Alternative Research Services, Inc.

Robert MacArthur rmacarthur@altresearch.com 203-244-5174 w 203-215-3843 m December 4, 2015

SAM -- $213

- Growth slowing; 25% to 6%; 2014 to 2015
- Guided lower throughout much of 2015
- Buying back stock aggressively
- Increased competition from small players
- Increased acquisitions by larger players
- Declining beer consumers
- Risks to the short: SAM makes sizable acquisitions

Market Cap.	$2.1b
Shares Out.	13.5 m
Float	9.4m
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	5.63x
Px/sales	2.86x
Px/EBITDA	11x

Source: Nasdaq.com/Schwab

For the last several years there has been a fantastic growth in the number of microbrewers. Currently, there are over 4,000 nationwide. These microbrews represent a major threat to the Sam Adams brand as they are smaller, more nimble, and more profitable and can often export their products locally, to areas within the region. These local brewers connect to local high-end restaurants and other venues establishing a brand loyalty displacing national brands. SAM has responded to this by expanding its own SAM brands with multiple line extensions.

However, in 2015 SAM has not been able to compete as well as it has over the last few years when acquisitions increased their growth rate. We believe that SAM is losing share and will continue to lose its market share to the smaller brewers, possibly even driving sales growth negative in 2016 without excessive advertising. Management talked about more advertising on the conference calls during the year.

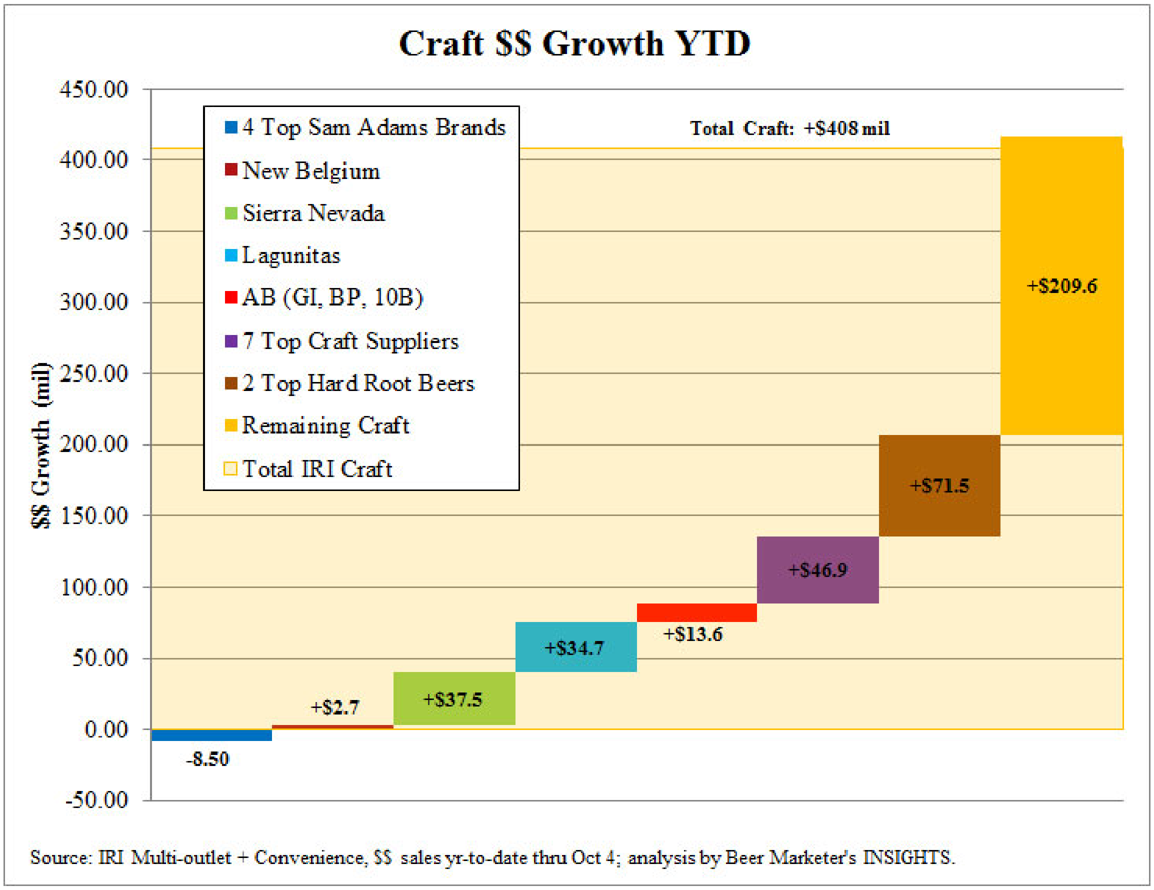
SAM, is the country's second-largest craft brewer with nearly $1 billion of revenue. For the 3rd quarter, earnings per share of $2.85 grew 2.1% from $2.79 yoy. Net revenue advanced 9% year over year to $293.1M vs. $269M from last year. According to Goldman Sachs, revenue for Q4 is expected to be up 4% while eps is expected to be down 18.6% caused largely by at 25% increase in SGA expense. In 2013, EBITDA was $139M, increasing to $181.7 and is expected to reach $199.6M in 2015. Earnings were $5.21 eps in 2013, $6.72 in 2014 and $7.27 expected in 2015 (eps for 9 months ended was $5.29) It seems very unlikely management can hit 2015 4Q estimate.

During the first quarter of 2012, the Company acquired substantially all of the assets of Southern California Brewing Company, Inc., d/b/a Angel City Brewing Company and the excess of the purchase price over the fair value of assets was allocated to goodwill. SAM's preliminary aggregate purchase price of $1.9 million, which includes a payment of $150,000 made in June 2012 and a payment of $200,000 to be made in March 2013.

The Company's *Angry Orchard* product line competes within the hard cider category. Some of these competitors include C&C Group PLC under the brand names 'Woodchuck,' 'Magners' and 'Hornsby's'; Heineken under the brand name 'Strongbow'; MillerCoors under the brand name 'Crispin Cider' and ABI InBev under 'Michelob Ultra Cider.' The Company believes that the hard cider category comprises less than

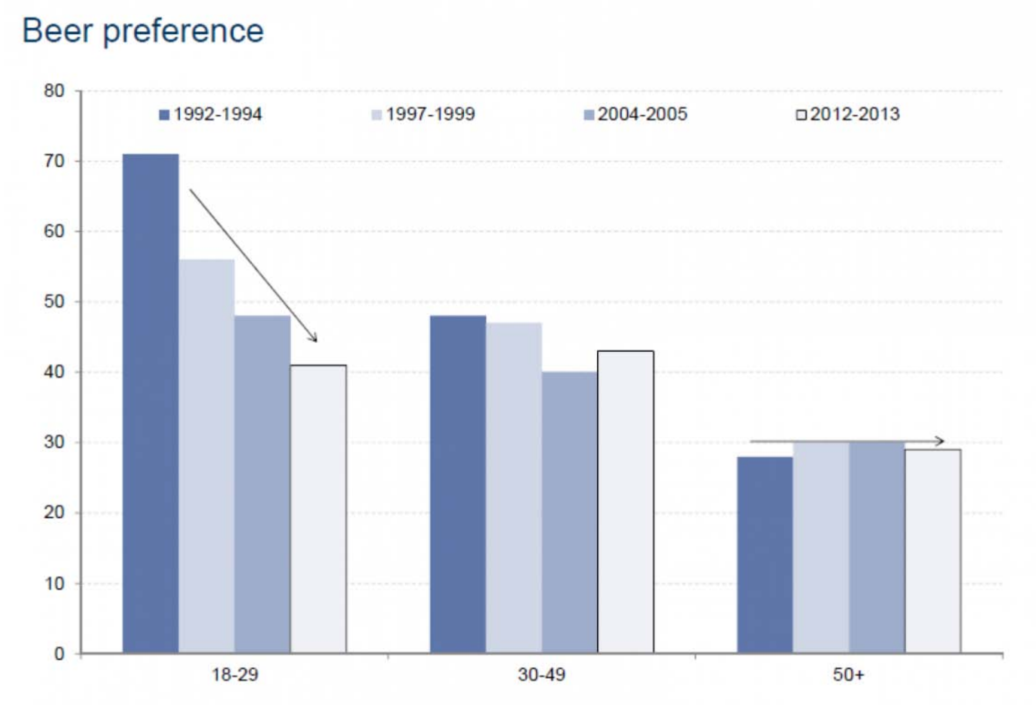
0.5% of United States beer consumption and that the volume comprising the hard cider category increased 60% to 70% in 2012.

The chart below breaks out craft's yr-to-date $$ growth by various players and groups of brands. So all the way on the left, a *$8.5-mil decline of four largest Sam Adams brands takes a toll.* They're still collectively almost 11 shares of craft $$, but down 2.3 share YTD. These 4 top Sam brands (Seasonal, Boston Lager, Variety Pk and Rebel) all down for 4 wks, only Rebel up YTD. Together they're -3.5% thru early Oct. New Belgium only eking out a little bit of $$ growth YTD and for 4-wks, while volume now down in the last month[1]



Goldman Sachs notes that drinkers between 18 and 29 don't like beer as much as they used to. Young beer drinkers went from roughly 75% beer-friendly in the mid-90s to just 40% today, like wine and hard alcohol gained ground. The upside? Don Draper's grandkids are growing out of that demographic, while first-generation craft brewers' grandkids are just coming into the picture. Since analysts say we drink what our grandparents drink, the beer exodus should level off a bit.[2]

[1] http://www.beerinsights.com/
[2] https://www.washingtonpost.com/news/wonk/wp/2014/12/03/the-great-beer-abandonment-americas-young-drinkers-are-increasingly-drinking-wine-and-hard-alcohol-instead/



[3]

Craft Brewers Maintain Their Growth Despite Overall Drop In Americans' Suds Sipping[4]

The Boston Beer Co Inc (NYSE:SAM), which makes the famous Sam Adams beer and ranks as America's largest craft beer brewer, is on track for "robust growth," according to a Citigroup Inc (NYSE:C) research note.

The company could also slash beer prices to undercut its competition and gain market share and could boost its advertising budget in coming months, wrote Citi analyst Vivien Azer. Come November, Azer said, Boston Beer could offer lower price targets, though it's unclear when potential prices cuts would translate to discounts on the shelves.

"We suspect pricing could again be below their leading beer competitors," she wrote, noting growing price competition from beer rivals and Boston Beer's push for more craft beer dominance.

Why Are American Drinkers Turning Against Beer?

Bad news for brews: Among the youngest Americans, beer preference is collapsing.

Poor beer. Just 20 years ago, it was America's most popular alcoholic beverage by far. Since then, per capita consumption of beer down 20 percent and despite population growth, annual domestic production has fallen, too.

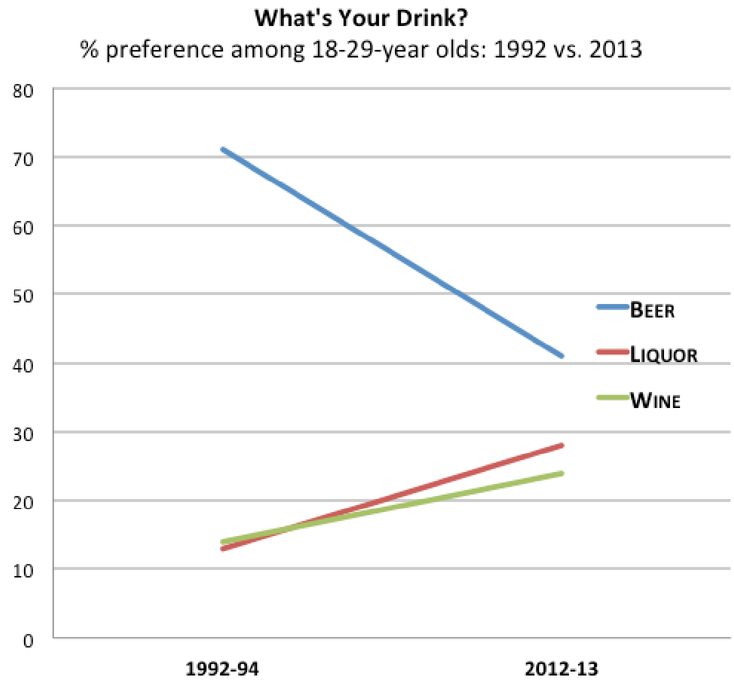
Gallup's new alcoholic preferences survey, summed up in the image above, finds that beer's lead over wine has slipped by 20 percentage points since the early 1990s. But the demographic breakdown is even more brutal.

---

[3] https://www.brewersassociation.org/statistics/national-beer-sales-production-data/

[4] http://www.ibtimes.com/craft-brewers-maintain-their-growth-despite-overall-drop-americans-suds-sipping-1375633

Young drinkers and nonwhite drinkers saw the steepest falls in beer preference. In other words, the fastest-growing segments of the country are also running the fastest away from brews.



[5][6]

SAM Conference Call Excerpts

For 9 months ended Sept 2015: Company depletions trend of *6%* in the third quarter of 2015 matched our year-to-date trends, but represents a slowing from our expectations, primarily as a result of weakness in our Sam Adams brand, due to increased competition, and a *slowing in the Cider* category. The slowing represents a very competitive craft beer category, where drinkers are seeing greatly increased choices and established brands are impacted…we believe our share of displays and features has been impacted.

During the third quarter, we completed our national rollout of our Coney Island Hard Root Beer, which was well-supported by distributors, retailers, and drinkers. The Hard Root Beer category is early in its development, and it is unclear how it will develop long term, as innovation and new competitors emerge.

…we also saw a slowing of the cider category, but the belief that Angry Orchard maintains its share even as competitors continue to enter or increase investment.

Net revenue for the third quarter was $293.1 million; a 9% increase compared to the same period last year, mainly due to core shipment growth and increased revenue per barrel due to product mix. Core shipment volume was approximately1.3 million barrels, a *4%* increase compared to the third quarter of 2014.

Q2 2015 Earnings Call July 30, 2015: Our total company depletions trends of *6%* in the second quarter of 2015 have slowed in comparison to prior quarters due to some *developing weakness* in our Samuel Adams brand. While our total growth is a testament to our strategy of the diversified brand portfolio, our Samuel Adams

[5] https://sullydish.files.wordpress.com/2013/08/beer-young.png

[6] http://www.theatlantic.com/business/archive/2013/08/why-are-american-drinkers-turning-against-beer/278370/

trends appear to represent a very competitive category where drinkers are facing increased choices and established brands.

Accordingly, we have *decreased our expectations* for full-year depletions growth to between 6% and 9% to reflect the most recent trends. We are working hard to improve the Samuel Adams brand trends, and in the second half of the year, we expect to introduce new packaging and advertising to support our planned promotional activity. (In the past management has increased prices 1-2% to offset higher advertising; however back in 2013, management had to cut prices due to the competitive environment causing margins to fall).

Based on the information in hand, year-to-date depletions through the 29 weeks ended July 18, 2015, are estimated to be up approximately *6%* from the comparable period in 2014. Core shipment volume was approximately 1.1 million barrels, a 7% increase compared to the second quarter of 2014. We have left unchanged our prediction of 2015 earnings per diluted share of between $7.10 and $7.50,

Q1 2015 Earnings Call April 29, 2015: Based on information in hand, year-to-date depletions through the 16 weeks ended April 18, 2015, are estimated to be up approximately 8% from the comparable period in 2014… depletions growth of 8% benefited from strength in our Angry Orchard, Twisted Tea and Traveler brands that offset slight declines in some of our Samuel Adams styles, as the comparables were tough.

We reported net income of $13.7 million, or $1 per diluted share for the first quarter, representing an increase of $5.4 million, or $0.38 per diluted share from the same period last year. This increase was primarily due to shipment increases and slightly improved gross margins.

Our depletion for the 13-week period ending March 28, 2015, grew by *8*% from the comparable 13-week period ended March 29, 2014. And full year estimated depletions and shipment growth remain unchanged between 8% and 12%. We are continuing to evaluate 2015 capital expenditures and currently estimate investments of between $80 million and $110 million

Q4 2014 Earnings Call: I'm pleased with our depletions growth of *13% for the quarter and 22% for the year…* As we anticipated, depletions growth rates *slowed* from earlier in the year as we faced tougher comparables and we did not benefit from new product launches as we did earlier in the year.

In the fourth quarter, we had lower sales and marketing spending and higher shipments than expected, which resulted in higher earnings than anticipated. Looking forward, we are excited but *expect the competitive environment to be tougher*. Based on information in hand, year-to-date depletions reported to the company through the seven weeks ended February 14, 2015, are estimated to be up approximately *12%* from the comparable period in 2014.

Q3 2014 Earnings Call October 30, 2014: Our depletions growth this quarter was *21%* and quite strong as a result of a number of factors, including effective sales execution, support from our distributors and retailers… Based on information which we are currently aware of, we have left unchanged our projected 2014 earnings per diluted share of between $6 and $6.40. We estimate 2014 shipments and depletions growth of between 20% and 24%.

Q2 2014 Earnings Call July 30, 2014: We achieved depletions growth of *23%*, and record total depletions in the second quarter growth benefited from the strength of our Samuel Adams, Angry Orchard, and Twisted Tea brands. We believe that the growth we see in our main brands reflects a response to our increased investments in media.

We intend to increase investments in advertising, promotion and selling expenses by between $37 million and $45 million and increase in the range from the previously communicated estimate of $34 million to $42 million. We are continuing to evaluate 2014 capital expenditures, and currently estimate investments of between $160 million to $185 million, a narrowing of the range from the previously communicated estimate of $160 million to $220 million, which could be significantly higher depending on capital required to meet future growth.

U.S. Passes 4,000 Breweries[7]

The Brewers Association reported its database is now at 4,000 active breweries. Given the strong pace of openings (approximately two openings/day with a net increase of 1.9/day factoring in closings), it is likely that later in 2015, or early in 2016, there will be more active breweries in the United States than at any point in our nation's history.

What it does not mean is that we've reached a saturation point. Most of the new entrants continue to be small and local, operating in neighborhoods or towns. What it means to be a brewery is shifting, back toward an era when breweries were largely local, and operated as a neighborhood bar or restaurant.

The past 15+ months have borne out that statement as the map of U.S. brewing has continued to diversify. There are now breweries in more than 2,000 unique cities across all 50 states. At the same time, there are also nearly 1,000 cities with a population of more than 10,000 that don't have a local brewery yet, and numerous neighborhoods in larger cities without a local brewpub or taproom. As America's beer culture continues to deepen and spread, there are still ample opportunities for well-differentiated, high-quality entrants. So, to all the hard-working brewers/brewery staff that have made 4,000 breweries a reality, and to the next wave of innovative entrants to follow, cheers![8]

Acquisitions[9]

One of the primary tenets of our short thesis relates to the acquisition market. We think that while the acquisition market is hot, industry buyers are paying excessive multiples of EBITDA—around 15x EBITDA. With the growth rate in the sector so hot, in the short-term, those multiples probably make sense for bigger companies that want to grow fast. We've noted a number of large acquisitions by the bigger players in the sector. The sector itself is bifurcated by the two types of manufacturers "overall brewers" and "craft brewers." Among the top craft brewers are Yuengling, SAM, Sierra Nevada, New Belgium, Gambrinus, Lagunitas, Descutes, Bell's, Stone, Brooklyn, with an additional 40 rounding out the top 50. On the overall list are Anheuser-Busch, Miller Coors, Pabst, Yuengling, SAM, North American, Sierra Nevada, New Belgium, Craft Brew Alliance. Today, two major brewers, Anheuser-Busch InBev ("AB InBev") and MillerCoors LLC ("MillerCoors"), comprise over 90% of all United States domestic beer production, excluding imports.[10]

Several of the bigger players have made sizable acquisitions recently. Their idea is to get into the craft business tomorrow by buying one or more versus starting from scratch. This has contributed to the rising valuations as the bigger players have had to compete. We also found that private equity companies are very involved in the

---

[7] https://www.brewersassociation.org/insights/4000-breweries/

[8] http://www.craftbeer.com/breweries/brewery-locator/find-a-us-brewery

[9] http://www.academia.edu/3590129/Too_Big_to_Ale_Globalization_and_Consolidation_in_the_Beer_Industry In the late 1990s, for example, the EU investigated Heineken, Bavaria, Grolsch and InBev for holding secret meetings to divide markets and fix prices in the Nether-lands. The first three firms were assessed a total of $370 million in fines in 2007, although InBev avoided penalties by providing information about the cartel (Associated Press 2013). Grolsch later won an appeal to overturn their fines by disavowing responsibility for the price-fixing ac-tions of their Dutch subsidiary (by that time Grolsch had been acquired by SABMiller) (Bouckley 2013).

[10] JPG of the industry participants: https://www.brewersassociation.org/wp-content/uploads/2015/04/2015_Top_50_700.jpg

mergers and acquisitions activity in the sector. Our goal is to observe the changing dynamics of the M&A market in the sector. We think a company like SAM, that is somewhere in the middle, could lose market share and possibly see its sales decline unless it makes an acquisition to keep up with other competitors. The price SAM pays may not be at a multiple they are comfortable paying; however, they may not have a choice.

SAM says, “Due to the increased leverage that these combined operations will have, the costs to the Company of competing could increase, and the availability of contract brewing capacity could be reduced. The potential also exists for these large competitors to increase their influence with their Distributors, making it difficult for smaller brewers to maintain their market presence or enter new markets.”

The Company’s (SAM’s) Angry Orchard product line competes within the hard cider category. This category is small but growing and highly competitive and includes large international and domestic competitors, as well as many small regional and local hard cider companies. Hard ciders are typically priced competitively with Better Beers and may compete for drinkers with beer, wine, spirits, or FMBs. Some of these competitors include C&C Group PLC under the brand names ‘Woodchuck’, ‘Magners’ and ‘Hornsby’s’; Heineken under the brand names ‘Strongbow’; AB InBev under ‘Johnny Appleseed,’ ‘Michelob Ultra Cider’ and ‘Stella Cidre’ and MillerCoors under the brand names ‘Smith and Forge’ and ‘Crispin Cider’.

On August 26, 2013, A&S acquired substantially all of the assets of the Coney Island business (“Coney Island”) and certain other assets from Shmaltz Brewing Company for a preliminary aggregate purchase price of $2.9 million of which $400,000 is being held in escrow to collateralize certain seller indemnification obligations.

What are the chances that SAM is bought out by a larger player? We think this won’t happen for a number of reasons. First, several of the bigger players are already digesting large acquisitions (see below). It will take at least a year, probably two before they’ve full integrated what they already bought. The chance of a smaller company or a company of equal size buying SAM seems unlikely as well. The risk we can’t see is a private equity fund buying SAM. Acquiring SAMs would demand upwards of $2-2.50 billion of capital. Not many players can afford that conservative multiple. Goldman has 2016 EBITDA of estimate for SAM of $223M vs. $199M estimate for 2015. We think EBITDA could easily be down yoy in 2016.

Boston Beer scored a huge coup[11]

Boston Beer’s total production was 3.4 million barrels last year, thanks to a diverse group of offerings that were notably absent from Koch’s (SAM founder) kitchen 30 years ago. In 2000, Boston Beer launched its Twisted Tea brand of flavored malt beverages that still bolsters the company’s $3 billion business to this day. After stumbling a bit with the Hard Core Cider, it released in 1995, Boston Beer scored a huge coup when it introduced its Angry Orchard cider line nationwide and became the top-selling cider producer in the country, according to market research firm IRI.

In 2011, the company teamed with Magic Hat Brewing Co. founder Alan Newman on a craft-beer incubator called Alchemy & Science. Based in Burlington, Vt., Alchemy & Science helped Boston Beer develop a line of shandies under the Traveler Beer brand and a line of low-alcohol session beers under the Just Beer Project label.

In 2012, Alchemy & Science acquired Los Angeles Brewer Angel City and revamped the brand, its brewing facilities, and its L.A. taproom. It followed that up last year by purchasing the Coney Island Craft Lagers brand from Shmaltz Brewing owner Jeremy Cowan, who used the proceeds to open his label’s first brewery in Clinton Park, N.Y.

---

[11] http://www.marketwatch.com/story/how-boston-beers-jim-koch-got-the-big-brewers-to-follow-him-2014-12-04

Ballast Point Brewing & Spirits, Inc.[12]

Recently, Constellation Brands (STZ) (Coors brands) bought a fast growing brewer, Ballast Point. Ballast is growing 165% top line.[13] Through 9 months September 2015, the company reported sales of $89M vs. $33M and $15M of net income vs. $3M. STZ offered $1 billion of cash and debt. STZ is paying "mid-to-high teens" of its projected EBITDA. STZ is no small company though so even with the Ballast excessive growth rate; it's only a band-aid on the core operations of STZ. For the fy ended February 15, beer sales were $3.1 billion vs. $2.8 billion, up 10% with beer at 52.9% up from 49.9% of sales. Wine sales at $2.5 billion were flat and liquor sales, while liquor sales were up slightly. Total sales growth for STZ was 6%.

One issue is how to value microbrewers if SAM decided they want to be in the acquisition business to offset their weakness. We were a little lucky in this regard as Ballast filed an S-1 with the SEC, revealing its sales and growth figures. This is no mom and pop with $53 million of revenue for 6 months ended June of 2015 vs. $20M, implying a 165% growth rate. On November 16th, STZ Constellation Brands announced an agreement to acquire San Diego-based Ballast Point Brewing & Spirits. Ballast Point is one of the fastest growing craft beer companies in the U.S. with a beer portfolio that includes more than 40 different styles of beer, led by its popular Sculpin IPA and Grapefruit Sculpin IPA. The partnership with Ballast Point provides a high-growth premium platform that will enable Constellation to compete in the fast-growing craft beer segment, further strengthening its position in the highest end of the U.S. beer market.

Constellation estimates that on a comparable basis, the acquisition is expected to be *neutral to diluted earnings per share for fiscal 2016* and $0.05 to $0.06 accretive for fiscal 2017. The transaction will be financed with cash and debt and is expected to close by the end of the calendar year 2015, subject to customary closing conditions.

Ballast produces over 30 styles of limited offering beers. In 2014, we sold a total of 122,890 barrels of beer as reported on a taxable basis, and recorded $48.9 million in net revenue compared to 37,161 barrels of beer and $14.0 million in net revenue in 2012, representing a compound annual growth rate, or CAGR, of 81.8% for barrels sold and 86.6% of net revenue.

For the 12 months ended September 30, 2015, Ballast sold a total of 250,218 barrels of beer and recorded $102.2 million in net revenue compared to 102,575 barrels of beer and $40.5 million in net revenue for the 12 months ended September 30, 2014, representing growth of 143.9% for barrels sold and 152.6% for net revenue. Through the collective effort of our skilled R&D personnel and many highly engaged employees, we introduced over 110 new beers in our tasting rooms in 2014.

In 2012, Ballast distributed to 19 states and 4 countries and had since expanded to over 30 states and 10 countries. For the year ended Sept. 2014, the company sold 102k barrels of beer. Through 12 months ended September 2015, the company sold 250k barrels representing 143.9% growth. Since 2012 when they shipped 37k barrels, their CAGR has grown 81%. Revenue increases from $40.5M to $102.2M for 12 months ended September 2015, representing 152.6% growth.

Within the U.S. beer market, we operate in the high-growth craft beer segment. Growth in the craft beer segment has outpaced growth in the broader beer market in recent years. According to the *Brewers Association*, U.S. craft beer retail sales grew from $8.8 billion in 2010 to $19.6 billion in 2014, which represents a *CAGR of 22.3%. During this same period, craft beer expanded both its volume share of the U.S. beer market from 5.0%* to 11.0% and its retail dollar share from 7.6% to 19.3%.

[12] http://www.sec.gov/Archives/edgar/data/1648798/000119312515358205/d87353ds1a.htm
[13] http://www.nasdaq.com/press-release/leading-craft-brewer-ballast-point-joins-constellation-brands-20151116-00593

Since we began brewing in 1996, we have successfully grown our distribution footprint to over 30 states. Recently, we have experienced significant growth in nearly all of our markets. Of the 26 states in which we have operated for at least one year, 24 states, or 92%, have generated triple-digit year-over-year growth for the nine-month period ended September 30, 2015. In our most mature market, San Diego, where we are headquartered, we generated year-over-year revenue growth of 39% for the same period.

For the nine-month period ended September 30, 2015, our top five states accounted for an estimated 67% of the total distribution. Within these five states, revenue grew 130% over the prior year period.

Further, the beer industry has seen continued consolidation among brewers to take advantage of cost savings opportunities for supplies, distribution, and operations. Illustrative of this consolidation are the domestic joint venture between SABMiller and Molson Coors and the acquisition of Anheuser-Busch by InBev, both of which occurred in 2008, the acquisition of FEMSA Cerveza by Heineken in 2010, and the acquisition of Grupo Modelo by AB InBev in 2013. Due to the increased bargaining leverage that these combined operations will have, *the costs to us of competing could increase*.

Brewing operations include the brewing of our craft beer and sale of that beer to distributors (who in turn sell to on-premise locations such as bars, restaurants and sports venues, and off-premise retail locations such as grocery and specialty stores) and through self-distribution. Constellation says it will keep Ballast Point running as an independent entity.

Craft brewer Oskar Blues could teach Anheuser-Busch a thing or two[14]

Founded by Dale Katechis out of a little brewpub in Lyons, Colo., in 1997, Oskar Blues became one of the first craft brewers to can beer when it did so in 2012 just to bring customers into the pub. The operation has since grown to include a brewery in Longmont, Colo., another in Brevard, N.C., a chain of hamburger restaurants, a bicycle-fabrication company, a coffee roaster, a manufacturer of aluminum can “growler” containers, a NASCAR sponsorship and, next year, a third brewing facility in Austin, Texas. It has watched production climb from roughly 86,000 barrels just before the Brevard brewery opened in 2012 to more than 140,000 barrels last year. (62% increase)

But is there any way to preserve your independence and get an influx of cash without turning to another, larger brewer? For Oskar Blues, the answer involved finding a private-equity firm that wouldn’t be overly controlling and using their money to acquire other breweries and avoid being the brewery acquired.

Earlier this year, Katechis sold a controlling stake in Oskar Blues to Fireman Capital in Boston just before buying Perrin Brewing in Comstock Park, Mich., just outside of Grand Rapids. Fireman also owns a $35 million stake in Utah Brewing Partners and their Wasatch and Squatters beers and has been, by all accounts, an ideal partner. However, the purchase of stakes in, or control of, Southern Tier in Lakewood, N.Y., SweetWater in Atlanta, Uinta in Salt Lake City and Full Sail in Hood River, Ore., to private-equity firms underscores the fact that private-equity money doesn’t always constitute independence.

Speaking with Katechis, it seems as if he’s not only found that partner, but a viable alternative to the recent spate of brewery buyouts: Pe guys think regarding buying or moving brewers that have synergies with local attractions. They want to sell in dense markets to cut back on shipping, e.g., Which gives them the flexibility over big incumbents.

[14] http://www.marketwatch.com/story/craft-brewer-oskar-blues-could-teach-anheuser-busch-a-thing-or-two-2015-04-03 By Jason Notte Published: Apr 3, 2015

Katechis: What we've learned is that the beer we ship from Colorado — and we do about 100,000 barrels in a 200-mile radius, and in Colorado, that's just Colorado — is 21% of the beer we sell, in just that radius. What we noticed when we went to North Carolina was that the cost of that brewery is already equal to the savings on shipping to date.

You, on a napkin, build these three breweries. That allows us to invest in our people and the communities that we sell beer — all of the fulfilling parts of working 16-hour days. In North Carolina, from the day that we opened — Dec. 12, 2012 — that first year we brewed 40,000 barrels. *We tripled our sales* within that 200-mile radius around that brewery, and we see growth because of the investment we've made in that community. *Three years later, North Carolina sales are up 45%, South Carolina is up 85%, and Florida is still up 45%.*

Craft Beer Is Booming, but Brewers See Crossroads[15]

Dan Kenary, a co-founder of Boston-based Harpoon Brewery, which has 190 full-time employees. He says that craft beer can be a business of local independent operators.[16]

When the term microbrewery had scarcely entered the vocabulary, Rich Doyle saw possibilities. Almost three decades ago, he became a co-founder of the Boston-based Harpoon Brewery, which has grown into the 12th-largest craft beer maker in the country.

Last July, with a stake of at least 40 percent in the business, he sensed it was the moment to make another move. He asked his partners to bring in an investor so the brewery could buy faltering competitors. And when they declined, he cashed out.

His decision reflects one side of the differing views within the industry about the direction the booming sector will take.

For those like Mr. Doyle, the current *exuberance surrounding craft beer is creating a bubble of expansion* that will pop and leave behind losers to be picked up on the cheap.

"I think that opportunity exists now and will exist even more when the exuberance cycle has run its course and people say, 'Wow, I have a lot of capacity. Wow, margins aren't as good as we thought,' " he said.

But his co-founder, Dan Kenary, and other shareholders have a different vision for Harpoon and its 190 full-time employees: that craft beer can continue to be a business of local independent operators with close relations between workers and management and constant, reasonable growth.

"To me, having grown up in this industry, philosophically it just fits well with craft beer — independent, authentic," Mr. Kenary said. "The idea of selling Harpoon, to anybody, didn't ring true to who we are as a company."

By any measurement, craft beer has been on a great run since it took off in the mid-1980s. *The number of brew pubs and regional and microbreweries jumped from 1,521 in 2008 to over 3,200 in 2014*, according to the Brewers Association, a trade group that defines craft brewers as those that produce fewer than six million barrels a year and are less than 25 percent owned by a large beverage maker.

---

[15] http://www.nytimes.com/2015/02/05/business/smallbusiness/betting-on-the-growth-of-microbreweries.html?_r=1 By IAN MOUNTFEB. 4, 2015

[16] http://www.nytimes.com/2015/02/05/business/smallbusiness/betting-on-the-growth-of-microbreweries.html?_r=1

To many in the industry, the growth seems unlikely to let up anytime soon. “I think that’s a consumer phenomenon that will persist for a while,” said Kim Jordan, chief executive and co-founder of New Belgium Brewing in Fort Collins, Colo. “I don’t think people will say, ‘Gosh, I have a hankering for Wonder Bread.’ ”

On the sales side, craft brewers sold 17.2 percent more volume in 2013 than in 2012, compared with a 1.9 percent drop in overall beer sales. And craft beer now accounts for 14.3 percent of the $100 billion United States beer market.

“Brewery after brewery is looking for ways to grow because when you talk to these companies, the biggest constraint is capacity,” said Bart Watson, chief economist for the Brewers Association. “They’re selling beer as fast as they can make it.”

This has changed the industry’s investment dynamic. After years of being rebuffed by breweries, private equity, and strategic investors are finally finding takers among craft brewers looking for capital to grow. Since last summer, SweetWater Brewing of Atlanta sold a stake to TSG Consumer Partners, Southern Tier Brewing in upstate New York sold a stake to Ulysses Management, and Uinta Brewing of Utah sold a majority share to the Riverside Company. And both Elysian Brewing of Seattle and 10 Barrel Brewing, based in Bend, Ore., sold themselves outright to Anheuser-Busch.

But for brewers who have shunned such investments, like Gary Fish, who founded Deschutes Brewery in Bend, Ore., in 1988, the way forward is reasonable growth. “We have a lot of runway in front of us,” said Mr. Fish, whose company brought in just under $100 million in 2014. “We’re happy managing growth around the 10 percent mark.”

For other brewers, the way to grow is to bring in outside money and expertise. One is Will Hamill, who has spent 22 years building Uinta into a craft brewery with a 144,000-barrel annual capacity. Even after a recent $18 million investment, projected growth of 30 to 35 percent this year would put the brewery again at its capacity limit. He wondered if the business needed more than his skills.

“Going from zero to 50,000 barrels requires branding, strong culture, and great distributors, and this can be accomplished by a special entrepreneur with a strong core team,” he said. “But to go from 50,000 to 250,000 and break into the top 10 craft brewers, you have extra infrastructure requirements, and that’s where a partner like Riverside can be helpful.”

For now, the question for brewers like Mr. Doyle is whether the push for growth will lead to more debt-laden firms and overbuilding — and bargains. “What’s interesting is you have a lot of entrants, with low barriers to entry, chasing a finite amount of growth,” he said. “The industry will do very well as a whole, but you have a lot of people who are doubling or tripling capacity and taking on debt to do it.”

“People have built out way in front,” he said. “They’ve made bets, and not all will succeed. It’s pretty likely there will be some that won’t survive. And then there might be some capacity available for cents on the dollar.”

Stars Align for Sep Volume Growth, +4% for 4 Wks, But AB+MC Shed 3+ $$ Share[17]

Most of that’s Constellation: cases up 26% for 4 wks, now +15% YTD. At the beginning of Sep, the cloudy overhang from subpar summer concerned some that season-ending Labor Day not so hot either. But latest Nielsen report suggests that by the 7th day, the holiday itself, Americans went back to buying more beer:

[17] http://www.beerinsights.com/

volume +4.3% for 4 weeks thru Oct 3 in all-outlet + convenience channel. Above-premium segments got all the growth. Only 2 segments slowed: *cider up just 1% for 4 wks vs. 16% YTD gain*, and malt liquor.

Megabrew is almost upon us, as biggest beer deal of all is agreed upon if not yet done, done. With the deadline looming, Anheuser-Busch InBev and SABMiller reached "agreement in principle" on a deal for 44 pounds per share cash, plus the partial share alternatives at 39.03 pounds. At about $106 billion, this will be by far the biggest beer deal of all time, and one of the biggest deals of any kind. ABI will reportedly be lining up $65-70 billion in debt.

ABI will, of course, have to divest the 58% of MillerCoors that SABMiller owns. And Molson Coors is the most likely acquirer. There will be other divestitures, regulatory hurdles, players yet to weigh in (Coke?), not to mention all the ripple effects and ramifications, both globally and in the US, that will emerge from what one source called an "earthquake" in the global beer biz. Stay tuned. The offer is "full but fair," says Evercore ISI's Robert Ottenstein. Implies blended multiple of *15.7x EBITDA*, sez, Robert.

Tho industry volume has easier "comp" in 2d half, <u>-1% volume decline for 1st 7 months not likely to be overcome</u>, according to Beer Inst economist Michael Uhrich.

According to Rich Doyle, former CEO of Harpoon Brewery and current Founder & President of Enjoy Beer, the amount of people drinking craft beer has grown from less than 1% of the market to 11%, and is well on its way to 20%, all since the founding of Harpoon in 1986. [18]

The ever-apparent consumer shift is just one contributing aspect in the growth of craft brewing. As the market gains momentum in its acceptance and appreciation for the craft, the business model for a brewer changes completely. Access to capital equipment is much more readily available with a larger range of suppliers, as well as a broad range of materials, "there's been an explosion in different kinds of hops you can use," says Doyle.

A whole new world indeed when looking back on the days of Doyle founding Harpoon, "we never had more than about a million dollars worth of equity capital. Back then you could start a business for that. Today, it's more like 10 million."

Possibilities are endless, as we see more and more craft collaborations emerging, lines become blurred and more options present themselves. It's an exciting place to be, and we look forward to seeing what the next 10 years bring.

Firestone Walker is expanding at home, investing upwards of $15 million to increase brewing capacity at its Paso Robles, Calif. brewing facility. Firestone Walker will integrate a new 250-barrel brewhouse into its existing production facility. Brewing capacity will double, Walker said, and the company will eventually be capable of producing 600,000 barrels annually with the addition of more fermentation tanks. [19]

Bold Rock Hard Cider Releases New India Pressed Apple in 6-Packs (SAM competition)[20] (Nov. 2015)

Bold Rock Hard Cider announces the widespread release of its new IPA, India Pressed Apple. The hopped cider, made with locally picked Blue Ridge apples, is now available in six packs where Bold Rock is sold.

[18] https://www.bevspot.com/2015/09/01/rich-doyle-on-the-craft-beer-movement/
[19] http://www.brewbound.com/news/firestone-walker-investing-15-million-to-double-brewhouse-capacity
[20] http://www.brewbound.com/news/bold-rock-hard-cider-releases-new-india-pressed-apple-in-6-packs

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. As the nation's largest independently owned cider company, Bold Rock has production facilities in Nellysford, Va., and Mills River, N.C., and is quickly ramping up distribution throughout the East Coast, now delivering across the Mid-Atlantic and Southeast from Pennsylvania through South Carolina.

MegaBrew Arrives: A-B InBev and SABMiller Reach $106 Billion Takeover Agreement[21]

These acquisitions, given their size, will prevent them from buying SAM's for 2 years.

After nearly two months of negotiations, extensions and industry speculation, global brewing giant Anheuser-Busch InBev said Wednesday that it had reached a formal agreement to acquire its largest competitor, London-based SABMiller, in a deal valued at approximately $106 billion. As part of the deal dubbed MegaBrew, and to appease U.S. antitrust regulators, the Belgium-based A-B InBev will divest its interest in MillerCoors, a joint venture between SABMiller and Molson Coors. Molson Coors will purchase the remaining 58 percent stake of MillerCoors that it did not already own for $12 billion.

Both transactions are not expected to close until the second half of 2016.

Molson Coors' acquisition of the MillerCoors joint venture is still contingent upon A-B InBev's takeover of SABMiller, however, which could face regulatory scrutiny in places like China and South Africa. Some analysts have suggested that additional divestitures in China could also be required. SABMiller owns a 49 percent stake in CR Snow, the nation's largest brewing company. Once finalized, the combined A-B InBev/SABMiller entity would control roughly one-third of the world's beer supply.

In the U.S., where the two companies do have overlapping footprints, A-B InBev currently controls about 45 percent of the market and sold about 96 million barrels of beer in 2014, according to Beer Marketer's Insights. By comparison, MillerCoors had about 25 percent market share and sold 55 million barrels in 2014. The next closest U.S. competitor, Constellation Brands, sold more than 14 million barrels in 2014 and had less than 7 percent market share.

The beer behemoth will have annual revenues of about $64 billion following the tie-up. Describing it as a "game-changing" opportunity, Molson Coors CEO Mark Hunter said consolidating ownership of MillerCoors would "strengthen" the company's presence in the U.S. and improve its "global scale and agility."

Upon completion, Molson Coors will wholly own MillerCoors, add $4.7 billion in incremental revenue and produce more than 90 million barrels of beer annually.

"This is a strategic, well-timed opportunity to acquire these businesses at an attractive price," said Gavin Hattersley, the CEO of MillerCoors and CFO of Molson Coors. "Fully integrating MillerCoors into Molson Coors, given our cost-saving capability and our cash-generating strength, will allow Molson Coors to pay down debt aggressively while investing more behind our brands and simultaneously maintaining our strong dividend policy.

[21] http://www.brewbound.com/news/megabrew-arrives-a-b-inbev-and-sabmiller-reach-106-billion-takeover-agreement

Labatt to buy Mike's Hard Lemonade, Okanagan Cider for $350-million[22]

In a separate transaction, A-B InBev, via its Canadian outfit Labatt Breweries, will purchase the Canadian rights to Mike's Hard Lemonade, owned by the Mark Anthony Brands, for *$350 million*. The deal will also include *Okanagan Cider*, Palm Bay pre-mixed drinks and the Turning Point Brewery in British Columbia, according to multiple reports. A-B InBev will also acquire the international trademark rights to the brands, excluding the U.S. business.

A growing taste for sweeter drinks has pushed Labatt Breweries into its latest acquisition for the Canadian rights to Mike's Hard Lemonade, Okanagan Cider and a couple of other alcoholic beverages. The Canadian brewer, which is owned by Belgian company Anheuser-Busch InBev, said late Tuesday it has struck a *$350-million* (U.S.) deal with the Mark Anthony Group of Companies that will also give it ownership of Palm Bay pre-mixed drinks and the Turning Point Brewery in British Columbia, which brews Stanley Park beers.

According to data from Labatt, sales of pre-mixed drinks have grown by 7 percent annually over the past three years. Popularity in ciders has also soared, rising *20 percent annually* over the same period after years of limited availability in Canadian bars and liquor stores.

Sierra Nevada Brewing's ambitions spill over to the East Coast[23]

When Sierra Nevada Brewing Co. in Chico, Calif., decided to expand to a second brewing facility across the country in Mills River, N.C., there was a lot on the line, as the company was spending over $100 million and beer production would top a heady 1 million barrels of beer a year.

Back in January 2012, Sierra Nevada founder and Chief Executive Officer Ken Grossman announced that his company had bought 90 acres in Henderson County, N.C. — Just beyond the cluster of breweries, bars and beer stores of craft-beer-soaked Asheville — for a production facility, restaurant and gift shop. It was nearly a $110 million investment that created about 95 full-time jobs and 80 part-time positions, increased Sierra Nevada's potential production capacity by almost a third and expanded the brand's presence in the Northeast and Southeast. The North Carolina facility pumps out 6,000 barrels of beer a week and is on pace to produce 200,000 this year.

Today, there are more than 3,000 breweries throughout the U.S. The Sierra Nevada grew from 663,000 barrels in 2007 to more than 985,000 by the end of 2013

As it turns out, Pabst and PBR aren't heading to Russia after all. Though a Business Wire release said otherwise, David Geller at DealBook notes that the real buyer is U.S. citizen Eugene Kashper. It's a bit confusing since Kashper just happened to be the chairman of Russian brewer and distributor Oasis Beverages when he decided he wanted to buy Pabst. Oh, and despite working independently with a San Francisco-based private-equity firm to buy Pabst, he initially had a deal in place with Oasis to distribute Pabst in Russia and Eastern Europe.

Kashper insists that a company he formed with the private-equity group, Blue Ribbon Intermediate Holdings, purchased Pabst and has nothing to do with Russia or Oasis. For the record, Pabst is still brewed at MillerCoors

[22] http://www.theglobeandmail.com/report-on-business/labatt-to-buy-mikes-hard-lemonade-okanagan-cider-for-350-million/article27197915/

[23] http://www.marketwatch.com/story/sierra-nevada-brewing-bridges-divide-between-east-coast-and-west-coast-2014-11-21

facilities here in the U.S., and that company is a joint venture of London-based SABMiller and Denver/Montreal-based MolsonCoors. We hope that clears this all up for you.

Brewery Consolidation Is Not Inevitable[24]

In the 2015 world of craft brewing, every week seems to bring news of a new acquisition or merger. Given this recent flurry of deals in the craft beer community, I've begun to hear a lot of musing about how the consolidation of craft brewing is inevitable in the long run. While forecasting the future is notoriously difficult, I think there are as many structural factors pushing against consolidation as there are factors pushing toward it. So I thought it might be helpful to do a more rigorous analysis of the beer market, how consolidated it is, how it's evolving, and what this means for the future.

While those theories may be useful to a certain point, beer isn't the widget you learned about in Econ 101. Economies of scale only work as they do in an econ textbook when every product is the same, regardless of the size of production. Much of the value of craft brewers is derived from things that are very difficult to execute at scale, or when scaled even lose part their value. Things like:

- The service component of your local microbrewery taproom or brewpub
- Local branding or ingredients
- Limited batches and special releases tied to a particular event or cause
- The ability to rapidly pivot into new styles or products
- Close personal connections with communities and employees

Hops Supply[25]

The current growth trends in the craft beer market – more brewers, more market share, and more hoppy beers – have led some in the industry to worry about the hop supply in the future. Even with thousands of new acres going in and the now widespread usage of hop contracts by craft brewers, there is a fear that growing demand will outstrip supply, particularly in the markets for niche varieties (craft brewers are using dozens of them).

The next five years will bring similarly extraordinary changes in hops, not just in type but in size of acreage. Based on updated estimates incorporating 2014 production, I estimate that US brewers will need an additional 24 million pounds of hops (primarily aroma) by 2020. The vast majority of these will be U.S. varieties, though, in an era of extreme shortage, a hop is a hop. If those hops all came from the U.S., that's roughly 12-13K new acres.

Based on the size of the domestic crop in 2014, usage of American hops is northward of 70 million pounds at the moment. If we assume a linear increase to 2020, that's *504 million pounds of hops from 2015 through 2020*. Suddenly, even $500-$750 million in investment doesn't seem so difficult – it's only $1-$1.50 for every pound of hops grown.

[24] https://www.brewersassociation.org/insights/brewery-consolidation/

[25] https://www.brewersassociation.org/insights/the-hops-market/

Industry Growth Rates

	Dec. 27 2014	Dec. 28 2013	Dec. 29 2012	Dec. 31 2011 (53 weeks)	Dec. 25 2010
	Year Ended				
	(in thousands, except per share and net revenue per barrel data)				
Income Statement Data:					
Revenue	$ 966,478	$ 793,705	$ 628,580	$ 558,282	$ 505,870
Less excise taxes	63,471	54,652	48,358	45,282	42,072
Net revenue	903,007	739,053	580,222	513,000	463,798
Cost of goods sold	437,996	354,131	265,012	228,433	207,471
Gross profit	465,011	384,922	315,210	284,567	256,327
Net income	$ 90,743	$ 70,392	$ 59,467	$ 66,059	$ 50,142
Net income per share — basic	$ 6.96	$ 5.47	$ 4.60	$ 5.08	$ 3.67
Net income per share — diluted	$ 6.69	$ 5.18	$ 4.39	$ 4.81	$ 3.52
Weighted average shares outstanding — basic	12,968	12,766	12,796	13,012	13,660
Weighted average shares outstanding — diluted	13,484	13,504	13,435	13,741	14,228

	September 26, 2015	December 27, 2014
Assets		
Current Assets:		
Cash and cash equivalents	$ 134,612	$ 76,402
Accounts receivable, net of allowance for doubtful accounts of $91 and $144 as of September 26, 2015 and December 27, 2014, respectively	57,121	36,860
Inventories	57,317	51,307
Prepaid expenses and other current assets	14,716	12,887
Income tax receivable	2,168	21,321
Deferred income taxes	6,335	8,685
Total current assets	272,269	207,462
Property, plant and equipment, net	405,415	381,569
Other assets	9,550	12,447
Goodwill	3,683	3,683
Total assets	$ 690,917	$ 605,161
Liabilities and Stockholders' Equity		
Current Liabilities:		
Accounts payable	$ 48,518	$ 35,576
Accrued expenses and other current liabilities	84,274	74,594
Total current liabilities	132,792	110,170
Deferred income taxes	47,355	50,717
Debt and capital lease obligations, less current portion	471	528
Other liabilities	15,499	7,606
Total liabilities	196,117	169,021
Commitments and Contingencies (See Note E)		
Total stockholders' equity	494,800	436,140
Total liabilities and stockholders' equity	$ 690,917	$ 605,161

Disclaimer: This material has been prepared by Alternative Research Services Inc., (ARS) employing appropriate expertise, and in the belief that it is fair and not misleading. The information upon which this material is based was obtained from sources believed to be reliable but has not been independently verified. We do not guarantee its accuracy. This information is not to be used as the primary basis for investment decisions. The firm does not make a market or hold positions in the securities mentioned herein, nor does the firm maintain any investment banking relationships in such securities. The opinions, estimates, and projections contained in this report are those of ARS as of the date of this report and are subject to change without notice.