The Boston Beer Company

Report

To: Martin F. Roper, President and CEO

From: Chris Brown, Consultant from Christopher Consultants

CC: Executive officers of The Boston Beer Company,
Thomas Lance, VP of Operations
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Date: 5/2/2011

Re: Mini-Keg and Expansion into California Recommendations

Executive Summary

The Boston Beer Company began operations over twenty-five years ago with Jim Koch brewing a recipe formulated more than 150 years for the signature Samuel Adams Boston Lager. Over the last twenty-five years, the company has experienced incredible growth and become the "largest craft brewer and the largest independently-owned brewer overall in the United States." It currently brews its beer in three breweries owned by the company and several others that are operated under services arrangements with other companies.

The company has continued to grow in every respect over the past five years even though revenues dropped across the beer industry and competition has increased. The company has been able to achieve its success by operating under a business strategy that appeals to its core competencies and focuses on the quality of its Sam Adams products.

Due to the company's reliance on the premium created by brewing a quality product, the company has only packaged its products in bottles and standard kegs. The company should expand its product selection by selling mini-kegs. These mini-kegs increase the potential audience for Sam Adams products by appealing to drinkers who purchase canned beer.

While the Samuel Adams brand is nationally recognized and distributed throughout the country, all of its production facilities are located in the eastern United States. This geographic limitation makes distribution expensive and inefficient. The company should expand its production to California in order to lower distribution costs and become a truly national company whose products can be found anywhere beer is sold.

I. Industry Analysis

The beer production industry in the United States has been in decline with total industry revenue declining at an average annual rate of 1.6% since 2006 (Kaczanowska). Nevertheless, IBISWorld, an industry analysis firm, expects this trend will reverse in 2011 and forecasts an increase in total industry revenue by 2.4%. IBISWorld projects that industry revenue will continue to grow at annual rate of 1.9% over the next five years reaching $31.6 billion by 2016 (Kaczanowska). This increase in revenues will be due in large part to the growth of the craft and premium beer segments which is expected to offset a contraction in total sales volume. The higher prices of these craft and premium beers will help expand the profit margin of the industry by .6% resulting in an industry profit margin of 11.7%.

Product substitutions and slowed consumer spending are two of the major causes of the decreasing revenue in the US beer industry over the past five years. Consumers are becoming increasingly knowledgeable and health-conscious which has caused them to trade up for higher-quality products. According to IBISWorld, "this trend has stimulated growth in the premium and craft beer segments, but to the detriment of high-volume sales of beer" (Kaczanowska). The increased competition in the beer industry coupled with rising production costs have led to mergers and acquisitions in the beer industry.

In 2008, InBev, a Belgium-based brewery, acquired the largest American brewer, Anheuser-Busch, for $52 billion. The combination of Anheuser-Busch and InBev created the single largest brewer in the world and one of the world's top five consumer products companies (Annual Report, AB-InBev). Even before InBev's purchase of Anheuser-Busch, InBev had identified $1.5 billion in cost synergies that could be eliminated over the course of three years (Spain). In order to stay competitive with this industry giant, the number two and three beer producers in the United States, SAB Miller and Molson Coors, decided to combine their US operations. In 2008, SAB Miller and Molson Coors created a jointly owned US subsidiary named MillerCoors. As a result of this consolidation, MillerCoors had anticipated cost reductions of $500 million over the first four years of combined operations. MillerCoors was able to achieve 40% of these cost saving measures in the first year alone (MillerCoors LLC).

While these combinations have created cost synergies for the industry's major players, they have failed to stimulate greater demand for their products. American consumers cut back on bulk beverage purchases and opted for more exotic substitute products of wine and spirits. These substitution products slowed industry sales as a whole even as consumers showed a significant interest in craft and premium beers (Kaczanowska).

The craft beer segment is one of the most promising segments of the US beer industry. According to the "Brewer Almanac 2010" produced by the Beer Institute, there were only 44 breweries in the United States in 1979, but by 2008 there were 1,679 breweries (Brewers Almanac). This increase in the number of breweries by 3,816% is due in large part to specialty breweries. In 1979, there were only 2 specialty breweries in the United States, but by 2008 there were 1,659 specialty breweries. This increase in the number of breweries has spurred greater competition and led to a very saturated domestic beer market. While American specialty breweries far outnumber those of the large multinational players, craft breweries only represent about 5.9% of industry revenue (Kaczanowska)

Overall, the beer production industry has suffered from declining revenues over the past five years, but still has a positive outlook for the future as both revenues and profit margin are expected to increase. Per capita consumption of mainstream American beer produced by the two major players is declining as preferences shift to premium drinks. The one segment that shows promise, the one Sam Adams operates in, is the craft brewing segment.

II. Competitor Analysis

Two companies, Anheuser-Busch InBev (AB-InBev) and MillerCoors LLC, dominate the American beer market. Together, they represent 74.3% of the U.S. beer production market (Kaczanowska). Due to their size, these two companies experience large economies of scale that lower production and distribution costs. Their national scale also makes their national advertising campaigns more cost effective because their beers can be bought at virtually any store or bar. While these two companies dominate the market, their flagship beers Bud Light, Miller Lite, and Coors Light are all light lagers which are very similar in taste. The similarity of their products forces these companies to differentiate their products by utilizing innovative advertising.

According to Market Watch, AB-InBev spent a total of $1.36 billion dollars on advertising in 2007. AB-InBev spent about two-thirds of that on trade promotions, sponsorships, and point-of purchase ad space while the remaining $475 million was spent on TV, radio, magazines, and the Internet (Spain). Many of these advertisements focused on creating brand focus and loyalty, but ignore the product itself. Some of the most memorable advertisements used by AB-InBev include the Real Men of Genius campaign, the "what's up" campaign, and the bud-weis-er frogs. One of the common themes demonstrated by these campaigns is the focus on how Budweiser is fun and funny, not how it is a superior product.

MillerCoors tries to differentiate itself from AB-InBev by using advertisements that focus on the associations that consumers make to their beer. Miller's current advertisement campaign tells the consumer to "man up" and drink beer with "great pilsner taste." This campaign features a man wearing feminine products such as a purse or tight jeans ordering a light beer at the bar where he tells the bartender, "I don't care how it tastes." The bartender responds, "When you start caring, put down your purse and I'll give you a Miller Lite." The commercial ends with the man deciding he wants a Miller Lite and the slogan "Taste Greatness." While this commercial does try to differentiate its product by demonstrating that its product has "triple-hop brewed" great taste, the commercial's underlying message is that drinking Miller Lite is masculine.

One of the major challenges facing these two major players is avoiding product cannibalization. Their products attract similar consumers and an increase in one product's sales usually leads to a decline in another product. MillerCoors produces both Keystone Light and Milwaukee's Best Light which are both low-end high-volume beers. The market for these products is largely a fixed-pie where the increased sales of Keystone Light will decrease sales of Milwaukee's Best Light or vice versa.

While the major players constitute 74.3% of the US beer market, smaller breweries also pose a threat to The Boston Beer Company. Regional breweries such as Yuengling and Son Inc command a loyal local following. Yuengling and Son is the oldest brewing company in the United States and was founded over 100 years ago (Kaczanowska). The company's products are distributed in eastern states from New York to Florida. Due to its geographic limitations, Yuengling and Son does not use national advertising which would be cost ineffective. Instead, it focuses on point-of-sale promotional items such as neon signs and glassware. Yuengling's lack of national advertising means that it does not have national recognition as a brand and can only compete regionally. Yuengling and Son's estimated market share is less than 1% (Kaczanowska)

Craft breweries in the United States tend to be mostly regional due to the difficulty and high expense of managing national marketing and distribution. Beer is difficult to ship across the country due to its low price per weight. Because the states were given the exclusive right to make laws pertaining to alcohol after the end of prohibition, laws regulating the beer industry differ from state to state. These laws create a barrier of entry for small breweries to expand out of their geographic location. Nevertheless, the federal government still regulates the beer industry through the three tier system.

III. Regulation and the Three Tier System

The three tier system was established after the end of prohibition and was intended to both increase regulation of the beer industry and prevent monopolies. Under the three tier system, brewers are not allowed to sell directly to consumers. Instead, breweries sell their beer to licensed distributors who in turn sell the beer to licensed retailers. Finally, licensed retailers sell the product to consumers. The only exception to this law is that some states allow breweries to sell beer that they produced on-site to customers.

Instead of preventing monopolies, the three tier system has created a barrier to entry for the beer industry and created problems for smaller breweries. Each licensed distributor only distributes products within the geographic area that they are licensed. Each area usually only has two or three distributors. Due to the large market share represented by each AB-InBev and MillerCoors, they are able to receive preferential contracts for their products often at the expense of other companies. Most of AB-InBev's distributors have exclusivity contracts with AB-InBev that state the distributor can only sell AB-InBev products. Most areas have only two distributors; one who exclusively sells AB-InBev products and the other that sells MillerCoors products and everything else. Distributors are extremely responsive to the major players in the beer industry because the major players constitute such a large percentage of their sales. While the major players benefit from a system intended to stop monopolies, smaller brewers fight for limited space on trucks and in warehouses.

Small breweries have to fight not only for space from distributors, but also at the retailers themselves. Retailer shelf space has become an increasingly important battleground for small breweries. Because the major players represent such a large percentage of the revenue from the beer industry, retailers tend to give them special privileges. According to *Beer Wars*, AB-InBev actually has a position known as a set captain who is responsible for creating product layout arrangements at retail locations. These layout arrangements are intended to give AB-InBev's portfolio of over 300 brands preferential shelf space at retail locations. The design layout takes advantage of the many different packages that AB-InBev products are sold in to create a banner effect. When a customer walks into the beer aisle, he will see a grouping of Budweiser beer being sold in twelve-packs, thirty-packs, six-packs of bottles, four-packs of cans, and large cans. This large number of products all grouped together creates a Budweiser banner which attracts a customer's attention and hopefully his wallet.

IV. Analysis of The Boston Beer Company

The Boston Beer Company began in 1984 when Jim Koch began brewing a beer whose original recipe was developed over 150 years ago and passed down through six generations of Kochs. The Boston Beer Company places a great deal of pride in its heritage stating in its 2009 Annual Report that "we are proud that 25 years into the American Craft Beer Revolution, with its continual proliferation of wonderful craft beers, our flagship Samuel Adams Boston Lager still stands tall and is brewed with the original recipe." The company has grown from one man brewing beer in his basement into a publically-owned company with a national presence.

Even though customers can buy Samuel Adams throughout the country, The Boston Beer Company only has an estimated market share of 1.9% in the US according to IBISWorld. This market share continues to expand as The Boston Beer Company had one-year sales growth of 11.74% and net income growth of 61.14% in fiscal year 2010 ("The Boston Beer Company"). The Boston Beer Company is the leading craft beer manufacturer and is in a good position to take advantage of the growing craft beer market. The sales volume of the craft beer segment grew by 6% in 2008 and by 5% in 2009 despite the turbulent economic environment.

While still relatively a small company with revenues of about $453 million in 2009, the company shows strong future prospects. It currently generates consistently strong cash flow and has no debt. The company is heavily concentrated in the eastern US, with breweries in Boston, Cincinnati, and Breinigsville, PA. This eastern concentration makes distribution to warehouses in the west expensive. The Boston Beer Company will need to take measures that expand its geographic location and lower its distribution costs.

Jim Koch's passion for beer began the Boston Beer Company over 25 years ago and its excellent business strategy has allowed it to expand from his basement to a national player with three different breweries. Nevertheless, the Boston Beer Company needs to continue to innovate to stay competitive in such a saturated US beer market. The company needs to ensure that it maintains its premium status even as it becomes a mass-marketed product. The company's business strategy must attempt to keep costs low, while still producing a quality product. Samuel Adams differentiates itself from AB-InBev and MillerCoors by focusing on the quality of its product, but the company should work to differentiae its product from other craft breweries by creating customer loyalty due to its national distribution. When someone goes to a bar or liquor store, we need them to think of Sam Adams as both a delicious and an All-American beer.

V. Recommendations

1. Sam Adams Mini-Keg

Currently The Boston Beer Company exclusively packages and sells its products in bottles and kegs. While this approach helps maintain the brand's premium, it also limits Samuel Adams market share. Of the total beer production market, bottles and kegs only constitute 43.5% of the US beer market (See Appendix Item IV). Standard 12-ounce cans, on the other hand, account for 45.8%. The Boston Beer Company needs a way that it can attract this market segment without risking the company's premium beer status.

Canned beer is typically consumed during social gatherings such as parties. Many consumers do not want to spend the type of money that premium beer in bottles costs for these types of events. In order to attract these consumers, The Boston Beer Company should begin to produce mini-kegs similar to the Heinekeg produced by Heineken and the home draft keg produced by MillerCoors. By doing this, Samuel Adams will be able to maintain its premium status while broadening its product offerings and potential market share.

Consumers tend to view canned beer as a lower-end product and some consumers even believe that canned beer has worse taste. Samuel Adams needs to avoid this image in order to stay true to its core competencies. Many consumers also do not want to buy full-size kegs because they worry that they will not be able to finish it or they do not like the social stigma of a crazy party attached to a keg. Buying a keg in most states is often difficult and involves a process beyond simply going in to a store and buying the keg. For instance, in the District of Columbia, the purchaser must pay a keg deposit and fill out certain forms. There is also extra expenses associated with buying a keg such as renting a tap because most consumers do not own their own tap.

Mini-kegs avoid the difficulty of this process by simply allowing a customer to go into a store and buy the mini-keg with a tap already attached. This easy purchase scheme will encourage more consumers to buy mini-kegs. The Sam Adams mini-keg should base its size and appearance on the MillerCoors home draft keg (See Appendix Item II). This design uses more inexpensive materials which would keep packaging costs low. The home draft keg's design also makes it easier to use because it can lay flat and fit on a refrigerator shelf or in a standard size cooler.

The target price for the mini-kegs should be $20. This price still includes a premium compared to the Coors Light home draft keg which sells for $13.99, yet is less than the Heinekeg which sells for $24.99. This price will entice consumers to buy mini-keg since the price is similar to twenty-four racks sold by AB-InBev and MillerCoors. Consumers typically buy twenty-four racks for social gatherings, so a similar price will help the consumer associate the product with social gatherings.

The mini-keg will provide the consumer with the opportunity to enjoy Samuel Adams products without the hassle of dealing with a large number of bottles. The Sam Adams min-keg should be marketed to people who are looking for the social-image created by purchasing a premium beer, but still want to have a good time. In the US beer market, 32.4% of consumers are aged 21 to 34 and most consumers tend to be male (See Appendix Item III). This segment includes many people who recently graduated from college and have disposable income. The Sam Adams mini-keg will appeal to these customers due to the ease of purchase and use. It can be brought to a tailgate party in a cooler or put in a fridge for a house party. The mini-kegs will keep beer fresh for up to 30 days and all the consumer has to do is turn a knob and pour a glass of beer.

This increased exposure at social gathering will also increase the number of people who have tried Samuel Adams products. Hopefully the quality and taste of Sam Adams beer can turn a one-time drinker into a repeat consumer. The next time that the consumer is considering which beer to drink, whether at a bar or at a liquor store, ideally he will remember the excellent taste of Sam Adams and the positive associations he has for when he was drinking his first Sam Adams beer.

Sam Adams mini-kegs should be an easy addition to make to The Boston Beer Company's product line and provide numerous benefits. First, the new product offering will be able to capture some of the beer can market which The Boston Beer Company has previously avoided. Second, it will allow more people to try to Sam Adams products which will encourage future purchases. Third, this recommendation does not put the brand's value at risk of losing its premium. By producing mini-kegs, The Boston Beer Company will experience numerous benefits and have an increased rate of return on its current large cash holdings.

This recommendation to begin producing mini-kegs would use the company's large cash reserves to increase the overall profitability of the company. The company should begin making the changes necessary to produce the mini-kegs in the brewery that will be the easiest and most cost-efficient to revamp. Next, the company should begin testing this recommendation in markets where it has a strong market presence such as Boston. If the mini-kegs are deemed profitable, then their production should be increased and their geographic area expanded.

Large Scale Implementation of Mini-Kegs:

Heineken	The Boston Beer Company
Revenues • Retail kegs represent $300 million in revenue after the impact of lost sales from bottles and cans • Still scarce enough that grocers can pocket 35% to 40% gross margins on them—17 to 20 percentage points better than what they typically get on a six-pack • More bargaining power for Heineken in the US to get coveted end-of-the-aisle floor space • In 2006, Heineken sold 1.4 million of its kegs in the United States and 10 million worldwide	Revenues (Under Scenario 3) • If the sales of Sam Adams mini-kegs mimics its proportion of market share to Heinekegs, then net sales revenue equals $5,806,836 • Retailers would maintain a gross margin of 35% • Improve brand awareness because retailers would improve the shelf space of the mini-kegs due to high gross margins • Expected sales of 483,903 mini-kegs
Costs • Heineken spent an estimated $15 million on a keg production line at its giant brewery in South Holland • At full speed the new line can churn out 120,000 min-kegs per day, holding 6% of Heineken's 19-million-barrel annual production worldwide	Costs • Contributed capital cost ranging from $10,250,000-$15,000,000 • Opportunity costs
Other • "Beer lovers frequently say they prefer 'draught beer,' even though the stuff coming out of taps isn't usually different from bottled beer. The difference in taste is due to exposure to the elements." • Rate of return under scenario 3 factors is 20%	

*Heineken information from article by Stephane Fitch in *Forbes*. See appendix item I for more information regarding profitability analysis.

<u>Rate of return (Scenario 1)=(2,923,211.30/10,250,000)= 28.5%</u>

- Sales are 483,903 mini-kegs selling at $20 each
- Retailer's cost=25% of gross sales revenue, Distribution cost=5% of gross sales revenue
- COGS=$5.50 per mini-keg
- Extra sales, general, and administrative expenses=10% of net sales revenue
- Depreciation expense assumes retrofitting cost of $10,250,000 over 20 year useful life

Rate of return (Scenario 2)=(2,439,308.30/10,250,000)= 23.8%

- Sales are 483,903 mini-kegs selling at $20 each
- Retailer's cost=25% of gross sales revenue, Distribution cost=5% of gross sales revenue
- COGS=$6.50 per mini-keg
- Extra sales, general, and administrative expenses=10% of net sales revenue
- Depreciation expense assumes retrofitting cost of $10,250,000 over 20 year useful life

Rate of return (Scenario 3)=(2,052,185.90/10,250,000)= 20%

- Sales are 483,903 mini-kegs selling at $20 each
- Retailer's cost=35% of gross sales revenue, Distribution cost=5% of gross sales revenue
- COGS=$5.50 per mini-keg
- Extra sales, general, and administrative expenses=10% of net sales revenue
- Depreciation expense assumes retrofitting cost of $10,250,000 over 20 year useful life

Rate of return (Scenario 4)=(1,814,685.90/15,000,000)= 12.1%

- Sales are 483,903 mini-kegs selling at $20 each
- Retailer's cost=35% of gross sales revenue, Distribution cost=5% of gross sales revenue
- COGS=$5.50 per mini-keg
- Extra sales, general, and administrative expenses=10% of net sales revenue
- Depreciation expense assumes retrofitting cost of $15,000,000 over 20 year useful life

Rate of return (Scenario 5)=(1,094,057.96/10,250,000)= 10.7%

- Sales are 483,903 mini-kegs selling at $20 each
- Retailer's cost=25% of gross sales revenue, Distribution cost=5% of gross sales revenue
- COGS=$5.50 per mini-keg
- All Sales, general, and administrative expenses are included even if they are unavoidable and therefore S,G,&A expense=37% (percentage from the company's 2009 income statement)
- Depreciation expense assumes retrofitting cost of $10,250,000 over 20 year useful life

Rate of return (Scenario 6)=(372,653.96/15,000,000)= 2.5%

- Sales are 483,903 mini-kegs selling at $20 each
- Retailer's cost=25% of gross sales revenue, Distribution cost=5% of gross sales revenue
- COGS=$6.50 per mini-keg
- All Sales, general, and administrative expenses are included even if they are unavoidable and therefore S,G,&A expense=37% (percentage from the company's 2009 income statement)
- Depreciation expense assumes retrofitting cost of $15,000,000 over 20 year useful life

Rate of return (Scenario 7)=(1,144,630.50/15,000,000)= 7.6%

- Sales are 400,000 mini-kegs selling at $20 each
- Retailer's cost=25% of gross sales revenue, Distribution cost=5% of gross sales revenue
- COGS=$6.50 per mini-keg

- Extra sales, general, and administrative expenses=10% of net sales revenue
- Depreciation expense assumes retrofitting cost of $15,000,000 over 20 year useful life

BEP (with contributed capital cost of $15,000,000)= 315,877 mini-kegs

- Sales are 315,877 mini-kegs selling at $20 each
- Retailer's cost=35% of gross sales revenue, Distribution cost=5% of gross sales revenue
- COGS=$5.50 per mini-keg
- Extra sales, general, and administrative expenses=10% of net sales revenue
- Depreciation expense assumes retrofitting cost of $15,000,000 over 20 year useful life

Information pertaining to cash reserves and rate of return without implementing recommendation:

- The Boston Beer Company's current rate if it obtained a 20-year CD is about 4%
- The Boston Beer Company's cash holdings as of 12/26/2009=$55,481,000

Potential Future Application of Mini-Kegs

One way that The Boston Beer Company could increase the value-added cost of the mini-kegs is by making them a green initiative. This would entice planet-conscience consumers to buy and use the mini-keg. When a consumer enters a retailer, they would put down a $10 deposit on the Sam Adams Mini-keg and have it filled by the retail outlet. The Boston Beer Company would provide retailers with large-kegs that are designed to refill the mini-kegs. Customers would then pay $15-$20 to have the mini-keg filled initially. The consumer may then return to have the mini-keg refilled for $10-$15.

Once a customer has put down their deposit on the mini-keg, they would be more likely to refill the mini-keg because of the cost savings. These cost savings would result because of the lower materials cost that The Boston Beer Company would have to incur to package their products. Glass bottles are expensive and more costly to distribute than their keg counterparts. Consumers could enjoy drinking draught-quality beer at a lower price and more frequently than if they had to buy more expensive bottles. They can do all this while lessening their impact on the environment.

Each retailer would be able to refill the mini-kegs with either Sam Adams or the current Sam Adams seasonal beer. Once customers have put down their deposit on the mini-keg, they would become more likely to become repeat purchasers as refills would be cost-effective for them. They could enjoy the classic Sam Adams beer year round or one of the four seasonal beer produced by The Boston Beer Company. One weakness with this reusing option is that the min-kegs could eventually have structural problems after constant use. To address this issue, each mini-keg would be marked when it is refilled by the retailer. Once it reaches its maximum life of about six months or 12 refills, the retailer would replace the mini-keg while still filling it at refill price. The min-kegs that have reached the end of their useful life would be sent back to a Boston Beer Company facility to be recycled for future mini-keg use.

By refilling the mini-kegs, The Boston Beer Company would have lower distribution and packaging costs that would in turn lead to a larger contribution margin. The only costs the company would incur are those associated with actually producing the beer. The large-kegs that the retailer would use to refill the mini-kegs would be reused by The Boston Beer Company and simply refilled at their breweries. All of the packaging and dispensing materials would be reused which would decrease waste and costs. Going green is not only popular with customers, it is also profitable.

2. Expansion of Production into California

The Boston Beer Company's owned production facilities currently are all located in the eastern part of the country—Boston, Cincinnati, and Breinigsville, PA. This geographic limitation makes distribution costly, difficult, and largely inefficient. In order to address these issues in the short term, The Boston Beer Company should form a services agreement with MillerCoors in California to lower distribution costs and increase their market share of the west coast.

The brewing services agreement aligns with the company's overall business strategy and historical precedent. In The Boston Beer Company's 2009 Annual Report, the company wrote that "the brewing services agreements with breweries owned by others have historically allowed the Company to utilize excess capacity, providing the Company flexibility, as well as cost advantages over its competitors, while maintaining full control over the brewing process for the Company's beers." The Boston Beer Company currently has "brewing and packaging services agreements with MillerCoors, City Brewing Company, LLC and Nestle Professional Vitality to produce its products at breweries in Eden, NC, Latrobe, PA, La Crosse, WI and Chicago, IL respectively."

The Boston Beer Company should increase the scope of its agreement with MillerCoors to include MillerCoors' brewery located in Irwindale, California. The brewery currently employs nearly 600 people who produce seven million barrels of beer annually according to MillerCoors' website. Currently The Boston Beer Company only has cumulative production of two million barrels annually. The ability to use even 5% of this brewery's capacity would result in the production of 350,000 barrels of beer which represents roughly 17.5% of The Boston Beer Company's total production needs. The agreement should allow The Boston Beer Company to use up to 5% of the plant's capacity, but not dictate how much needs to be produced each month. The Boston Beer Company should only produce enough beer at this location to meet demand in the local west coast market.

This services agreement would mirror those already established between MillerCoors and the Boston Beer Company. The Boston Beer Company would send brew masters and other quality control representatives to the plant in order to ensure that the brewing process of the Sam Adams products is properly maintained with a quality product as the result. The representatives need to ascertain the brewery's ability to utilize traditional brewing methods and check to make sure that the brewery has first-rate quality control capabilities throughout brewing, fermentation, finishing, and packaging process. Once the representatives are able to audit the capabilities of the brewery and provide a reasonable level assurance concerning the brewery's capabilities, The Boston Beer Company should enter into a services agreement with MillerCoors.

As the sale of conventional mass marketed beers such as those produced by MillerCoors continues to decline, MillerCoors will benefit from the revenues associated with utilizing its excess capacity. MillerCoors will charge The Boston Beer Company a per unit rate for its products that are produced at the Irwindale, California brewery. This rate represents a variable cost that varies directs with the number of products produced. On top of this rate, The Boston Beer Company stated in its 2009 Annual Report that it "bears the costs of raw materials, excise taxes and deposits for pallets and kegs and specialized equipment required to brew and package the Company's beers."

When Miller and Coors combined operations in the United States in 2008, one of the major drivers for the merger was creating cost efficiencies. In order to achieve this goal, the combined MillerCoors reallocated its beer production to breweries with excess capacity and those closer to the market that the product would be served to the end-user. Even though MillerCoors may be able to eliminate its avoidable costs related to excess capacity, MillerCoors is still burdened with large sunk costs associated with its extensive network of production facilities. If MillerCoors were to reject this agreement, then it would experience a large opportunity cost related to this offer. It would be rejecting a profitable proposal even though nationally the company possesses excess capacity. The brewery would become an investment center for MillerCoors where it could profit instead of just a cost center that it must incur in order to brew and package its product.

While some critics may wonder why MillerCoors would allow a competitor to use its production facilities, MillerCoors would have several motivating factors to accept this proposal. First, as discussed above, MillerCoors would profit from the agreement and be able to produce revenue on facilities that it must already incur costs. Second, The Boston Beer Company does not pose a significant threat to MillerCoors' market share. The merger of Miller and Coors operations in the United States was intended to reduce costs and increase its competitive advantage against the other large player in the beer production industry, AB-InBev. Most of the brands owned by MillerCoors compete directly with those owned by AB-InBev. Its products do not appeal to the same audience that consumes craft beers such as Sam Adams. Finally, creating a strong relationship with an expanding beer company such as The Boston Beer Company provides MillerCoors a greater opportunity to benefit in the long term. If Sam Adams needs extra production capacity in the future, then MillerCoors will be able to profit from its own excess capacity. MillerCoors would also gain a strategic ally in the continuing battle for market share in the US beer market.

The services agreement will be a mutually beneficial agreement that provides excellent short term opportunities for both companies. MillerCoors will be able to profit from any excess capacity it has while The Boston Beer Company is able to expand its production to the west coast. The ability to increase the supply of Sam Adams products in the west coast will also provide The Boston Company the opportunity to increase its product saturation in the west coast. The per unit cost paid to MillerCoors will be offset by the cost savings associated with the transportation of Sam Adams products from their current manufacturing facilities on the east coast all the way to the west coast. Hopefully the increased supply of Sam Adams products will spur the sale of Sam Adams products. Brand loyalty will also increase as consumers will be able to purchase Sam Adams products at more locations. This infusion of product into the west coast market will allow The Boston Beer Company to overcome barriers to entry in the market while only incurring variable costs. Beer production tends to be very capital intensive, but this recommendation allows The Boston Beer Company to increase its production without incurring large fixed costs. The services agreement contract based on variable costs reduces the risk associated with this recommendation.

The Boston Beer Company will be able to reduce distribution costs and increase the supply of its products to customers located on the west coast by entering into this services agreement. The services agreement also allows the company to test the successfulness of its products without having to incur large capital costs. Nevertheless, this recommendation does not provide an adequate answer to production and distribution in the long term. If MillerCoors begins to see Sam Adams products as a direct competitor, it may sever the agreement with The Boston Beer Company. The Boston Beer Company would be in a very difficult situation and unable to meet its production requirements. Therefore, the company should begin to examine long term solutions for production and distribution on the west coast to mitigate the risk of disruption. It should complete a comprehensive market research study on the demand for its products on the west coast.

After completing research concerning the quantity demanded of its product, it should look to acquire a brewery with similar production capacity or build a brewery with the desired capacity. The company can finance this long-term expansion with its large cash reserves that currently are earning very small interest rates. The company will be able to create a greater long-term return on this cash if it is invested in the company instead of banks and short-term securities. In 2008, the company purchased the property, plant, and equipment of the Pennsylvania Brewery for a total of $56.5 million. As of December 26, 2009, the company reported cash assets of $55.5 million and positive cash inflow for the year of $46.4 million even after it repurchased $7 million worth of common stock (See Appendix Item VIII). This large cash holding could be used to purchase a brewery and manufacturing facility of similar magnitude to the Pennsylvania Brewery. If the purchase price of the new brewery exceeds the cash holdings available for the acquisition, then the company could issue a short-term note payable for the remaining amount. This note could be paid off within the year from the company's cash inflow and the company could continue its history of having zero debt.

Expansion through acquisition creates a great deal of risk for The Boston Beer Company which the company must mitigate in order to create a more secure future of profitability. After the company purchased the Pennsylvania Brewery, the company cited the risk in its 2009 Annual Report that "there can be no assurance that the Company will effectively manage such increased complexity [of running a larger company] without experiencing operating inefficiencies or control deficiencies. Such inefficiencies or deficiencies could have a material adverse effect on the business." To address this risk, the company must have managers and laborers who can adequately execute their responsibilities. One way the company could achieve this goal is by forming a management team for the newly acquired brewery that includes both experienced managers from The Boston Beer Company and managers from the acquired brewery.

The Boston Beer Company should prepare its internal staff by having certain brewery managers train other employees to take over their job. These experienced managers will be offered incentives to move to California and assume management of the new brewery. Corporate management should send a human resource management team to the acquired brewery to hire vital employees that have a good understanding of how the brewery operates. The HR team should also review the plant's laborers to see which workers will be able to benefit The Boston Beer Company.

Currently The Boston Beer Company employs a sales force of approximately 265 people to deal with distributors and retailers. In order to create a viable distribution and retail network, the company should hire an additional 25 employees to deal with the increased product supply on the west coast. These employees will be responsible for coordinating participation in local "cultural and community events, local beer festivals, and promotional events at local establishments, to the extent permitted under local law and regulation." They will also work with retailers to install point-of-sale items in their stores such as banners, neon signs, umbrellas, and glassware. These items are "designed to stimulate sales and continued awareness" of the Sam Adams brand. The work of this local sales force will be used to complement the company's national media campaigns on television, radio, and in print.

The Boston Beer Company's production expansion to the west coast is a multi-step process that will ultimately benefit the company. In the short term, the company should enter into a services agreement with MillerCoors concerning its production facility in Irwindale, California. This agreement provides an excellent short term answer to production on the west coast, but also poses an increasing risk of disruption as The Boston Beer Company becomes more reliant on this production. While operating under this agreement, management should begin assessing the quantity demanded of its products on the west coast. After it has a reasonable estimate of demand, the company should begin to prepare its staff for the acquisition and operation of the brewery and packaging facility. Once the company has adequately prepared for the expansion, it should acquire the facility using its large cash reserves and finance any remaining expense using a short term note payable. After the facility begins full operation, The Boston Beer Company should terminate its contract with MillerCoors and use the newly acquired facility as the center for its west coast production. (For a summary of steps to take, see appendix item VII.)

Appendix:

Item I. Profit Analysis of Mini-Kegs

Mini-Kegs
Net Result on Operating Profit for First Year
Scenario 1

Gross Sales Revenue	$ 9,678,060.00	
Less:		
Retailer's cost (25%)	$ 2,419,515.00	
Distribution cost (5%)	$ 483,903.00	
Net Sales Revenue		$ 6,774,642.00
COGS ($5.50 per mini-keg)		$ 2,661,466.50
Gross Profit		$ 4,113,175.50
Sales, general, and administrative expenses	$ 677,464.20	
Depreciation expense	$ 512,500.00	
Net result on operating profit		$ 2,923,211.30

Mini-Kegs
Net Result on Operating Profit for First Year
Scenario 2

Gross Sales Revenue	$ 9,678,060.00	
Less:		
Retailer's cost (25%)	$ 2,419,515.00	
Distribution cost (5%)	$ 483,903.00	
Net Sales Revenue		$ 6,774,642.00
COGS ($6.50 per mini-keg)		$ 3,145,369.50
Gross Profit		$ 3,629,272.50
Sales, general, and administrative expenses	$ 677,464.20	
Depreciation expense	$ 512,500.00	
Net result on operating profit		$ 2,439,308.30

Mini-Kegs
Net Result on Operating Profit for First Year
Scenario 3

Gross Sales Revenue	$ 9,678,060.00	
Less:		
Retailer's cost (35%)	$ 3,387,321.00	
Distribution cost (5%)	$ 483,903.00	
Net Sales Revenue		$ 5,806,836.00
COGS ($5.50 per mini-keg)		$ 2,661,466.50
Gross Profit		$ 3,145,369.50
Sales, general, and administrative expenses	$ 580,683.60	
Depreciation expense	$ 512,500.00	
Net result on operating profit		$ 2,052,185.90

Mini-Kegs
Net Result on Operating Profit for First Year
Scenario 4

Gross Sales Revenue	$ 9,678,060.00	
Less:		
Retailer's cost (35%)	$ 3,387,321.00	
Distribution cost (5%)	$ 483,903.00	
Net Sales Revenue		$ 5,806,836.00
COGS ($5.50 per mini-keg)		$ 2,661,466.50
Gross Profit		$ 3,145,369.50
Sales, general, and administrative expenses	$ 580,683.60	
Depreciation expense (CC of $15,000,000)	$ 750,000.00	
Net result on operating profit		$ 1,814,685.90

Mini-Kegs
Net Result on Operating Profit for First Year
Scenario 5

Gross Sales Revenue	$ 9,678,060.00	
Less:		
Retailer's cost (25%)	$ 2,419,515.00	
Distribution cost (5%)	$ 483,903.00	
Net Sales Revenue		$ 6,774,642.00
COGS ($5.50 per mini-keg)		$ 2,661,466.50
Gross Profit		$ 4,113,175.50
S,G,&A expenses (including unavoidable)	$ 2,506,617.54	
Depreciation expense	$ 512,500.00	
Net result on operating profit		$ 1,094,057.96

Mini-Kegs
Net Result on Operating Profit for First Year
Scenario 6

Gross Sales Revenue	$ 9,678,060.00	
Less:		
Retailer's cost (25%)	$ 2,419,515.00	
Distribution cost (5%)	$ 483,903.00	
Net Sales Revenue		$ 6,774,642.00
COGS ($6.50 per mini-keg)		$ 3,145,369.50
Gross Profit		$ 3,629,272.50
S,G,&A expenses (including unavoidable)	$ 2,506,617.54	
Depreciation expense (CC of $15 mil)	$ 750,000.00	
Net result on operating profit		$ 372,654.96

Mini-Kegs
Net Result on Operating Profit for First Year
Scenario 7, 400,000 mini-kegs sold

Gross Sales Revenue	$ 8,000,000.00	
Less:		
Retailer's cost (25%)	$ 2,000,000.00	
Distribution cost (5%)	$ 400,000.00	
Net Sales Revenue		$ 5,600,000.00
COGS ($6.50 per mini-keg)		$ 3,145,369.50
Gross Profit		$ 2,454,630.50
S,G,&A expenses	$ 560,000.00	
Depreciation expense (CC of $15 mil)	$ 750,000.00	
Net result on operating profit		$ 1,144,630.50

Mini-Kegs

Net Result on Operating Profit for First Year

BEP, Sales = 315,877 mini-kegs

Gross Sales Revenue	$ 6,317,540.00	
Less:		
Retailer's cost (35%)	$ 2,211,139.00	
Distribution cost (5%)	$ 315,877.00	
Net Sales Revenue		$ 3,790,524.00
COGS ($5.50 per mini-keg)		$ 2,661,466.50
Gross Profit		$ 1,129,057.50
Sales, general, and administrative expenses	$ 379,052.40	
Depreciation expense (Cap costs $15 million)	$ 750,000.00	
Net result on operating profit		$ 5.10

Notes on Projections:

1. In FY 2009, The Boston Beer Company according to its annual report "sold approximately 2 million barrels of its proprietary products ("core brands") and brewed or packaged approximately 200,000 barrels under contract ("non-core brands") for third parties."

2. 1 beer barrel=117.347765 liters. Each mini-keg holds 5 liters. Each beer barrel therefore would result in 23.46956 mini-kegs.

3. Heineken sold 10 million mini-kegs in 2005. This is equivalent to selling 50 million liters or roughly 426,084 barrels of beer. If we assume a 10% annual increase in sales, this means that Heineken sold 16,105,100 mini-kegs worldwide ($10,000,000*1.1^5$) in FY 2010. If we assume that US sales remain a constant 14% of Heineken's worldwide mini-keg sales, then Heineken would have sold 2,254,714 (16,105,100*.14) mini-kegs in the US in FY 2010.

4. The Boston Beer Company's 2009 revenue=$453.446 million

5. Heineken's 2009 Worldwide revenue=$21,128 million. Heineken's US sales equal 10% of total. Heineken's estimated 2009 US revenue=.1($21,128)=$2,112.8 million

6. The Boston Beer Company's US market share compared to Heineken = (453.446/2,112.8)=21.46%.

7. Projected sales of Sam Adams mini-kegs= (proportion of US market share controlled by The Boston Beer Company compared to Heineken)*(estimate of 2010 US Heineken mini-keg sales)
   Projected sales of Sam Adams mini-kegs=.2146*2,254,714 mini-kegs=483,903 mini-kegs

8. If we assume that the retailer and distributors share of sales price is 30% of $20, then The Boston Beer Company's share of revenue per keg sold is $14.

9. Even though no reliable data exists due to brewing company's trade secrets, I would estimate that it costs The Boston Beer Company roughly $.40 per liter to brew its beer including fixed and variable costs. I would also predict that it would cost the Boston Beer Company roughly $2.50 per mini-keg. The total manufacturing costs to brew and package a mini-keg= (5*.6)+ $2.50=$5.50 per mini-keg. This means that the Sam Adams mini-keg would have gross profit margin of 58%.

10. The Boston Beer Company's 2010 gross profit margin is 55.3%. The 3% increase in profit margin is attributable to the lower direct materials cost to purchase one mini-keg compared to 14 bottles (each mini-keg actually holds the equivalent of about 14.5 bottles). The lower cost is also associated with less direct labor costs as it will take fewer employees to package 483,903 mini-kegs compared to 7,016,594 (14.5 bottles*483,903 mini-kegs) bottles of beer.

11. The company FY 2010 sales, general, and admin expenses constitute 37.7% ($174.85/$463.8) of the company's revenue. Nevertheless, most of these expenses are unavoidable as the employees are salaried employees. Therefore, I am only including a SG&A expense equal to 10% of revenues due to some variable costs in SG&A and any new employees hired to assist in the SG&A of this product.

12. In order to produce mini-kegs, The Boston Beer Company will have to incur fixed costs to retrofit its production facility. It cost Heineken $15 million to retrofit its production facilities in order to create production capacity of 120,000 mini-kegs per day. The Boston Beer Company, on the other hand, would be able to meet its production needs if it could produce 3,000 mini-kegs per day. This means our capacity needs are only 2.5% (3,000/120,000) of Heineken's. I would assume that $10 million of the cost to retrofit are regarding unavoidable fixed costs, but the remaining $5 million dollars may be partly avoided based on the scope of retrofitting the plant.

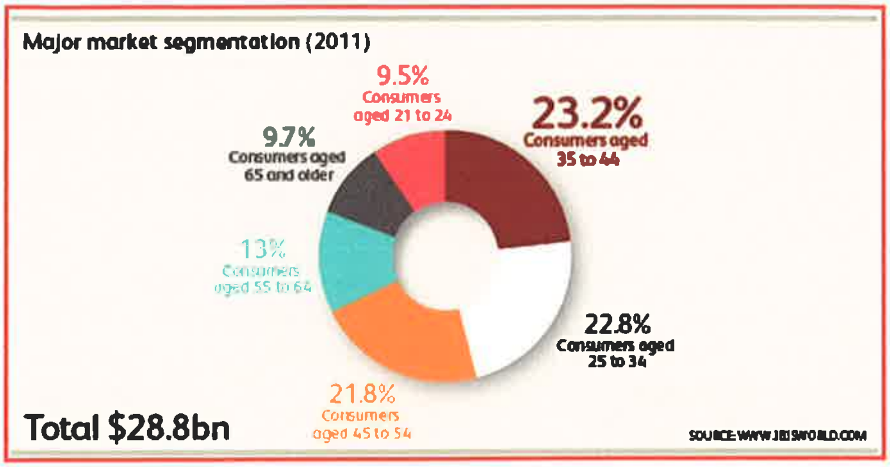
13. Cost to retrofit=(unavoidable portion)+ (avoidable portion*capacity needs proportion)
Cost to retrofit=$10,000,000+($5,000,000*.025)
Cost to retrofit=$10,000,000+$125,000=$10,250,00.

14. This cost to retrofit would be depreciated over a 20 year useful life as is the typical period that The Boston Beer Company uses according to its 2009 Annual Report. Therefore annual depreciation expense directly related to this proposal= 10,250,000/20=$512,500 annually.

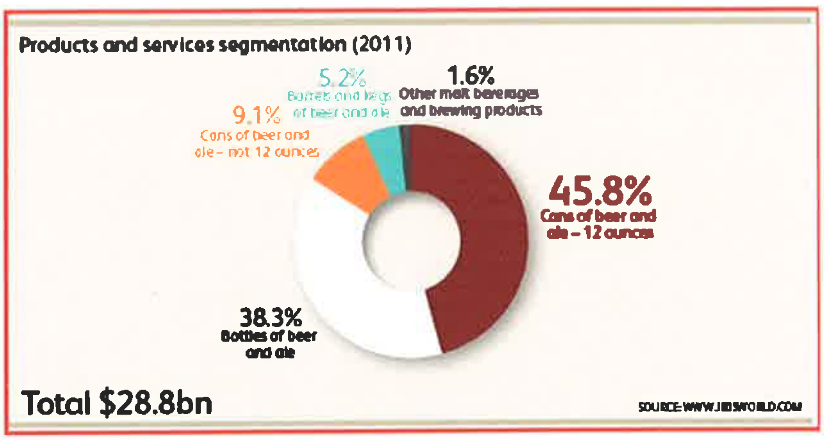
15. Details of the different scenarios can be found on pages 7-9.

Item II. Miller Lite Home Draft Keg & Heinekeg

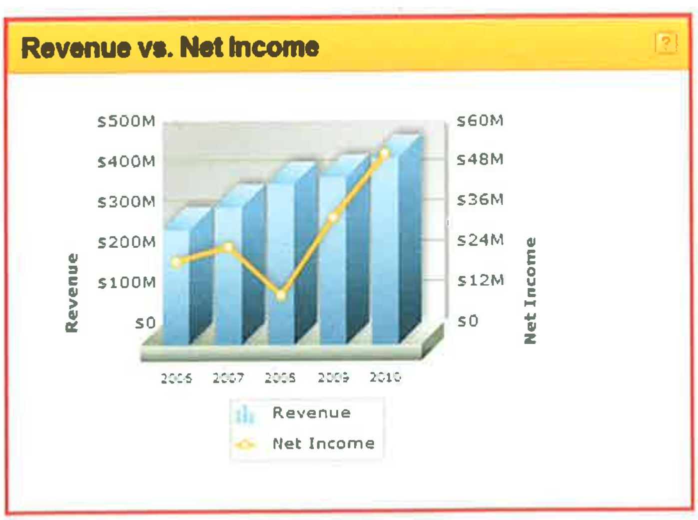
Item III. Major Market Segmentation



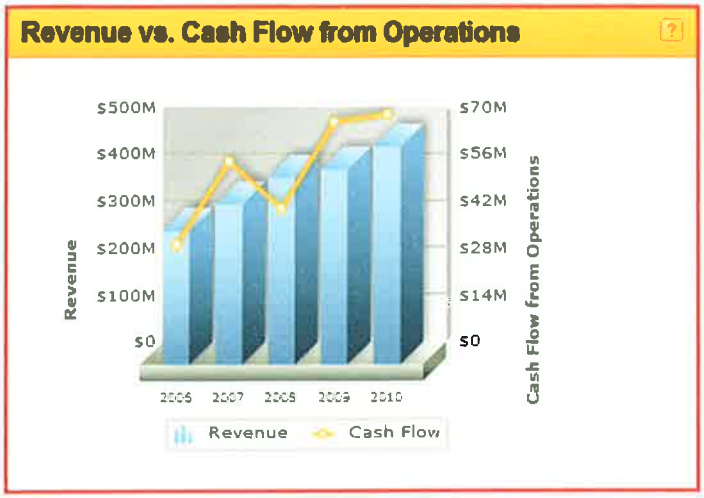
Item IV. Products and Services Segmentation



Item V. Revenue vs. Net Income



Item VI. Revenue vs. Cash Flow from Operations



Item VII. Summary of Expansion Plan

1. Create a services agreement with MillerCoors' brewing and packaging facility located Irwindale, CA.
2. Conduct market research concerning the quantity demanded of Sam Adams products.
3. Find a brewery and packaging facility that correlates with the quantity demanded.
4. Prepare management to run the facility in a way that mitigates risk to the company.
5. Hire additional sales representatives to spur demand in the west coast market.
6. Acquire the brewery and packaging facility in California using the company's large cash reserves. Finance any remaining amount using a short-term note payable.

Item VIII. The Boston Beer Company Consolidated Balance Sheet

THE BOSTON BEER COMPANY, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
(In thousands, except share data)

	December 26, 2009	December 27, 2008
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 55,481	$ 9,074
Accounts receivable, net of allowance for doubtful accounts of $199 and $255 as of December 26, 2009 and December 27, 2008, respectively	17,856	18,057
Inventories	25,558	22,708
Prepaid expenses and other assets	9,710	16,281
Deferred income taxes	4,425	2,734
Total current assets	113,030	68,854
Property, plant and equipment, net	147,021	147,920
Other assets	1,508	1,606
Goodwill	1,377	1,377
Total assets	$262,936	$219,757
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$ 25,255	$ 20,203
Accrued expenses	48,531	46,854
Total current liabilities	73,786	67,057
Deferred income taxes	13,439	9,617
Other liabilities	2,556	3,055
Total liabilities	89,781	79,729
Commitments and contingencies		
Stockholders' Equity:		
Class A Common Stock, $.01 par value; 22,700,000 shares authorized; 10,142,494 and 10,068,486 shares issued and outstanding as of December 26, 2009 and December 27, 2008, respectively	101	101
Class B Common Stock, $.01 par value; 4,200,000 shares authorized; 4,107,355 shares issued and outstanding	41	41
Additional paid-in capital	111,668	102,653
Accumulated other comprehensive loss, net of tax	(359)	(431)
Retained earnings	61,704	37,664
Total stockholders' equity	173,155	140,028
Total liabilities and stockholders' equity	$262,936	$219,757

Item IX. The Boston Beer Company's Consolidated Income Statement

THE BOSTON BEER COMPANY, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share data)

	Year Ended		
	December 26, 2009	December 27, 2008	December 29, 2007
Revenue (net of product recall returns of $13,222 in fiscal 2008)	$453,446	$436,332	$380,575
Less excise taxes	38,393	37,932	38,928
Net revenue	415,053	398,400	341,647
Cost of goods sold (including costs associated with product recall of $9,473 in fiscal 2008)	201,235	214,513	152,288
Gross profit	213,818	183,887	189,359
Operating expenses:			
Advertising, promotional and selling expenses	121,560	132,901	124,457
General and administrative expenses	36,938	34,988	24,574
Impairment of long-lived assets	1,049	1,936	3,443
Total operating expenses	159,547	169,825	152,474
Operating income	54,271	14,062	36,885
Other income, net:			
Interest income	112	1,604	4,252
Other (expense) income, net	(16)	174	507
Total other income, net	96	1,778	4,759
Income before provision for income taxes	54,367	15,840	41,644
Provision for income taxes	23,249	7,752	19,153
Net income	$ 31,118	$ 8,088	$ 22,491
Net income per common share — basic	$ 2.21	$ 0.58	$ 1.58
Net income per common share — diluted	$ 2.17	$ 0.56	$ 1.53
Weighted-average number of common shares — basic	14,059	13,927	14,193
Weighted-average number of common shares — diluted	14,356	14,341	14,699

Item X. The Boston Beer Company's Consolidated Statement of Cash Flows

THE BOSTON BEER COMPANY, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Year Ended		
	December 26, 2009	December 27, 2008	December 29, 2007
Cash flows provided by operating activities:			
Net income	$ 31,118	$ 8,088	$ 22,491
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	16,919	12,503	6,654
Impairment of long-lived assets	1,049	1,936	3,443
Loss on disposal of property, plant and equipment	25	119	161
Bad debt expense	24	57	34
Stock-based compensation expense	4,106	4,148	3,058
Excess tax benefit from stock-based compensation arrangements	(1,640)	(4,065)	(1,792)
Deferred income taxes	2,131	7,758	(1,702)
Purchases of trading securities	—	—	(47,520)
Proceeds from sale of trading securities	—	16,200	50,543
Changes in operating assets and liabilities:			
Accounts receivable	177	(142)	(236)
Inventories	(2,850)	(4,618)	(1,056)
Prepaid expenses and other assets	6,483	(8,875)	963
Accounts payable	5,052	2,495	(234)
Accrued expenses	3,398	4,405	19,521
Other liabilities	(427)	(167)	(534)
Net cash provided by operating activities	65,565	39,842	53,794
Cash flows used in investing activities:			
Purchases of property, plant and equipment	(16,997)	(59,539)	(25,607)
Proceeds from disposal of property, plant and equipment	8	11	5
Acquisition of brewery assets	—	(44,960)	(11,507)
Net cash used in investing activities	(16,989)	(104,488)	(37,109)
Cash flows used in financing activities:			
Repurchase of Class A Common Stock	(7,080)	(15,324)	(6,084)
Proceeds from exercise of stock options	2,806	5,274	3,448
Excess tax benefit from stock-based compensation arrangements	1,640	4,065	1,792
Net proceeds from sale of investment shares	465	416	301
Net cash used in financing activities	(2,169)	(5,569)	(543)
Change in cash and cash equivalents	46,407	(70,215)	16,142
Cash and cash equivalents at beginning of year	9,074	79,289	63,147
Cash and cash equivalents at end of year	$ 55,481	$ 9,074	$ 79,289
Supplemental disclosure of cash flow information:			
Income taxes paid	$ 18,193	$ 8,837	$ 14,721
Reclassification of deposits and costs related to brewery acquisition to property, plant and equipment	$ —	$ 11,507	$ —

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