Beer Industry Mega-Trends

by Harry Schuhmacher

The U.S beer business in 2007 and so far in 2008 has been nothing less than transformational. That's the word that Molson Coors CEO Leo Kiely used when I asked him to sum up our fair industry. And 2008 shows no sign of our industry slowing up.

It is with that in mind that we mark six mega-trends that, when taken together, promise to change our industry forever. Some are good, some are, as we say, challenges. But regardless they will make this a fascinating segment to cover over the next two years. I'm glad I have a front row seat.

MillerCoors will carry a bigger bat, A-B a smaller one (than before)

Two words: Holy cow. MillerCoors came out strong as garlic out of the gate on consolidation. Not only did they issue a strong-worded new distributor agreement which takes control of the consolidation process even before talks start, but about 40 distributors didn't even get the contract in California, Indiana, Colorado, and Ohio. It is no doubt the talk of the NBWA Convention as you read this. And about a half dozen consolidated distributors didn't get it, indicating that MC is intent on moving even consolidated folks out of the market. While 60% of MillerCoors volume already consolidated, there are still several major markets that aren't; to wit: Austin, Birmingham, Charlotte, Cleveland, Denver, Detroit, Fort Worth, Memphis, Los Angeles, Las Vegas, New York, Philly, Pittsburgh, Sacramento, San Diego, Salt Lake City. Many deals are already being negotiated, with big Pac Nor'west and Milwaukee deals already in the can.

In the rest of the states with stronger fair dealing laws, MillerCoors will play along the margin, making changes and applying pressure where it can. It doesn't want another Maris on its hands (referring to the 2005 court settlement where A-B paid the Maris family $120 million to settle their lawsuits which sprang from A-B's termination of that distributorship in 1997), but it also wants to strike while the iron's hot and while they have this window of opportunity to make changes. Distributors are bracing for the little things that MillerCoors can do to make life miserable for its unwanted distributors: no more half truckloads, no new products or line extensions, no Grolsch, shorter credit terms, higher trade standards, and the old standby: finding out-of-code Miller Chill in the market, buried in November under cases of Bud Light Lime.

In the old days, if a hot new beer brand came to town, they basically had two choices: Go with the Miller-Coors distributor, or go with the wine and spirits distributor. Naturally, the lion's share went to the MillerCoors distributor, and this made those distributors large and profitable, while the A-B distributor contented himself with whatever A-B could come up with.

Today, there are two major developments which have put this model into helter skelter. First, the MillerCoors joint venture will have much more leverage with distributors and retailers. Their bat just got bigger. They will have viable brands in every segment in the industry, from budget to craft to import, and they will ask for and get their due attention to those brands.

One of the things they'll use that bigger bat for is to get distributor consolidations accomplished in the way they want them to get them accomplished. That's good news if you are a buyer who is among "the chosen" by the J-V, and bad news if you are a red headed stepchild.

At the same time, Anheuser-Busch has loosened its exclusivity parameters, and regardless many A-B distributors are ignoring exclusivity guidelines anyway, such as those A-B distributors in Tennessee who took on Yuengling and then New Belgium. A-B distributors from Jersey to Florida are banding together to form a single beachhead for crafts and imports. A-B's bat just got smaller (though still a big bat to be sure. Never let it be said that I have ever impugned the size of A-B's bat). That opens up an entirely new network of high quality distributors who have the unusual trait of being simultaneously hungry and rich.

So while MillerCoors works to keep their brand values low while consolidation occurs, that puts pressure on all the other brands' values to go up. Because now A-B distributors are in play, and the Heineken USA's and Crown's and New Belgium's of the world have a choice to go into the red system (provided AB InBev continues to loosen exclusivity requirements, which we happen to believe it will, as an olive branch while they squeeze margins). And they may be increasingly leaning toward that choice as MillerCoors carries a heavier bat in the blue-silver system and A-B carries a lighter bat in the red system.

AB InBev: What it means?

Several questions arise about the new AB InBev. First, at presstime nobody seems to know what will become of Grupo Modelo. Secondly, as I said above, we happen to think that AB InBev will continue along the path of loosening exclusivity requirements with one hand, while the other hand picks distributors pockets by squeezing margins and pushing more costs down the supply chain. The other question is how far AB InBev will go to force horizontal distributor consolidation. They will likely encourage it, but will they go as far as MillerCoors has gone? That remains to be seen.

It's a small world after all

The reassignment of Grolsch's U.S. importation rights to Miller Brewing Co. from Anheuser-Busch is but one example of the tangled web our industry has become. A-B had acquired the rights to Grolsch back in early 2006, hounded its distributors to acquire the brand from their competitors, allowed SABMiller to swoop in and buy the mothership brewery, Royal Grolsch, for $1.2 billion in November 2007, and now A-B sells the importation rights to SABMiller, with the consolation to their distributors that it will help compensate them. The situation hit an all-time high on the bizzaro meter when I was told to expect a joint conference call from A-B's Dave Peacock and Miller's Tom Cardella. That was a first. It's indicative of the fact that the beer industry today is truly global, and every brewer of consequence has some sort of business relationship with every other brewer of consequence somewhere on the planet, be it in Canada or India. It's a small club, and all the members know each other.

The high end is still where it's at

Yes, there's a soft economy, and yes, casual dining is way off. But the high end beer industry continues to roar despite ridiculous increases in commodity and hop prices. Craft beers were up another 12 percent last year despite the fact that the craft segment had the most difficult comparisons to cycle, and they continue to gain share this year. The story here is one of increased consumer interest in more flavorful, local beers, of course. But it is also a story of trade acceptance. Distributors and chain retailers "woke up" to the fact that craft beers are not only the fastest growing segment in the beer industry, it is the fastest growing segment in all of beverage alcohol. One only had to look at the sheer number of distributors in attendance at the 2008 Craft Brewers Conference in San Diego.

Imported beers also grew, but the data are skewed there. Imported beer shipments into the United States were up just 1.5 percent in 2007, or about 450,000 barrels, according to the Beer Institute. That is a marked slow down from the 15 percent gain in 2006 and the 7 percent gain in 2005. But the vast majority of the soft sales were due to the two largest players: Corona and Heineken, both of which took large price increases in 2007. Both brands are suffering in 2008. Import shipments are down 3% so far this year.

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For distributors, the big get bigger

If big is good, then mega is great. Just ask the Reyes brothers. They are first one billion dollar beer distributor. They added 20 million cases to their volume in just one year, on top of 7 million cases the year before, and 8 million cases so far this year. Other billion dollar companies that include beer distributorships are Ingram Entertainment, Soave Enterprises, Ben E. Keith Companies, Honickman Affiliates, and Glazer's, among others.

This beer business is big business. And it makes sense. Beer distributors typically have high fixed costs. In fact, one Colorado distributor told me last week that he often feels like all of his costs are fixed, whether he sells one case of beer or a million. So the more cases over which you can spread those costs, the more cash you'll have for more acquisitions. It's a virtuous cycle, and one that's likely to, like the Energizer Bunny, to keep on going.

The three-tier system is safe, for now

Yes, there are over 15 court cases being litigated around the country at the moment. And their outcomes are uncertain. But the beer industry's middle tier is in a good place at this point in time. For one, there are no plans by a major chain to seek direct shipments from the big brewers at the moment. A-B tried it, and it failed. Coke tried it, and it failed. Pabst tried it, and it failed. Beer is heavy, has a high velocity, is a high-touch item, and is perishable. All that points to DSD.

Fuel prices change everything

With gas and diesel hitting four dollars a gallon, the most common complaint I get from distributors and brewers alike is the soaring price of fuel. For many distributors, the increase in fuel costs is adding over a dime a case to expenses. Brewers and chain retailers have discouraged distributors from adding fuel surcharges to their invoices, though some have done so anyway. Increasing beer pricing above the brewer suggested PTR has also proved to be a challenge. All this plays in the hand of consolidation advocates.

The only other solutions involve reducing service thresholds, and that holds a risky consequence for the long term future of three tier. Adding more accounts to tel-sell, enacting delivery minimums, and reducing call ratios are the favored tactics. Distributors argue that these measures must be taken in order to maintain net margins. Brewers argue that the value of the three-tier system diminishes with each service cut. This tug-o-war will be among the most important challenges the beer industry faces over the next two years.

Harry Schuhmacher is editor and publisher of Beer Business Daily, a daily email newsletter, and producer of the Beer Industry Summit, a yearly executive conference. He maintains a personal blog at www.beereditor.blogspot.com