Beverage market update

Industry Consulting Team | Q1 2022

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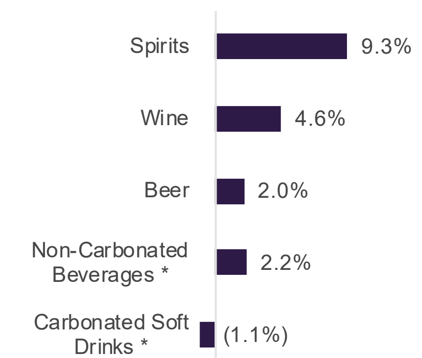
Table 1

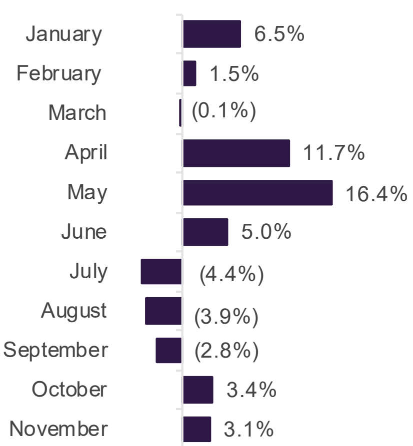
Total Beverage Industry Volume 2021 vs. 2020



** CSD & NCB data as of Q3-21*

Table 2

2021 vs. 2020 US Beer Volume Dom & Imp Shipments by Month



1: Unless otherwise noted, YTD and YoY statistics throughout the newsletter reflect data through December 2021

TRUIST

Highlights

- The total Beverage category continued to perform well in 2021; volumes and pricing have sustained and in most cases surpassed 2020 levels, although degrees of softness developed through H2 of 2021
- Beer shipments climbed 3% YoY through FY21; despite very tough comps in Q3 and Q4
- Wine & Spirits accelerated growth trends and emerge as strongest segments of Total Beverage Alcohol
- Non-Alcoholic (NA) beverage volumes yield mixed results through Q3 of 2021, Carbonated Soft Drinks (CSDs) face steep 2020 comps while Non-Carbonated Beverages (NCBs) continue growth trajectory

2021 Industry Trends & Observations [1]

BEER: Beer trends continued to grow with total domestic + import volume increasing ~2.0% through FYE 21. Domestic shipments were essentially flat with 0.4% growth, while import shipments carried the category gaining 9.5% in FY21. Strong import trends reflect an improved international supply chain, although a full restoration of import supply still has a ways to go, but strong consumer demand remains leaving imports and primarily Mexican beers as one of the industry's strongest horses. Mexican shipments which accounted for nearly 75% of all US imports increased 13.6% in FY21. Hard seltzers remained the other hot sector in broader beer, although the insatiable demand and interest in hard seltzers began to plateau in H2-21. Hard seltzers will approach $6Bn in sales in FY21 and the segment is still growing in the +20% range. Seltzers and RTDs are arguably the most competitive space in all of beverage right now. Within trade channels the Off-Premise observed modest declines of ~4% in FY21 following extremely aggressive comps in the prior year; while the On-Premise trade jumped more than 60% YoY in FY21 as bars and restaurants reopened after the 2020 Covid induced closures. Notably, the latest wave of the Omicron variant has stymied the On-Premise resurgence with each of the last 3 and 6 month growth trends decelerating from the snapback in early 2021.

SPIRITS: The spirits sector continued to demonstrate strength over other bev-alcohol industries with YoY volume growth of 9.3% through 2021. Similar to hard seltzers in the beer category, Ready-to-Drink (RTD) or canned cocktails have emerged as a growth engine within the broader spirits sector posting +42% YoY growth on a still small but rapidly expanding base. Spirit based RTDs are becoming a meaningful competitor to malt based hard seltzers despite sales channel restrictions and generally higher price points due to higher tax levels. Tequila is the other rising star in spirits gaining +18% volume YoY. Tequila and similarly mezcal brands have observed years of consistent growth, but through FY20 and 21 growth has accelerated accounting for nearly 20% of the spirits industry. Whiskey continued to show strength with yet another year of strong gains with volume growing 5.4% in FY21. Whiskey's ongoing growth is impressive given the segment's size as the second largest spirit category by volume and the largest category by revenue. Other spirits segments demonstrated mixed results with vodka declining (1.4%) as well as gin which fell (3.6%) while rum was flat YoY through FY21.

WINE: Total wine volumes increased just over 4.6% in FY21 led by Sparkling and Table wine segments. Sparkling wine snapped back from a challenging 2020 with volume growth of 29% YoY through FYE 21. Table wines had another strong year in FY21, increasing more than 3.2% for the total category. Domestic table wines plateaued demonstrating minimal growth up only 1.3%, while imported table wines drove the category increasing 8.3% through FYE 21. Table wines still make up more than 80% of total wine sales, so strong table wine performance is critical to the category's health. Much like the other beverage alcohol sectors, product innovations have become a focal point. Wine based RTD beverages have joined the market vying for shelf space in the ultra competitive hard seltzer space. Trade channel sales for wine were similar to the trends mentioned above. Off-Premise sales were effectively flat for FY21 falling less than (1%) on the year while the On-Premise trade was up nearly 56% in FY21 illustrating outlet re-openings and continuing consumer demand.

NON-ALCOHOLIC: Total Non-Alcoholic beverages (NAs) delivered mixed results YoY through Q3 of 2021 comping some of the pantry loading and panic buying weeks of 2020. Energy continued to lead the category in growth through Q3-21 at 13.7%. Carbonated soft drinks have slowed facing tough comps from FY20 along with the ongoing shift to other more health-conscious carbonated beverages. Keurig Dr. Pepper (KDP) led in CSDs with 1.9% volume gains, ahead of PepsiCo's 0.4% while The Coca-Cola Company trailed declining (1.5%) through Q3-21. In total CSDs declined (0.8%) YTD. Enhanced and flavored waters are another expanding category within NAs and one of the direct beneficiaries of the increasingly health conscious consumer. Enhanced and flavored waters gained 8% YoY, followed by plain bottled waters +6.3% in volume at YTD Q3-21. The "Healthier / Better-For-You" trend is still clearly a top influencing factor of consumers' purchasing decisions. Additionally, a series of acquisitions and corporate partnerships have brought companies historically focused on the non-alcoholic sector into the alcoholic world and vice-versa; this new set of competition will certainly have an impact on the market and could materially change the landscape of the beverage industry in the years to come.

Beverage Sectors In-Focus

The Automation Evolution of Distribution – The COVID pandemic has caused countless problems and challenges from travel restrictions to office and school closures to the relentless backlog and delay of supply chains. COVID has also accelerated certain trends such as the migration of consumers to online shopping, even for lagging industries like grocery and beverage. One other noted acceleration has been the continuously shrinking workforce that has driven labor cost higher and higher. What was once a battle between peer companies over a similarly trained labor pool is now opened up to nearly every company all competing on wages, benefits, sign on bonuses and other perks regardless of the role in fast food, department stores and of course Amazon. In particular, beverage distributors have experienced dramatic shifts in their businesses. With the significant expansion of brands and SKUs being managed and distributed daily, a distributor's supplier management has never been more complex. At the same time, the labor pool has continued to shrink leaving delivery and warehousing functions understaffed, overly stressed, and inefficient. **Continued to the following page…**

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Table 3

US Wine Industry
YTD December 2021 vs. 2020

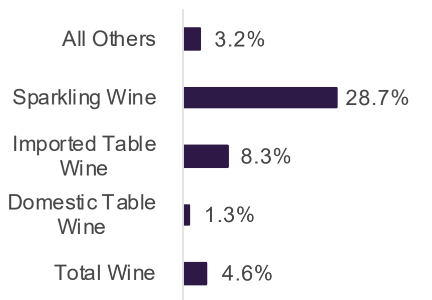
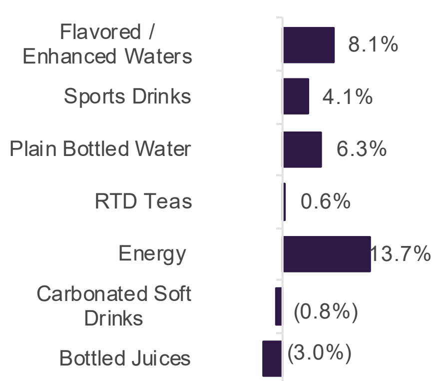


Table 4

US Spirit Industry Volume
YTD December 2021 vs. 2020

Table 5

Total Non-Alcoholic Beverages
YoY Q3-21 Volume Trends



Beverage Sectors In-Focus (Continued)

To counteract the lack of labor and the effects of rising wages, distributors are leaning in on technology and looking for increased efficiencies in automation. The idea of incorporating automation into a distributor's operations was once only feasible for the very large operators; but now through technological improvements, automation systems can provide material operational savings and yield needed ROI's for companies much smaller in comparison to historic norms. Throughout 2021, many companies sought out various types of automation improvements that could help fend off the lack of available labor and the increasing costs of what labor that could be hired. Across many markets automation and labor costs have crossed an imbalance causing beverage distributors, along with others, to investigate and invest in automation to create efficiencies in their operations and hedge against rising labor costs on a diminishing labor pool. Operators with case volume as low as 2MM cases have found ways to integrate automation.

One of several companies providing automation services and equipment to distributors is Cirrus Tech. Cirrus Tech offers both a semi-automated option primarily designed for operators in the 2MM-8MM case range and a fully automated option that focuses above the 8MM CE mark. Automation designs come in many different forms and in most cases are built / designed to address each company's specific challenges, which can be the result of various factors such as warehouse flow and design, market nuances, portfolio composition, among others. Generally these automation investments are targeting an ROI ranging between 2 – 5 years depending on the SKU count, portfolio complexity, and operations. As distributors have benefitted from various product innovations that have improved revenues, they're increasingly focusing on technology and data as a way to systemically improve operating efficiency and cash flow production. Truly leveraging this technology and the data that comes from it has become a differentiator in the market for some.

Despite numerous factors supporting automation investments, there still remain some risks. If not properly designed / engineered for the business, the SKUs, the portfolio and routes, etc., reliance on ill-equipped and/or ill-designed systems can lead to major problems. Horror stories, albeit few and far between, scatter the industry describing major investments that ultimately fail to yield the targeted results. Worse yet, some create more inefficiency and challenges than improvements. And then what solutions exist when automated systems have mechanical failures? Despite these very real concerns and risks, automation is the next phase in the evolution of most beverage distributors.

Merger & Acquisition Activity Still Sizzling Hot – 2021 closed out the year with what else but more deals closing. Lion / New Belgium completed their acquisition of Bell's Brewery, Tilray (owner of SweetWater Brewing) acquired Breckenridge Distillery, and Redwood Capital closed on their acquisition of Heidelberg Distributing. Based on the deal flow being announced thus far through 2022, it doesn't look like there will be any hangover as the new year kicks off. Within the first week of 2022, Breakthru Beverage announced the acquisition of Missouri's Major Brands. The very same day RNDC announce plans to acquire the Anheuser Busch distributorship in Alaska from K&L Distributors. And just last week Monster broke news they would officially be entering the beverage alcohol sector through the acquisition of CANarchy for $330MM. Certainly there's a chance some of these deals were planned for a 2021 closing and could have pushed into 2022 for a variety of reasons; but more importantly all indications and market chatter suggest the strong M&A activity will continue through 2022.

What's driving the rapid pace of deals? Throughout 2021, we observed a lot of transactions getting done with big valuations supported by very low interest rates and an abundance of liquidity in the market. Buyers were positioned with dry powder to make acquisitions and the looming threat of potential capital gains tax increases added extra incentive for sellers who were on the fence of exiting. While concerns of capital gains increases have broadly abated for the time being, many of the same influencing factors still remain. Market liquidity and financing capacity remains robust from lenders as well as the non-bank financiers, and interest rates are still at near historic lows. Thus far through the early part of 2022, deal activity is keeping pace with 2021 and there are no signs of it slowing down. We expect valuations to remain high in the near term with the chance to push even higher as buyers aggressively pursue a competitive deal marketplace.

A bigger universe of buyers. As we've covered in previous memos, there is a blurring of lines underway between beverage categories be it alcoholic compared to non-alcoholic or even beer vs. wine vs. spirits segments in beverage alcohol. The crossover of companies into adjacent industries has introduced a new set of buyers and upped the ante on valuations and competition. Two very recent examples include Tilray / SweetWater's acquisition of Breckenridge Distilling and Monster's entry into beverage alcohol with the acquisition of CANarchy. No longer are companies content to stay in their historic silos, but rather buyers and sellers are now looking at other companies in contiguous categories as a partner for future growth as well as an exit strategy.

Our crystal ball. Deals have a unique way of leading to more deals. Given the energy permeating through nearly every beverage category, we see values remaining high to possibly edging higher over the near term. Mid to longer term, we expect market dynamics to apply some form of downward pressure. A rise in interest rates and or the tightening of liquidity sources all drive the cost of capital upwards and have the corresponding opposite effect on valuations. The timing of these changes among others are clearly uncertain, but nonetheless represent risks to the currently very strong environment. While the market inevitably ebbs and flows, we expect 2022 will run full tilt based on strong deal dynamics… a lot of buyers looking for deals, lots of liquidity, and a compressed cost of capital will keep the headlines rolling in 2022.

Sources: bw166, Beer Institute, DISCUS, Beverage Digest, Brewers Association, Nielsen, CGA