

The LakeView Restaurant and Food Chain Report Featuring “The Finance Professor” Scott Rothbort



Investment and trade ideas from the farm to your mouth

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Welcome to Oktoberfest

We are closing in on the end of the annual Oktoberfest in Germany. However, many US beer makers are extending that Bavarian festival until the end of October as their marketing efforts continue to attract traditional beer drinkers, whether they are students who have begun the fall semester or football fans huddling up for those tailgate parties. Thus, I thought it was appropriate to take a look at some of the publicly traded beer brewers for this edition of the newsletter.

There are three such brewers which come to mind – Anheuser-Busch InBev (BUD), Molson Coors Brewing Company (TAP) and Boston Beer (SAM).

Anheuser-Busch InBev

Anheuser-Busch InBev (BUD) was formed by the acquisition of the old Anheuser-Busch beer company by InBev, a Belgian com-

pany. In order to fund this \$52 billion purchase, InBev issued nearly \$45 billion in debt. Currently BUD carries about \$55 billion in debt which is quite large for a \$135 billion market cap company. The company was delisted in the US markets immediately after the acquisition and then relisted in July 2009. In August, BUD reported second quarter and first half 2009 results for the periods ended June 30, 2009. BUD generated earnings per share of 68 cents for the quarter and \$1.13 for the six month half of the year. Gross margins were 53.9% for the second quarter and 52.6% for the first six months of 2009. At this point in time, I do not believe that there is enough data from which more than a guess can be made on BUD. Furthermore, I am reluctant to recommend purchasing a company with a huge

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Price Targets 12/31/10

TAP	\$57.00
SAM	\$44.50
BUD	no opinion

Beer Facts

Source: Brewers Association (8/17/09)

- Growth of the craft brewing industry in the first half of 2009 was 5% by volume and 9% by dollars.
- Craft brewers sold an estimated 4.2 million barrels of beer in the first half of 2009, up from 4 million barrels in the first half of 2008.
- Overall US beer sales are down 1.3% in the first 6 months of 2009.
- Imported beer sales are down 9.5% in the first 6 months.
- Growth of the craft brewing industry in 2008 was 5.9% by volume and 10.1% by dollars.
- The craft brewing industry produced nearly 8.6 million barrels of craft beer in the US in 2008.
- The craft brewing sales share as of December '08 was 4% by volume and 6.3% by dollars.
- Total US craft brewing industry annual dollar volume is \$6.3 billion.
- The US brewery count of 1,525 on July 31, 2009 is the highest total in 100 years. (2008 total includes breweries that closed during the year, and the July 2009 count is higher than at any time in 2008.)



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Oktoberfest (continued)

amount of debt relative to its market capitalization. Thus, it is prudent to set aside consideration of BUD until a later date.

Molson Coors Brewing Company

Molson Coors Brewing Company (TAP) brews, sells and/or distributes many well known beer labels such as Molson, Coors, Miller High Life, Amstel Light and Asahi as well as other lesser recognizable brands of beer. Product-wise, TAP beers compete directly with many of the BUD labels such as Budweiser and Michelob. Sales growth has been rather spotty over the past few years: 2007 (+5.9%); 2008 (-8.0%) and first half 2009 (+2.0%). Earnings per share have had far more variation, increasing 31.5% in 2007, declining 23.9% in 2008 and rising 118% for

the first half of 2009. Gross profit margins for TAP have been in a steady decline the past few years going from 46% in 2007 to 40% in 2008 and so far 39% in 2009. That is not a trend about which I am excited.

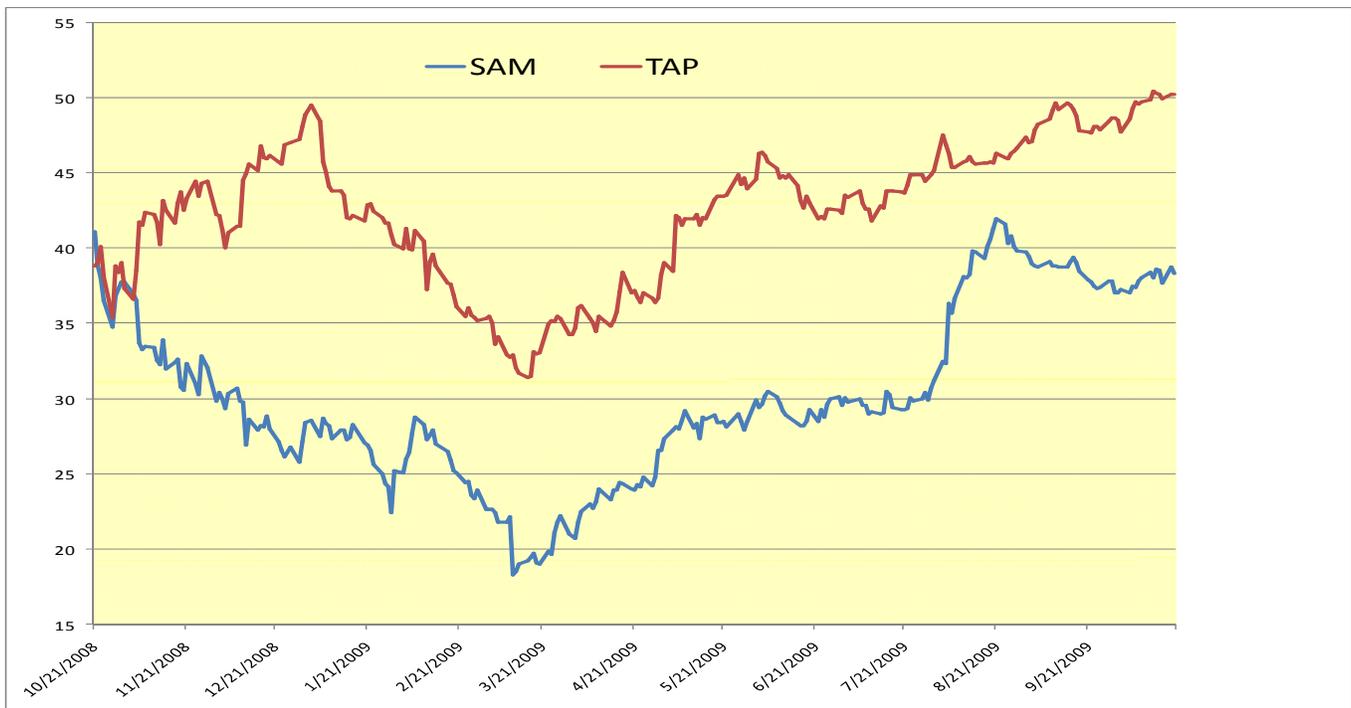
Next, let's peer at the company's balance sheet. TAP currently has \$1.939 billion of long-term debt with approximately \$300 million of cash on hand. The current market cap of TAP is \$9.28 billion. Thus, a potential acquirer would have to pay at least \$11 billion for TAP which had \$4.8 billion in net sales in 2008. TAP debt to equity is currently about 20%. To the company's credit, management has paid down over \$500 million of debt over the last year. That is a trend which I would like to continue.

Currently Wall Street consensus estimates are expecting full-year earnings to rise 30% in 2009 and 6% in 2010. I am not very confident that TAP can deliver superior earnings growth in the next year or beyond to justify paying more than 15 times earnings. Based on 2010 earnings estimates of \$3.80, that would imply a price target of \$57.00 for shares of TAP by the end of 2010. However, I see potential risks to that earnings and price target. TAP derives its sales from various countries: US (33%), Canada (38%), UK (27%) and other International sales (2%). A weakening US Dollar is certain to have a negative impact on both future earnings and sales. Furthermore, increased competition, especially from

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One Year Price Chart of TAP and SAM

Source: LakeView Asset Management, LLC





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Oktoberfest (continued)

BUD and rising commodity prices may further erode margins and earnings. Thus, the price target of \$57.00 is a best case scenario for TAP. Lastly, there is a bright side to owning TAP. Shareholders will receive an annual dividend yield of 1.90% at the current quarterly stated dividend payout. Taken together, purchasing TAP now would yield just over 15% on a total return basis from the most recent closing price of \$50.28 to the end of 2010, on a best case basis.

Boston Beer Co.

Boston Beer Co. (SAM) was founded as a local brewery in 1984, having since gone national and then international, to a lesser extent. SAM produces hand crafted beer under the Sam Adams brand name and flavored malt beverages under the Twisted Tea brand. The company manufactures all-year-round beers such as Sam Adams Boston Lager as well as a variety of seasonal, specialty and flavored beers. All beers are sold only in brown bottles (not cans) to ensure maintaining its full flavor and decrease spoilage or in draught for bars and restaurants.

SAM has delivered steady and consistent earnings growth over the past four years and is expected to do so again in 2009 and 2010. EPS is expected to grow 6.8% in 2009 and 15.7% in 2010. The five year revenue growth rate is nearly 19%. Given that SAM is a fast growing brand and only controls a 1/2% market share in the US, the company has ample opportunity

for future growth at rates comparable to those which it has enjoyed in the past. (See the box on the bottom of page 1 for industry metrics on the beer and crafted beer markets.) While SAM does market outside of the US, the impact from foreign exchange will be insignificant compared to gains made from market share expansion.

The company's balance sheet is in excellent condition having no debt and about \$30 million in cash. The market capitalization of SAM is just under \$550 million. The company does not pay a dividend. Insiders hold just 5% of outstanding shares of which the founder and chairman, James Koch owns about 3%.

What will make the difference for SAM is the company's ability to increase distribution. That could be achieved through a joint venture, agreement with a large beverage distributor or acquisition by a larger company. While I would prefer to consider potential takeovers as pure conjecture, it is very possible that for the right price a deep pocket buyer could pay up for SAM. Should that occur, the buyer would have to pay at least three times sales for SAM which currently sells for 1.3 times current year sales.

Excluding the pie in the sky valuation for a takeover, what are shares of SAM worth? Looking at expected earnings for the company, I am projecting EPS of \$1.80 for 2009 and \$2.02 for 2010. These estimates are significantly more aggressive than the

three analysts who currently cover SAM. I would add that as more analysts begin to cover SAM, the earnings and price targets should get more robust. I believe that SAM has proven its ability to grow and will continue to do so. Thus, it is reasonable to pay a premium earnings multiple for SAM relative to its peer TAP. Given the historical and expected future earnings growth of SAM, I am willing to pay 22 times earnings for SAM. This would imply a 2009 year-end price target of \$39.60 and a 2010 year end price target of \$44.50 for SAM. As SAM does not pay a dividend, buying SAM at current prices would imply a 16% return to my 2010 price target from yesterday's closing price of \$38.31.

Conclusion

Beer is a good business. There were three companies which were discussed in this newsletter issue – BUD, TAP and SAM. At this time I think that BUD is too big, has too much debt and does not have enough financial data after the acquisition to warrant buying the stock. TAP is a solid beer company with an established distribution network but does not offer the growth that many investors desire. For an income oriented investment in the beer segment one may want to take a sip of TAP. My favorite brewer is SAM which may appear to be riskier or more expensive but offers the highest degree of growth both near term and long term. Given a choice from all of the beer companies I discussed, I would select SAM as my first choice.

As of the date of this newsletter Scott Rothbort, his family and/or clients of LakeView Asset Management, LLC did not own shares of BUD, SAM or TAP --- although positions can change at any time.



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