" on the price at which a suitor will pay, probably in the neighborhood of $225-$235 per share. Q4 is probably a miss with the potential for more lowered guidance based on the negative news during the quarter regarding cider sales, causing the stock to trade on fundamentals, not takeover speculation yielding a much lower price. Speculators can only hold on for so long in a deteriorating fundamental environment. The home run in the stock is to capture the inflection point from speculation to fundamentals.

If the stock trades off fundamentals, it could certainly come into 10x 180M of EBITDA or $133 per share over the next two years, or ~$100 point profit from where we are today in December of 2015. We think Heineken will buy SAM in 2018 for 10x EBITDA or about $133. Goldman's estimate of $223M of EBITDA in 2017 seems high.

One more issue on the takeover potential: On December 17th, an institutional shareholder of SAM spoke negatively about the fundamental negative trends in an interview. However, at the end of the interview, he went on to say to despite all of that, SAM is still worth 20-25x EBIT. The estimate for 2016 EBIT is $164M. He called out $320/share in a takeover, suggesting SAM can command the same premium despite flattening growth. In the interview, the portfolio manager compared Ballast Point growing 165% yoy with a hot product to SAM. Clearly, $320 is on his Christmas wish list. That kind of inflammatory price works to our advantage. If that's the speculation we are fighting, we are even more bearish on SAM.[1] And if we are completely wrong, and SAM does get acquired sooner, at a higher premium, we think the current price of the stock at $206 insulates short investors from high percentage losses. Is it worth $10-20 points of pain to make 100 points or more of return? We think so.

		2015	***2016***	***2017***	***2018***
EBITDA x*	**10**	**1920**	**1900**	**1850**	**1800**
	12	**2304**	**2280**	**2220**	**2160**
	15	**2880**	**2850**	**2775**	**2700**
	17	**3264**	**3230**	**3145**	**3060**
	20	**3840**	**3800**	**3700**	**3600**
	Est*	**192**	**190**	**185**	**180**
EBITDA (est)					
Share price	**13.5**	**Share price**			
	10	**$142**	**$141**	**$137**	**$133**
	12	**$171**	**$169**	**$164**	**$160**
	15	**$213**	**$211**	**$206**	**$200**
	17	**$242**	**$239**	**$233**	**$227**
	20	**$284**	**$281**	**$274**	**$267**
Goldman EBITDA x 2015, 16, 17		**192**	**203**	**213**	**223**

"I am long SAM March 210 puts"

We were lucky enough to interview a long time (25+ years) industry participant who validated several of our thoughts. A source commented that SAM is dying on the vine. The core brands are getting weak, as new craft brewers offer consumers variety of choice. The cider category, which SAM has become heavily reliant on, is becoming weak, as the category has attracted more competitors over the years. New root beer products from Anheuser-Busch and from Pabst named "Not My Father's Root Beer" are challenging the new root beer category.[2]

"There are just too many people offering the same products these days. It's getting harder to make money in this environment," referring to one of the bigger brewers. Our source concurred that A/B, Molson/Coors, and Constellation are unlikely suitors for SAM. In fact, the CEO at SAM has blasted A/B over the years, creating a rift between the two companies. The source suggested Heineken made some sense because of the overlap in

[1] Video can be seen here https://finance.yahoo.com/video/why-hedge-fund-manager-says-155442888.html
[2] http://smalltownbrewery.com/our-beers/nyfrb/

distribution here in the US. It is worthy to note that Heineken also made recent acquisitions that it is still adjusting and probably will be for the next 18 months.

The source said, “SAMs Rebel product is nothing special—in fact, nothing they’ve come up with has been something special.” A source says he’s long on SAM March that puts betting the next 2 quarters are soft. He concurred with our theory that the EBITDA for a mature, no-growth company, losing market share would likely sell-out for no more than 10x EBITDA (which we think will be negative growth in 2017 vs. 2016). A source talked about the Ballast Point which was an expensive acquisition that SAMs just couldn’t make (Ballast sold for $1 billion). We had heard Carlsberg that is based in Europe, as a possible suitor. But according to our source, Carlsberg has a strategy of selling in developing countries and seems less ready to penetrate into the US market aggressively. Yuengling was shot down as a suitor mostly based on corporate culture. They are a large craft brewer, but not large enough to acquire SAM.

A slightly more bullish perspective

We interviewed a second industry participant. A source has over 25 + years expertise in the sector.[3] Today, he is helping brewers raise capital to buy plants, or move plants, to Canada where production costs are much lower in than in the US. Bottom line, Jim Koch can be difficult to work with. He has botched many joint-venture dealers with co-packers and distribution partners claiming—no one can produce SAM like him. SAM *had* a great product and was well positioned a decade ago. Now, there are several craft brewers to choose from, like the Sierra Nevada. So while SAM has had success nipping the heels of Anheuser-Bush, taking share away, the craft brewers have done the same to SAM over the past few years. SAM has too many SKU's and is always behind the curve. It’s also risking losing margin points by small production runs, especially since the introduction of root beer, and cider.

SAM, he said, has a lot of upside potential in international markets. We pressed source on a potential takeover suitor. Heineken needs to grow fast, and buying SAM would be the best choice. He also added that the chance that SAM would make a big acquisition at this point seems small. Pabst comes to mind, but they are making a big comeback with root beer now, and it’s not the greatest cultural fit as Pabst beer is a low-end line. Because SAM is losing share to the craft brewers, the EBITDA multiple will come down, he concurred. Our source indicated that the Cider is not going to save SAM, at least not for another year.

Mull This: Hot Hard Cider Market Showing Signs of Cooling[4]

Entering the holiday's cider sales have lost their zest. Big hard cider brands such as Boston Beer's Angry Orchard and Woodchuck Cider have been affected in the past few months by growing competition. There has been a slowdown in the sector, as drinkers are showing a greater willingness to switch to other categories, like hard sodas. There is a hope that the November, and December holidays might rekindle cider sales growth, but industry experts say that the recent trends are not encouraging. They believe the winning strategy may be more seasonal offerings, and new flavors. Boston Beer CEO, Martin Roper told analysts during the company's third-

[3] We are seeking the long-term industry participants on purpose as they have a better prospective vs. an owner of a recently launched brewery.

[4] http://www.nbcnews.com/business/business-news/mull-hot-hard-cider-market-showing-signs-cooling-n466446 (Nov 15)

quarter earnings conference call, that he remains "positive about the long-term cider category potential, but short-term growth is less certain."

SAM

	2012	2013	2013	2014	2014	2015E	2015E	2016E
	% of Vol	Growth	% of Vol	Growth	% of Vol	Growth	% of Vol	Growth
Total Beer	**79%**	**6%**	**71%**	**8%**	**63%**	**-4%**	**57%**	**1.70%**
Off-premise Beer	**45%**	**10%**	**41%**	**11%**	**38%**	**-5%**	**34%**	**2.90%**
Seasonal	18%	13%	17%	15%	17%	-5%	16%	-2.00%
Boston Lager	13%	9%	11%	3%	12%	-9%	10%	-8.00%
Rebel IPA				N/A	5%	30%	6%	32.50%
Other Beer	14%	8%	13%	-17%	4%	-37%	2%	11.30%
On-premise Beer	**36%**	**1%**	**30%**	**5%**	**25%**	**-3%**	**23%**	**0.00%**
Non-Beer	**21%**	**81%**	**29%**	**56%**	**37%**	**21%**	**42%**	**9.40%**
Twisted Tea	16%	22%	16%	15%	15%	14%	15%	8.00%
Angry Orchard	3%	450%	13%	105%	22%	17%	24%	0.00%
Traveler's Shandy							1%	40.00%
Root Beer					0%	32852.40%	2%	120.00%
Total	**100%**	**22%**	**100%**	**22%**	**100%**	**5%**	**100%**	**5.00%**

(Goldman est.)

As of Thursday, November 19th, 2015, shares of Boston Beer — the maker of Sam Adams — were down more than 26% for the year. Total U.S. *cider sales were down 3.4% in the 13 weeks* ended Nov. 7, and the rate of decline accelerated to about 7% over the past four weeks, according to Nielsen. Four, or five years ago, the rate of growth was in the heady triple-digits. Even a year back, the pace of growth was nearly 50%. Danelle Kosmal, vice president of the beverage alcohol practice at Nielsen, said, "It's been getting a lot of attention, because of all the huge growth rates in the past three to five years. It's obviously difficult to sustain those triple-digit growth rates.

Vivien Azer, a beverage analyst at Cowen, said, "Boston Beer has guided down three times on the top line, in part reflecting the deceleration on cider. What caught people off guard were that the deceleration got worse with the introduction of (Coney Island) Hard Root Beer." Coney Island Brewing is a unit of Boston Beer.
Angry Orchard was credited with igniting the U.S. cider category when it was introduced in 2012. Cowen & Co. estimates Boston Beer's Angry Orchard has roughly a *60 percent share of the hard cider category* and that cider on average contributed to about 65 percent of the company's sales growth in each of the last three years (2012-14). Three cider lines — Woodchuck Cider, owned by Ireland's C&C Group PLC; SABMiller's Smith & Forge Hard Cider; and Anheuser-Busch InBev's Johnny Appleseed — have all suffered double-digit sales drops in the latest four-week sales data. In the same period, Angry Orchard's decline was single-digit.

Big cider brands aren't seeing the boom they used to[5]

Roper told analysts "When we do drink research, we get very positive feedback on the aggregates of cider, the refreshment of the sort of all-natural element of it, the gluten-free element of it, and sort of associations with the

[5] http://www.cnbc.com/2015/11/19/big-cider-brands-arent-seeing-the-boom-they-used-to.html Nov 19th, 2015

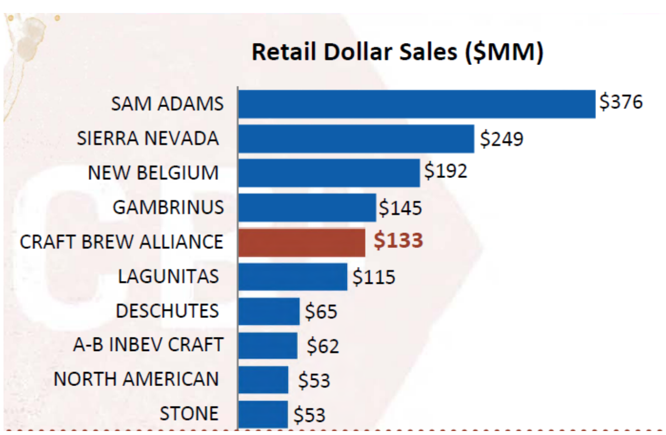
farm or orchard that cider brings." Vivien Azer, beverage analyst, Cowen has a "neutral" rating on Boston Beer's stock. "At this point, we're watching for and hoping for stabilization, because right now every single month the rate of growth we see in the syndicated data is continuing to decelerate."

There's been more competition from soda like beers such as Small Town Brewery's "Not Your Father's Root Beer" (distributed by Pabst Brewing). Additionally, the category is about to get more crowded with MillerCoors introducing Henry's Hard Soda nationwide in January, and Anheuser-Busch InBev launching a similar alcoholic soda product called "Best Damned Root Beer." According to head cider maker, Nick Vellanoweth, in Sacramento, California, Two Rivers Cider — a brand sold in Northern California, and Oregon — has seen sales soar at least 500% in the past eight years, and about 50% in the last two years. He also added that there's "no sign of things slowing down. We see bigger growth, and looking at expanding to Southern California."

Jim Koch, the most recognizable man in American beer, who sold us all on the idea of craft brew three decades ago on his way to a billion-dollar fortune, might be losing his grip in the industry. Unfortunately for Koch, the simple truth is that more and more beer drinkers don't want Sam Adams, and in turn, an increasing number of bars won't sell the famous amber lager. Koch's Boston Beer Company may have built the craft-beer business as we know it, but local beer geeks—the industry's connoisseurs—think he has lost his edge.

Max Toste, co-owner of Deep Ellum, in Allston says "Their beers are middle of the road." Max questions the brand's quality; he doesn't carry any of the Sam Adams lines. Max adds "I think what they are trying to do is make beer that is more flavorful than the fizzy yellow lager that was [once] popular everywhere. [But] they just don't fit into what I am doing. For me, serving something that is mediocre is just really not what I do." Daniel Lanigan, owner of the beer bar Lord Hobo, in Cambridge, agrees, "I just never considered their beers to be world class, and I decided not to sell them. Koch's attitude is clear: He doesn't give a damn. "You can't meet the needs of every hipster bar," he tells me from inside the tasting room at his J.P. brewery. He has no plans for retirement and has no intention to sell. His only plan, he says, is "to not die." Whether Koch will be able to market his way back into the hearts and mouths of today's craft beer elite is up for grabs, but he's clearly pissed off, and anything is possible.

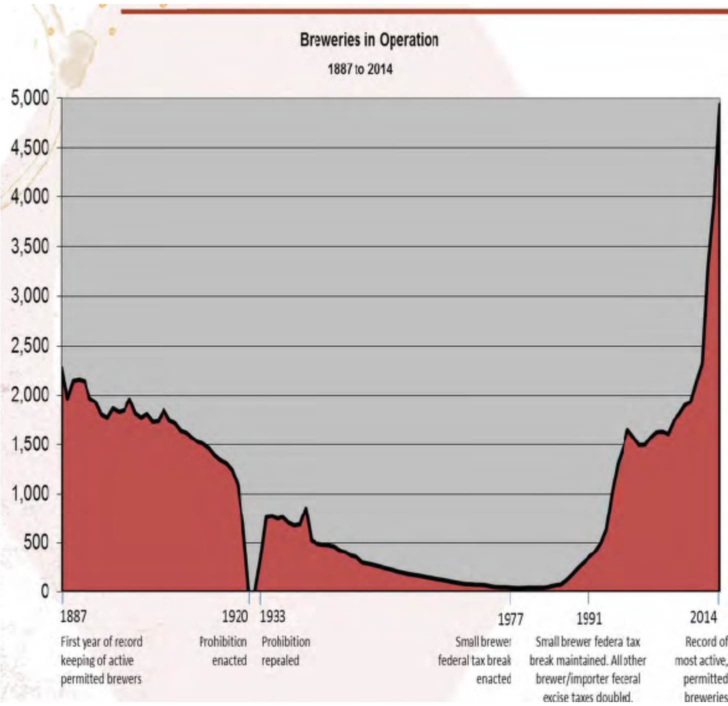
According to recent industry data, Sam Adams has had \$376M of retail sales for 52 weeks ended June of 2015. That makes them the top leader in the specialty brewer category, with Sierra Nevada second at \$249M; New Belgium at \$192M; Gambrinus at \$145M; Craft Brew at \$133M, and Lagunitas at \$115M. And there are several more below that we will name for future reference: Bell's Brewery, Deschutes, Duvel Moortgat, Brooklyn Brewery, Stone Brewery, and Harpoon.



Dollar Share of Total Craft	% Distribution (CWD)	Average Items Per Store Selling
14.5	77.8	8.9
9.6	63.7	6.2
7.4	62.1	6.8
5.6	47.9	4.6
5.2	47.2	6.2
4.4	39.4	4.3
2.5	22.1	5.5
2.4	54.4	4.4
2.1	38.6	3.8
2.0	30.4	4.4

Total Number of U.S. Breweries Hits 4,144[6]

The Brewers Association announced today that as of Nov. 30, there are 4,144 breweries operating in the country. As of now, 15 states have more than 100 breweries each, and new breweries are opening across the country at a rate of more than two per day. Additionally, most craft drinkers said they value knowing whether a brewery is "small and independent" and that it influences their product choices.



Active Permitted Breweries in the US

STATE	2013	2014	Change	STATE	2013	2014	Change
Alaska	25	28	3	Montana	49	62	13
Alabama	23	25	2	North Carolina	125	155	30
Arkansas	18	23	5	North Dakota	8	10	2
Arizona	59	77	18	Nebraska	25	35	10
California	528	654	126	New Hampshire	35	46	11
Colorado	234	300	66	New Jersey	37	49	12
Connecticut	39	50	11	New Mexico	48	60	12
District of Columbia	11	12	1	Nevada	26	34	8
Delaware	13	15	2	New York	193	255	62
Florida	113	158	45	Ohio	114	151	37
Georgia	37	48	11	Oklahoma	17	18	1
Hawaii	17	20	3	**Oregon**	220	244	24
Iowa	54	60	6	Pennsylvania	183	233	50
Idaho	42	51	9	Rhode Island	12	14	2
Illinois	123	164	41	South Carolina	30	37	7
Indiana	95	116	21	South Dakota	12	15	3
Kansas	25	27	2	Tennessee	51	69	18
Kentucky	25	38	13	Texas	128	170	42
Louisiana	15	17	2	Utah	24	27	3
Massachusetts	82	98	16	Virginia	85	117	32
Maryland	43	55	12	Vermont	45	51	6
Maine	60	71	11	**Washington**	266	314	48
Michigan	195	256	61	Wisconsin	146	168	22
Minnesota	75	113	38	West Virginia	9	13	4
Missouri	63	77	14	Wyoming	25	28	3
Mississippi	7	10	3	**Total**	**3,934**	**4,938**	**1,004**

In 2014, the study underscored last year's BA findings. Watson noted, "The majority of Americans live within 10 miles of a local brewery, and with *almost 2,000 planning breweries* in the BA database, that percentage is only going to climb." The new report shows a clear continuation of production growth trends seen in the last few years. As it stands, the number of breweries in the country has already increased by 19.6 % compared to 2014 (4,144 v. 3,464). That's only a slight increase in the rate of brewery openings, however, as more and more entrepreneurs are getting started: The national brewery count grew by 18.7% in 2014 (3,464 v. 2917), and by 18.8% in 2013 (2,917 v. 2456). It is not yet clear how this will affect the BA's prediction that craft will represent 20% of US beer production by 2020. The organization will release a comprehensive summary of 2015 beer production in March of next year. Last year, *U.S. craft breweries produced 22.2 million barrels, an 18% increase over 2013*. That accounted for $19.6 billion in sales and represented 19.3% of overall beer market share in the U.S. Craft also accounted for 11% of all beer produced in the country – the first time the segment earned a double-digit volume share.

The BA also noted that the IPA continues to be the dominating style among independent craft breweries, and is growing at a faster rate than the craft industry itself. Boston Beer Company, the parent of Samuel Adams Boston Lager, has stayed relevant by introducing the wildly successful Rebel IPA line at a time when sales for their erstwhile main brew are waning (it also doesn't hurt that Boston Beer owns Angry Orchard cider).

[6] http://www.brewbound.com/news/total-number-of-u-s-breweries-hits-4144 Dec 2 2015

More Brewers are banking on the drink-local trend[7]

Even as new craft breweries pop up on a monthly, sometimes weekly, basis in the Pittsburgh region, the city's North Side has long been home to just one brewer: Penn Brewery in Troy Hill.

Bier said, “Going to local breweries and seeing small scale production and new beers every single week, I loved that. You go in and say, what are they going to have on tap this week? That made me want to start making my beer because it's fun and it's great to have beer on tap at your house. You got to love what you do, and I don't necessarily agree with that. I think there's plenty of room to make money owning a brewery. Otherwise, I wouldn't want to do it. I feel that beer is very lucrative right now, especially craft beer. It only accounts for 10% of the beer market, but it's growing rapidly. People are switching from industrial-style beers like Budweiser or IC Light and seeing the benefits of going local. So I think there is money to be made. Right now the craft beer scene is booming, so I think it's the right time to get in. I don't think we're late, that we're at the tail end of this. I think it's got a lot more room to grow.

Bold Rock Hard Cider is one of the fastest-growing craft cider companies in the country. A winner of more than 40 awards in the past two years, Bold Rock produces six hard ciders, all made from apples locally grown and handpicked in the Blue Ridge Mountains of Virginia and North Carolina. However, only that last deal involved private-equity money — from Fulham and Co., which has owned Long Trail since 2006. In fact, the last time we heard from Fireman Capital Partners, it was buying a $35 million stake in Utah Brewing Partners and their Wasatch and Squatters beers. Since then, Southern Tier in Lakewood, N.Y.; SweetWater in Atlanta; Uinta in Salt Lake City; and Full Sail in Hood River, Ore., all sold stakes to private-equity firms.[8] New Belgium New Belgium currently sells beer in 38 states, the District of Columbia and British Columbia. In 2014, New Belgium Brewing produced 945,000 barrels of beer. New Belgium Brewing is the fourth-largest brewer of craft beer in the nation and the eighth-largest brewery in the United States.

Heineken - 15 October 2015

Heineken® brand, the Group, has a powerful portfolio of more than 250 international, regional, local and specialty beers and ciders. Heineken announced that a transaction to acquire a 50% shareholding in the Lagunitas Brewing Company had been completed. The closing of the transaction follows fulfillment of all conditions precedent as agreed on 8 September when the intention to enter into a partnership with Lagunitas was announced. It also announced the completion of the transaction to acquire the majority stake of Pivovarna Laško d.d for a price of EUR25.56 per share as agreed in the sale and purchase agreement dated 13 April 2015 ("the Agreement"). A total number of 4,673,941 shares were acquired from a consortium of shareholders representing 53.43% of the issued share capital, for a total consideration of *EUR119.5m.*

Jean-François van Boxmeer, a lifelong beer aficionado and now CEO of HEINEKEN added: "We are very excited to partner with Lagunitas. We recognize and respect the tremendous success of Tony and his team in building one of the great American Craft Beer brands. We look forward to that same team partnering with us to expand Lagunitas globally, so it can reach parts that other craft beer brands have not."

In another recent transaction, the total net cash consideration payable by HEINEKEN to Diageo is *US$ 780.5 million* (c. EUR 696 million). Commenting on the transaction, Jean-François van Boxmeer, HEINEKEN CEO and Chairman of the Executive Board, said: “Today’s transaction represents another important step towards ensuring that our portfolio of assets and participations is optimally structured to support our strategic agenda.”

[7] http://triblive.com/lifestyles/fooddrink/9258143-74/brewery-bier-beer#axzz3trFHQulV
[8] http://www.marketwatch.com/story/craft-brewer-oskar-blues-could-teach-anheuser-busch-a-thing-or-two-2015-04-03

Heineken - 3 August 2015

HEINEKEN's solid results are in line with our expectations and demonstrate the further progress made in delivering on strategy. Despite strong prior year comparatives and challenging conditions in some markets, we saw the positive top line and profit growth. Heineken® volume in the premium segment grew a further 4.7%, outperforming the total beer market. This continued positive momentum reflects the benefit from our exposure to high growth markets, a sustained focus on marketing and innovation, and the ability to drive efficiencies throughout the business. Our emphasis on innovation delivered €854 million in revenues. *Group revenue +2.0% organically* with group revenue per hectolitre up 1.1% *Group beer volume +1.0% driven by Americas, Asia Pacific, and Africa Middle East*

Heineken® volume in the premium segment grew organically by 3.9% in the third quarter and by 4.4% in the first nine months of 2015. Americas: Consolidated revenue grew *12% organically in Q3*, driven by 7.2% total volume growth and revenue per hectolitre up 4.2%, benefiting from continued effective revenue management. In the US sales to retailers were up in the quarter, outperforming the total beer market. Heineken® brand volume was positive in the quarter, supported by further growth of the Mexican beer portfolio and Strongbow.

Here's why Pabst Brewing isn't afraid of the craft beer movement[9]

Pabst Brewing Company CFO Cordell Sweeney is not afraid of the American consumer's shift towards craft beers. His company is fully embracing the popularity of craft brews. Business Insider recently spoke to Sweeney about the recent shift in consumer beer tastes and how his company is dealing with that shift. Sweeney is the finance chief behind such American classics as Pabst Blue Ribbon, Schlitz, Old Style, Old Milwaukee, and Schaefer, among others. He also adds "While industry volumes are expected to be flat, there are 1,500 new small craft breweries and brew pubs scheduled to come on line in the next 12 to 18 months, which will ultimately add additional SKUs into the system." He also says the Pabst Brewing Company already has plans to embrace the craft brew culture. "Our strategy is to bring back the craft style recipes in our existing portfolio of 80 iconic brands, partnering with existing craft brewers and investing with craft brewers where appropriate".

In 2016, Pabst Brewing will bring back Old Tankard Ale, which was formerly one of the country's best-selling ales. The company had possibly one of its biggest hits of 2015 when it partnered with Small Town Brewery to distribute "Not Your Father's Root Beer" nationally. It tastes like a classic bottle of non-alcoholic root beer and has become one of the fastest-selling craft beers in the country. Sweeney says that through the Small Town brand family, the company has created "Not Your Father's Ginger Ale" for release in November 2015.

OUR source indicated that 'not your father...' is doing extremely well and there are high expectations for the next round of new products in ginger ale.

Sweeney says the number of beers currently available on the market is astounding. He recalls that not too long ago there were 500 to 1,000 SKUs available across the entire industry. *"Today, total SKU count is estimated in the 30,000 range. This rapid expansion has driven complexity for suppliers, distributors, retailers, and consumers".*

Legislative issues to monitor

The merger of ABI/SAB Miller is drawing anti-trust concerns in Congress, driven by the craft brewers as they are worried about ABI's monopolistic behavior in the distribution channel. Within the craft brewing sector, there are sub-groups. For example, some brewers just sell their beer in their restaurant, sometimes selling into

[9] http://finance.yahoo.com/news/heres-why-pabst-brewing-isnt-200515605.html;_ylt=AwrC0wwbVmhWIG8ATjbQtDMD;_ylu=X3oDMTByOHZyb21tBGNvbG8DYmYxBHBvcwMxBHZ0aWQDBHNlYwNzcg--

the local distribution market such as local grocery stores and c-stores, while some of having expanded into sizable chains (Rock Bottom, Gordon Biersch, and Mellow Mushroom have hundreds of stores).

Vermont Senator Leahy Releases Statement After Hearing on ABI/SAB Miller Merger[10]

The Senate Judiciary Committee's Subcommittee on Antitrust, Competition Policy, and Consumer Rights heard testimony on Tuesday, regarding the proposed merger of Anheuser-Busch InBev, and SAB Miller. After the December 8 hearing, Senator Patrick Leahy of Vermont released a statement acknowledging "concerns in distribution: specifically, concerns that the large brewers' power over distribution is shutting out competitors and undermining consumer choice."

Senator Leahy's statement on A/B merger w/ Miller

Today's hearing on the proposed merger of AB InBev and SABMiller is important not only to American consumers but craft brewers and independent distributors across the country. Vermont was one of the earliest incubators of craft brewing. Our 40 breweries make some of the best, award-winning beers in the world. They contribute to our economy and have helped make Vermont a destination state. We want to ensure that these craft brewers and the Brewers of tomorrow can continue to compete and that consumers continue to have choices.

The proposed merger we consider today would join the two giants of the beer industry, which are together responsible for more than 70 percent of the U.S. market. The parties have announced that AB InBev will divest ownership of SAB's stake in Miller Coors, selling it to Molson. I welcome that effort to address some concerns about the proposed merger. But given the size of these companies, we need to look closely at this transaction. I want to hear more about how the divestment will operate in practice, and whether the merger will have other consequences for the beer market—including given the practice of big brewers buying up small craft breweries. It is important that we also consider competition in the markets for hops, barley, glass, and aluminum. These are essential inputs for any brewer to compete. I also want to hear more about concerns in distribution: specifically, concerns that the large brewers' power over distribution is shutting out competitors and undermining consumer choice. A product can only be sold if customers can find it. If craft brewers are being squeezed off the shelf because of restrictive behavior by the dominant companies that harms competition and limits consumers' options.

One way for large brewers to influence distribution is by buying up distributors. AB InBev has indicated that following this merger; it will not increase its ownership of distributors above its current level of ten percent. Mr. Brito, at a minimum, I ask you to make a formal commitment to that today. For its part, Molson has indicated that, after it gains 100 percent ownership of MillerCoors, it will not increase its ownership of distributors—nor change its current practice of giving distributors leeway to showcase competitors' brands. Mr. Hunter, I ask you to make a formal commitment to that today. The pathway from Brewer to the buyer is critical if we want small companies to compete. State laws regulating distribution vary dramatically, and many small brewers feel constrained by the current state of distribution. I hope this issue will remain a subject of close review.

The growth of craft brewing is a success story in Vermont and other states across the country. I knew these craft brewers personally and met with them as recently as last month. Their creativity is shaping our economy, and we should make sure they have a level playing field. I thank Senators Lee and Klobuchar for holding this hearing today.

[10] https://www.brewersassociation.org/current-issues/vermont-senator-leahy-releases-statement-hearing-abisab-miller-merger/

Brewers Association CEO Bob Pease Testifies on ABI/SAB Miller Merger (December 8, 2015)[11]

Earlier today, the U.S. Senate Committee on the Judiciary held a hearing regarding the merger of two of the largest multi-national breweries, Anheuser-Busch InBev and SAB Miller. Brewers Association CEO Bob Pease was invited to testify as a witness for the hearing entitled Ensuring Competition Remains on Tap: The AB InBev/SABMiller Merger and the State of Competition in the Beer Industry.

I am the Chief Executive Officer of the Brewers Association, which represents more than 2,800 craft brewers and 1,100 industry suppliers of agricultural commodities, brewing equipment, packaging, and other goods and services required by modern breweries. The proposed acquisition of South Africa Breweries by Anheuser - Busch InBev (ABI) must be viewed in light of other developments affecting competition in the beer industry. Federal alcohol laws and the Twenty-first Amendment to the U.S. Constitution authorize each state to regulate alcohol beverage sales and distribution within their respective borders. The legal framework for the alcohol beverage industry provides each state with significant latitude to regulate distribution and sale of beer, wine, and spirits.

Today, the 30 largest beer wholesalers control almost a third of all U.S. beer sales to retailers. Exhibit C is a list of the largest U.S. beer wholesalers with information on their respective sales and recent acquisitions. The raw numbers mask the true effects of wholesaler consolidation. The raw numbers mask the true effects of wholesaler consolidation. Based on current trends the Brewers Association believes that by the year 2020, only about 200-250 full-service beer wholesalers. Only two substantial wholesalers, ABI wholesaler, and a Miller-Coors wholesaler are now serving the majority of markets in the U.S. While the two primary wholesalers are known by the names of the largest brewers, the wholesalers also sell other brands. For example, an ABI wholesaler may also sell Corona, Sam Adams, and dozens of smaller brands.

In fifteen states, large brewers such as Anheuser-Busch InBev are allowed to own wholesalers. At present, ABI is the largest beer supplier and one of the largest beer wholesalers in nine states. The states where ABI is currently a major wholesaler include California, Colorado, Hawaii, Massachusetts, New York, Ohio, Oklahoma Oregon, and Washington. Exhibit E lists the cities and states where ABI owns wholesale operations. In major population centers of those states, ABI controls one of the two routes to market that craft brewers must use to effectively sell beer to retailers.

Over the last several months, ABI demonstrated its ability to expand control of the wholesale tier by leveraging its company-owned wholesalers and relationships with favored wholesalers. The enormous disruption occurred in the market as the Brewers had to abandon long-term business relationships, and scramble to establish new sales and distribution operations in a very short period. In July 2015, ABI purchased a significant independent New York City distributor that serves the borough of Staten Island. ABI already owned a large distributor in the Bronx.

If ABI is permitted to maintain ownership of wholesalers, ABI can continue to systematically sell parts of its wholesaler network to other favored wholesalers that ABI effectively controls. Simultaneously, ABI will continue to purchase additional independent wholesalers and discontinue sales of competing brands that the independent wholesalers currently sell. Craft brands will then be forced into the Miller Coors network or to small specialty distributors that lack the ability to fully serve a territory. ABI's massive economic presence and control over wholesalers allow ABI to engage in these disruptive and harmful tactics. The Colorado and California transactions involved assets worth hundreds of millions of dollars and both involved many subtle tactics to disrupt sales of competing brands totaling hundreds of millions of dollars to independent wholesalers that reduce sales of competing brands. The ABI system is based on a sliding scale with the largest financial rewards to those who limit sales of competing brands to 2%, 5%, and 10 %.

[11] We care about this because if the deal breaks, SAM could be in play as a buyout by A/B

With incremental Spending of approximately $150m in 2016, AB's focus will be on four pillars of its commercial strategy: elevate the core, win the high end, evolve the innovation model and win together attitude. To "win together," and execute against those other objectives, AB will bring a lot of incremental resources to bear in 2016. Indeed, AB will spend an incremental $150 m on marketing, and sales in 2016. It will spend an incremental $100m on marketing, including 17% more on core brands, 4% more on innovations and brands like the Ritas, and 20% more against its growing high-end. AB will also spend $50m more on sales investments, including doubling its investments on premise. AB has gained share in tuff on-premise channel during the last 9 months.

Beer battle between wholesalers, and brewers[12]

Beer wholesalers are pushing a bill in the Missouri Legislature that would protect their role as middlemen, by banning brewers from owning wholesalers and codifying the industry's vaunted three-tier distribution system into state law. It's a pre-emptive strike against Anheuser-Busch InBev, which wants to streamline its complex distribution network between the big brewer, and the people who deliver its product. While state laws vary, the three-tier system — in which separate companies make beer, ship it, and sell it to consumers — has been in place since the end of Prohibition, when it was designed to rein in aggressive sales tactics and streamline regulation. Anheuser-Busch has more than 500 distributors across the country — five in the St. Louis area — nearly all of which are independent companies with an exclusive contract to sell A-B beer in a certain geographical area. It's a lucrative franchise; distributors typically take about $4 per case, according to calculations by Beer Business Daily. And in recent years, the so-called "red network" of A-B wholesalers has won extra profits by shedding exclusivity agreements and carrying more craft beer, with higher margins and few extra costs.

Wall Street analysts say that more efficient distribution could play a big role in A-B InBev's target of $1 billion in U.S. cost savings. By buying out the middleman and self-distributing, the brewery could tap wholesaler profits estimated at $1 a case, and centralize functions such as phone operations and truck maintenance.

Harry Schuhmacher, the editor of Beer Business Daily, says, "It's a good way to squeeze out costs." These kind of acquisitions are legal in about 20 states, and A-B InBev already owns 14 distributorships — which it calls "branches" — including some in big, if not especially profitable, markets such as New York and Los Angeles. It has bought two just since December, with a third deal pending in Seattle. Bucalo wrote, "We estimate that ABI could hypothetically control nearly 50% of its distribution, compared to 8% today. We believe it will continue to move in that direction." But A-B's "costs" are distributors' profits, and distributors are pushing back. Even as the brewer had talked of consolidation, wholesaler groups are resisting. They warn of job cuts and short-term profit taking. They argue that the big brewer could restrict sales of other brands at its branches, making it harder for craft beers and imports to find a market.

The arguments have gained traction in state legislatures. In the past two years, laws banning self-distribution have been passed in Louisiana, Wisconsin, Nebraska and Illinois — where lawmakers acted after A-B InBev's attempt to buy a majority stake in its Chicago distributorship prompted a federal lawsuit. But Brian Gelner, vice president of Premium Beverage, a Miller-Coors distributor in Springfield, and legislative chairman of the Missouri Beer Wholesalers Association, said he was hopeful that the bill would at least get to a full floor vote. He says that the three-tier system has been a really good system. Any changes in the system will hurt the whole industry.

[12] http://www.stltoday.com/business/local/beer-battle-between-wholesalers-brewers/article_d7985f04-96d5-11e1-920a-001a4bcf6878.html May 06, 2012

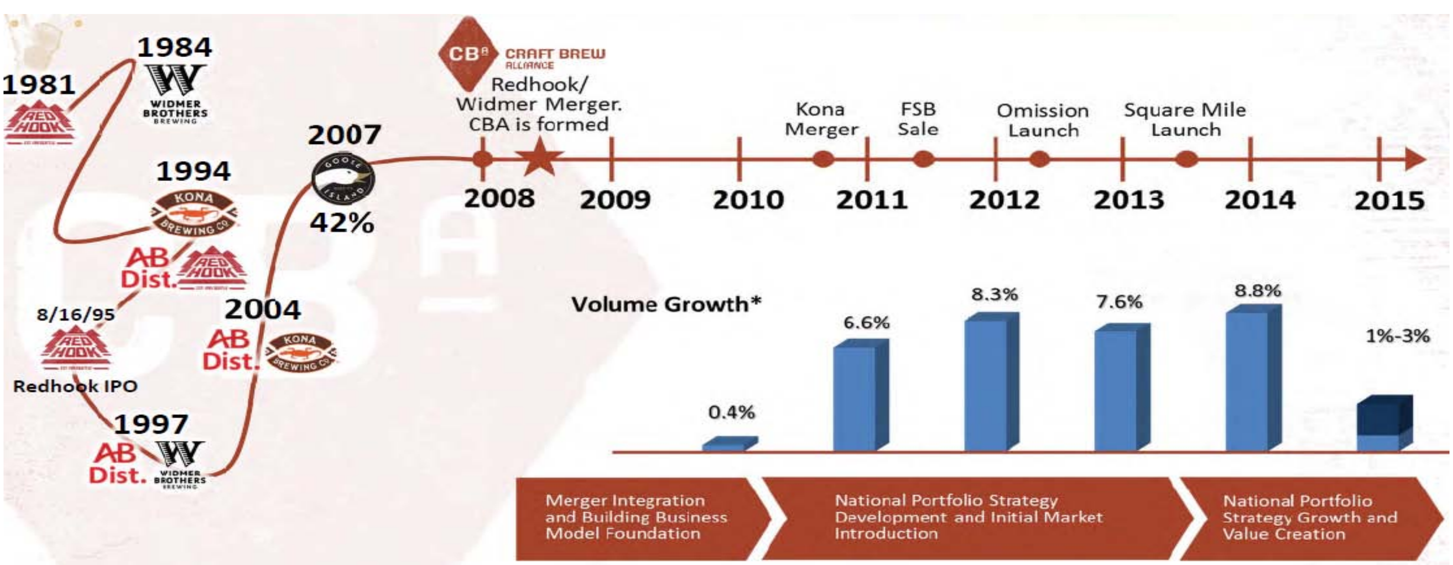
Example of anemic industry growth and roll up: BREW $8.94

Craft Brewer Alliance (BREW) is an amalgamation of several microbrewers. They are showing slowing sales as well. It seems they joined for no specific reason other than to make themselves into a bigger company that would allow them to go public. Unfortunately, for them, the underlying growth rate just isn't there. They made an interesting investor presentation back in September**.** The report suggests sales are going from $132M to $200M from FY10-14, a 51% growth rate; however, EBITDA went from $12M to $15.3M with a 27.5% growth rate. According to their presentation, 5-year CAGR growth rate of domestic "full-calorie" beer *is -1%*, while craft beer has a 5-year CAGR of 12%. We've read a lot of data about cider being a particularly tough category. This is relevant because SAM bought a cider company a few years back.

The Company reported net sales of $54.7 m., an increase of $2.6 m., or 5% over the third quarter of 2014, driven by a 2.2% increase in shipment volume and higher net sales per barrel. Gross profit for the quarter increased 15.1% to $16.9 m., and gross margin expanded by 270 basis points to 30.8%, primarily as a result of increased pricing, better brewery balance, and lower distribution costs compared to the same period last year.

Conference call comments from the Nov 5 BREW call:

- Cider strong everything else soft; guided lower.
- Volumes down in CA due to distribution chain realign.
- There are 60 brewers within the city limits of Portland. The market is changing where craft is mainstreaming. When that happens, you look at the opportunity for growth. We are Oregon's favorite beer. We are local and have a lot of market share. Wholesalers have a large portfolio of craft beer.
- Pricing in the face of intense competition? The market, by the market to see if there is determination.
- Corona is the pricing leader in the beer industry.
- Consumers continue to want to trade up regarding the quality of the beer they drink.
- BREW Q2: acceleration in new entrants into the industry…saturation. No growth.
- Lowered guidance shipment 6% to 8% to 1% to 3% growth vs. 2014 pricing unchanged at 1-2%[13]



[13] http://phx.corporate-ir.net/phoenix.zhtml?c=95666&p=irol-IRHome

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