INDEPENDENT IBG BEVERAGE GROUP

Consolidation Realities….

January, 2009

IBG is committed to continuing the process of reducing cost, improving DSD performance and creating value through distributor consolidation. The purpose of this message is to offer our view of the industry with regard to today's realities of beer distributor consolidation. We acknowledge that some believe, and in certain circumstances may be right, that several small distributors in a given geography may be better than one large distributor. However, we are convinced that the economic scale advantages created by mega distributors are the future of beer distribution. We also believe that the smaller distributors will be less profitable and, therefore, have a lower equity value than today.

We have worked closely with distributors, suppliers, consultants, and many others in order to form our opinions. In addition, IBG continues to be the largest team specializing in the consolidation of beer distributors. This paper will focus on four areas of consolidation we feel need discussion. (1) Price/Value: What will a distributorship be worth moving forward, (2) Pressure: The pressure points of consolidation, (3) Process: Supplier approval issues, (4) People: The need to work with professionals who don't create unattainable expectations while maximizing value.

Price/Value: This is probably the most often discussed and least understood issue at the present time. These discussions are a natural by-product of supplier pressure and the increasing frequency of consolidations. Unfortunately, what the industry is struggling with is 'selling distributors' letting extreme price/value information, whether factual or not, influence their expectations of value. Many sellers seem to feel that they are being forced to sell, whether by suppliers or industry dynamics, and therefore, the buyer should pay a higher price. They also rationalize that their value can be determined by what someone else may have sold for. As a result, the industry has moved from fair value to punitive damages. The reality of value has given way to gross profit multiple one-upmanship! Recently, however, buyers (and banks) have been pushing back. In fact, many buyers are simply refusing to negotiate in response to inflated asking prices. Seller expectations and demands have ballooned beyond reality and this disconnect will slow the pace of consolidation until more reasonable views return. As proof of what we have stated we are currently aware of a number of potential transactions (7 declared sellers) with over 30 million total cases for sale and no buyer willing to waste time and money negotiating what they perceive to be unrealistic prices. This is unprecedented in our industry. Unrealistic asking prices are complicating an already difficult process. At IBG we are 100% commission based so the more we get for our clients the more we get paid. We are very strong advocates for getting top dollar. We are convinced that current price (not value) expectations are stopping deals that need to happen. These expectations heighten emotions when sellers and buyers should be focused on the reality of value not trying to get more than they think someone else got.

We believe each market has a narrow range of value that will work for buyers, sellers, suppliers and banks. We understand that the objective should be to maximize value, but this can only be achieved if both parties are willing to work together. If either party becomes discouraged or feels like they are being taken advantage of, it takes a long time to recover momentum and often simply kills the deal. IBG's experience is that most acquiring distributors are willing to pay a premium price if it can be justified within the transaction. This willingness of buyers to share potential synergies with sellers has enabled consolidation to steadily move forward. Now, some sellers and their advisors are getting much too aggressive in terms of price. If this continues, savvy buyers will increasingly see the advantage of waiting for prices to decline. In fact, we believe prices peaked in the summer of 2008. We already know of a few mega distributors who have changed their attitude about paying premium prices. Let's hope greed doesn't screw up what has been a healthy process for both for buyers and sellers.

Pressure: Many industry pundits predicted a dramatic acceleration in consolidation in 2008 and, in fact, that is just what happened. Historically, distributors have been consolidating at a rate of about 75 per year. In 2008 that number increased to approximately 125. Our forecast for distributor consolidations is about 100 each year for the next 5 years. This will leave about 600 full service DSD distributors doing over 85% of the industry's volume and 250 of these doing over 60%. Increased pressure will come from supplier consolidations and the ripple effect these will have on the system. This is a relatively new phenomenon. MillerCoors has been the most aggressive at consolidating their system. The old AB had been relatively passive; but, AB InBev will become more proactive in order to reduce its structural cost and regain the competitive advantage it historically enjoyed in the capability of its distribution system.

IBG expects slower profitability in 2009 and this will pressure some of the distributors that are on the fence to sell. While most distributors have done a solid job of reducing controllable cost, they will continue to be hit as suppliers and retailers force their increased costs down to the distributor. Another issue will be the slowing of the "Better Beer" category. This trading down will depress distributor's margins. Margin and volume pressure will escalate rather quickly if discounting escalates, excise taxes are imposed or the economy continues its decline.

There is also a significant new pressure point emerging. Small suppliers have recently demonstrated a willingness to go into the AB InBev system. During the fourth quarter, IBG closed several transactions on the West Coast with about $100 million in combined gross profit. Historically, all of this would have gone to the MillerCoors system because of the exclusivity incentive from AB. However, $14 million went to the AB InBev system. If this trend continues, this could reshape the consolidation outcome for many of the non-consolidated markets. So, while we talk mostly about Big Two consolidation, the suppliers that may have the most influence in a transaction could be a combination of small suppliers. Their decisions will affect value and service in both the MillerCoors and AB InBev distribution systems.

Finally, on an unexpected note, we see less emotional attachment to distributorships than in the past. We have noticed a more pragmatic view from beer distributors. There will always be a few die-hards who will never willingly sell their business for emotional reasons; but, this attitude has changed in the past year. We believe that the math of families coupled with the fast pace of supplier consolidation and resultant break down of loyalty to and from suppliers has torn down many of the old emotional barriers. Being the “Beer Guy” is still cool but it’s not as much fun. As the industry is forced to reduce redundant cost and create new value added services, the pressure applied to consolidate will continue to take its toll and emotions will continue to give way to good business decisions.

Process: The ability to sell a business is now more difficult than ever. The AB InBev distribution system is trying to catch up in terms of consolidation and portfolio diversity as fast as possible. This means we no longer know for sure where many ‘secondary’ brands will go in a given transaction. IBG has extensive experience with virtually every supplier but even we are occasionally surprised by distributors that are approved or disapproved. This new trend complicates the process because once a seller accepts an offer for an entire business and any supplier disapproves the proposed purchaser the designee often tries to leverage their approval at the expense of the selling distributor. This could cause the seller and initial buyer to renegotiate the original deal. Further, the seller’s original deal is often threatened because the supplier’s new designated distributor has a difficult attitude which slows or completely negates the entire transaction. The new party to the transaction may even have an incentive to be difficult because, if the original deal falls apart, his competitor could be left with a distressed organization. IBG is experienced at working through these very real problems which are creating chaos in transactions. All suppliers play a role in transactions so it helps to work with people who are well respected and have good relationships with the supplier community.

People: The team you chose to assist you in the buy/sell/merge process is critical. We use the word team because it truly takes an experienced group to help a distributor through the increasingly complex consolidation process. You will need a group that understands the industry to help you develop a workable strategy and execute it through closing. Obviously, good legal and accounting assistance is necessary. Usually, however, local professionals are not well-versed on the uniqueness of the beer business. Your team must not get hung up on things that don’t matter. The process needs someone with experience and a healthy working history with suppliers. Every transaction needs someone on both sides who can keep the process moving forward. Accountants run numbers, lawyer’s debate language, and suppliers have their own agendas. Good transaction professionals provide leadership and keep everyone focused and moving toward the finish line. We encourage you to personally visit with anyone you are considering as a transaction leader. The people you chose to help you through the buy/sell/merge process will determine your success. Do your homework. Check references.

Summary: For the past several years the beer industry has had volume and margin growth coupled with easy credit and aggressive mega distributors paying premium prices which has promoted distributor consolidation. But the consolidation model has changed. The future will be marked by slower volume and margin growth, restricted credit, and less aggressive mega distributors. Yet, supplier pressure to create mega distributors will escalate. Values will probably begin to decline and exiting the industry will become more and more difficult. Distributors of all sizes and shapes will find it harder to grow profitability and will be constantly dealing with increasing supplier interference. If you are considering buying, selling, or merging, do your homework, understand your options and work with proven professionals who have enough experience and industry credibility to maximize value.

IBG is committed to creating transactions that work. We understand the industry and work very hard to help you develop and successfully execute what you want to do. IBG looks forward to hearing from you.