

Canadian Investment Letter

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THE DISTILLING INDUSTRY

Statistics pertaining to the U.S., the major world market, and Canada, indicate that growth in adult per capita liquor consumption has stabilized in recent years. It seems that more people are drinking less and sales figures are primarily reflecting the increase in the number of adults of drinking age. The gain in liquor consumption in 1975 amounted to just 1.9%, held back by lower real disposable income, high unemployment and a shift to wine.

CONSUMPTION TRENDS IN U.S. MARKET

	Liquor (Gallons)		Wine (Gallons)	
	Per Capita	Adults	Per Capita	Adults
1960	1.31	2.17	.88	1.46
1965	1.52	2.58	.94	1.60
1970	1.83	3.05	1.26	2.09
1973	1.93	3.01	1.61	2.51
1974	1.97	3.03	1.62	2.49
1975	1.98	3.02	1.70	2.58

Wine is continuing to show a good growth rate and appears to be accounting for an increasing share of the alcoholic beverage market. Preliminary estimates indicate that 1976 will be another good year, with the imported brands experiencing especially strong demand. Industry forecasts suggest excellent future potential and this fact has not gone unnoticed by the liquor companies, as a good number have already positioned themselves in the market.

The trend in consumer taste continues to be away from whiskies to the lighter tasting white liquors which carry lower profit margins. In 1975 liquors such as vodka and rum posted better advances than whiskies. In the whiskey sector, imported spirits including Canadian, outperformed U.S. brands but growth was mainly in the lower profit bulk whiskey markets. Imports of bottled whiskey where Walkers and Seagrams are powerhouses actually declined last year.

In view of the slowdown in traditional products, the industry is diversifying into faster growing segments of the market and attempting to streamline marketing operations to feature brands which

STOP PRESS RE QUEBEC ELECTION

The surprising win by the Parti Quebecois in the Quebec provincial election has focussed the investment spotlight on the future outlook for companies based in the province. Our initial advice is to "stand pat" while heads cool and thoughts clear on the issue. More detailed comment will appear in next week's investment letter.

offer the best returns. As well, companies are building up sales revenues through increased penetration of overseas markets. Both Walkers and Seagrams have substantial international business on which to build, reporting last year that more than 20% of their revenues originated outside North America. It is significant that foreign earnings remain outside the jurisdiction of the AIB program. Earnings of these companies have traditionally been subject to adjustments for currency translations and this factor seems likely to take greater significance in the future as foreign business is expanded.

SALES PERFORMANCE IN 1975

	(Percentage Change 1974-1975)	
	U.S.	Canada
Liquor	+1.4	+2.4
Wine	5.2	5.0

DISTRIBUTION IN U.S. LIQUOR MARKET

	1965		1975	
	Millions of Gallons	% of Market	Millions of Gallons	% of Market
Total Whiskey	203.9	67.9	238.6	53.2
Total U.S. Whiskey	151.5	50.0	134.2	29.9
Total Canadian Whiskey	19.6	6.5	47.8	10.7
Total Non-Whiskey	96.2	32.1	209.5	46.8

Liquor sales bounced back earlier this year in line with higher GNP figures. A strong recovery phase has not yet been indicated and the slower than anticipated economic pace which has shaped up since spring is likely to postpone the upswing. The "trading down" process during the recession

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period curiously enough did not affect the premium brands as much as it did products in the middle range. At this stage it appears that most customers are still content to buy lower-priced brands.

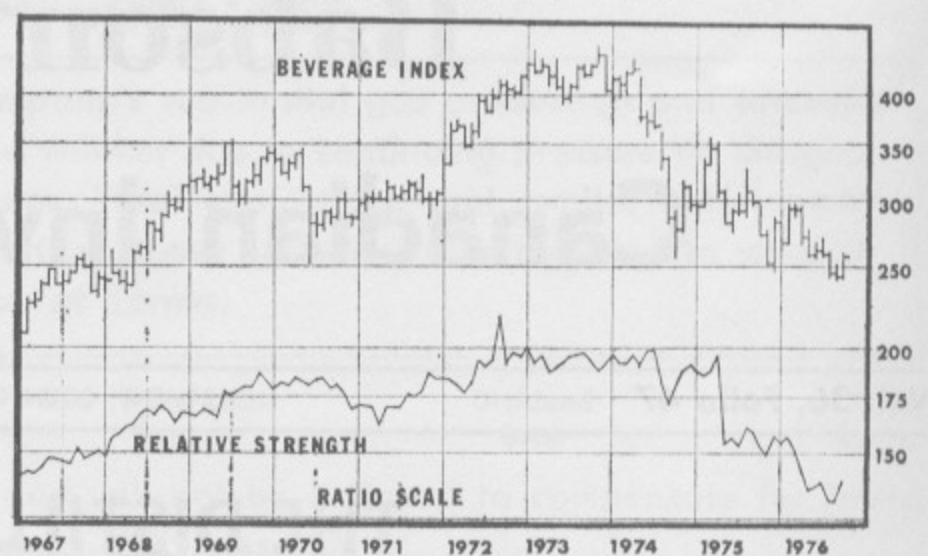
Prospects are that the industry will continue a modest recovery from the recession lows and the rate of economic progress will be instrumental in determining the strength of the trend. The fact that the potential market is growing is especially favorable for expansion of sales. It is estimated that over the next decade the total U.S. population will grow by about 10% while the heavy-consuming 25-44 age group will increase in excess of 30%. In view of recent trends, it appears that the preferred companies in the industry will be flexible in adapting to consumer preferences, have foreign expansion under way and possess good representation in wine, which is becoming increasingly competitive because of its "lighter" taste and cheaper price.

The distilling stocks in the past have consistently displayed earnings growth, but the recession and high inflation levels took their toll in 1975, producing earnings declines. Investors have been according the issues a lower multiple and the respective P/E ratios are now more in line with the TSE Industrial Index. The Beverage Index, where Seagram and Walkers carry a 78% weighting, recently fell to the level of March, 1968. While the immediate outlook suggests caution, we see longer term values and at this time recommend accumulation of Seagram for investment accounts because of its strong wine operations and growing earnings contributions from oil and gas. Our comments on the specific companies follow.

SEAGRAM (\$22 ³/₈) — Earnings over the second half of the fiscal year ended July 31, displayed a firmer tone as full-year results advanced by 9% to \$2.30 per share, just under the \$2.33 reported in 1974. Sales were ahead by 9% to exceed \$2 billion for the first time.

The world's largest producer of distilled spirits is taking measures to improve its longer term returns through expansion in foreign markets, including Japan and South America. The company has become an important marketer of wines in the U.S. and these operations should produce a good rate of growth. In the tight markets that prevailed last year, Seagram was forced to make a major reorganization of its marketing activities, including the upgrading of personnel, the closing of several sales companies and

TSE BEVERAGE INDEX



more promotion of successful lines.

The diversification into oil and gas has proved to be an attractive area for developing additional profits and earnings in this sector are likely to grow more rapidly than spirits and wine. The company has high hopes for the energy sector and we expect continued spending for additional exploration acreage and development of new production. In view of the company's underlying strengths, **the stock offers merit for longer term price recovery and is recommended for purchase at these levels.**

WALKERS (\$28 ⁷/₈) — Evidence of a turnaround was visible in the fiscal year ended August 31 as earnings rose 9.2% to \$3.21 per share. Sales net of excise taxes increased by 5.2%. Acting as favorable influences were higher unit sales, better prices, improved cost control and lower interest costs. Negative factors which held back reported earnings were foreign exchange losses because of the devaluation of the pound sterling and higher goodwill charges in connection with a 1974 acquisition.

In the U.S. market, whiskey sales remained soft, although cordials, liqueurs, cognac and kahlua, lucrative sales areas for Walkers, continued to record advances. The Canadian market made a positive contribution and the reporting of results was aided by the appreciation in the Canadian dollar during the fiscal year since the company's accounts are expressed in U.S. currency. The international sector made an improved showing despite the devaluation of the pound as scotch sales were up appreciably.

Walkers has not diversified outside the beverage industry and will be dependent on its ability to meet changing consumer tastes and expand in world markets. The recent pause in the economic recovery may delay progress in the distilled spirits market as well as the recovery in bottled whiskey sales, and the stock is rated as an attractive hold at this time.

COMPARATIVE STATISTICS

	Recent Price	Revenues Average Growth (5 Years)	Earnings Per Share			P/E Ratio '77 Est.	Indicated Dividend	Indicated Yield	Price Range 1975-1976
			1975	1976	1977 (Est.)				
Seagram	\$22 ³ / ₈	6.6%	\$2.11	\$2.30	\$2.45	9.1	\$.80	3.6%	36 ⁷ / ₈ - 21 ⁷ / ₈
Walker G & W	\$28 ⁷ / ₈	3.6	2.94	3.21	3.55	8.1	1.40	4.8	43 ³ / ₄ - 26 ¹ / ₄