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THE BREWING INDUSTRY

During the early 1970s, volume growth in the beer industry was abnormally high, responding to an increasing number of drinkers. Per capita consumption peaked in 1973 and beer sales over the past two years have slowed, reflecting consumer resistance to higher prices and the poor economic environment. Statistics for the first eight months of 1976 indicate that the weaker trend is continuing, although poor summer weather has been a factor, as total sales were level with 1975 figures and the best that can be expected for the full year is a modest gain.

Due to changing demographic and market influences, it is likely that there will be a swing away from annual sales gains exceeding 5%, to a more moderate range of 2-3% per year, on average. The post war "baby boom" has now reached legal drinking age, the rate of increase in the adult population is decelerating and wine represents tougher competition.

Statistics for 1974 (the latest available) shown in our production cost chart indicate that the industry experienced another sharp rise in costs during 1974. This trend continued into 1975, reducing profit margins which were further squeezed by regulatory lags in obtaining price increases from the various

provincial agencies. The operating environment is now considerably improved, with higher prices being approved across the country and costs being held in check by lower inflation and AIB regulations which will limit labor expenses to a gain of about 10%.

Basically, the Canadian beer industry consists of Carling O'Keefe, Labatt and Molson which sell a wide variety of brands, although only a few are actively promoted. The regional brewers account for a small portion of the total sales. Nevertheless it is a competitive market. During the 1970s Labatt and Molson have been steadily expanding their market share, aided by aggressive promotion, and it appears that marketing is now the key factor in influencing beer sales. Molson and Labatt combine to account for about three-quarters of total Canadian sales with Labatt still the leader (38.3% market share in August) due to its strong presence in British Columbia and the Maritimes. Carling appears to have strengthened its operations and thus we foresee some moderation in market share growth for the two companies.

Favorable developments within the industry are the trend to packaged sales at the expense of the

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BREWING INDUSTRY PRODUCTION AND COSTS (1970-1974)

	1970	1971	1972	1973	1974
Production (millions of gals.)	371.0	404.8	422.9	447.6	459.8
Production Costs (millions)					
Materials & Supplies	\$103.6	\$116.9	\$121.5	\$146.1	\$196.1
Salaries & Wages	85.2	95.3	103.9	117.6	143.2
Fuel & Electricity	4.7	5.6	5.9	6.8	9.1
	<u>\$193.5</u>	<u>\$217.8</u>	<u>\$231.3</u>	<u>\$270.5</u>	<u>\$348.4</u>
Production Costs (per gallon)					
Materials & Supplies	27.9c	28.9c	28.7c	32.6c	42.7c
Wages & Salaries	23.0	23.5	24.6	26.2	31.2
Fuel & Electricity	1.3	1.4	1.4	1.5	1.9
	<u>52.2c</u>	<u>53.8c</u>	<u>54.7c</u>	<u>60.3c</u>	<u>75.8</u>
Percentage Increases 1970-1974					
Production	23.9				
Production Costs	80.9				
Production Costs (per gallon)	45.2				

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lower-margined draught beer, and the dramatic rise in export shipments where further good potential exists. Exports of beer from Canada in the 1972-1975 period more than tripled and shipments are up substantially in 1976. Molson is now marketing in 15 states in the U.S., claiming to be the number two imported brand after Heinekin, while Labatt reports encouraging results from its sales efforts in 9 states. This business is profitable, growing, and significantly, outside the AIB jurisdiction.

BEER SALES IN CANADA				
(March 31 Year-end)				
Year	Value (millions)	% Increase	Volume (Millions of gallons)	% Increase
1975	\$1,174	11.6	423	2.4
1974	1,052	8.9	413	5.3
1973	966	9.4	392	5.3
1972	883	9.8	372	7.5
1971	804	9.9	346	5.8
1970	731	—	327	—

PER CAPITA CONSUMPTION (Gallons)				
Year	Total Population	% Change	Adult Population	% Change
1975	18.89	.9	25.66	-.1
1974	18.71	.7	25.69	-.4
1973	18.58	5.6	25.80	4.3
1972	17.59	3.8	24.72	2.7
1971	16.93	6.0	24.05	4.9
1970	15.97	—	22.91	—

There has been increasing government concern about moderation in drinking and there have been proposals for an increase in the drinking age and further curtailments on advertising. In our opinion, such moves would have little impact on consumption patterns as advertising funds would probably be channelled into other promotional activities in line with the current trend to sports sponsorship. It could conceivably mean lower marketing costs as a percentage of sales, if the companies choose to hold the line on promotion.

Both Labatt and Molson acted years ago to improve their future growth potential by launching significant diversification moves using the massive cash flows generated from brewing. The non-brewing activities will become more important in the future in helping these companies achieve acceptable growth rates, and it is significant that good progress is being made after earlier difficulties. The recent recession has prompted operating efficiencies which will be reflected on a greater scale when the economy takes on a firmer tone.

LABATT (\$15 3/4) — Last year growth in beer sales again outpaced the market, as volume rose by 6% compared with an industry gain of 2.5%. The Con-

sumer Group made its first significant contribution with earnings before interest and taxes advancing to \$4.4 million from \$1.5 million, reflecting efficiency moves at Catelli and Laura Secord. Performance in the Agri products division suffered in a weaker demand environment but profits are now turning up. In the first quarter, Labatt's earnings results reflected the leaner operating stance as the company managed an earnings advance of 22% (85c versus 75c) on a sales gain of 12.2%.

Labatt is well situated to continue its growth trend. The working capital and general financial condition is strong, cash flow is rising and it is expected that internal funds will be sufficient to handle capital expenditures totalling \$180 million over the next five years. The company is directing its efforts toward developing on the present operational base, including acquisitions of closely-related operations, introduction of new products and services, etc. Recently, Labatt increased its interest in Brazil's third largest brewery to 39% and purchased a California-based natural food chain. **Selling at a low multiple and offering an above-average yield, the stock is attractive for purchase.**

MOLSON (\$14 3/4) — Difficulties in retail merchandising which caused lower profits in 1975 have been overcome, as earnings per share advanced by 20% in 1976 and a continuation of the favorable trend is evident. For the first half ended September 30, earnings were ahead by 13% to \$1.31 per share from \$1.16, while sales showed a similar advance.

It is expected that the company will continue to outperform the Canadian beer industry, primarily through additional marketing emphasis in areas where sales are below average and good growth in exports. Capital expenditures for brewing over the next five years will total more than \$100 million. The building supplies division has made significant progress, as sales have more than tripled since 1972 and an additional 25 major home centres are scheduled by 1980. Management appears to have its retailing expenses under better control, with resulting improvement in margins and there still appears to be ample scope for further advances. Molson's other activities will show little upward momentum until the economy shows more spark.

We foresee an earnings gain of 13% this fiscal year, to be followed by a similar increase in 1978. The company has about one-quarter of its operations in Quebec. **The stock is attractive in view of its prospects and can be purchased.**

	Recent Price	Earnings Average Growth (5 years)	Earnings Per Share			P/E Ratio '77 Est.	Indicated Dividend	Indicated Yield	Price Range 1975-1976
			1975	1976	1977 (Est.)				
Labatt	\$15 3/4	9.4%	1.84	1.89	2.10	7.5	\$1.10	7.0%	21 - 14 3/4
Molson	\$14 3/4	9.0	1.43	1.72	1.95	7.6	.864	5.9	22 3/4 - 14 3/4