Beverages: Time to chill out and have a drink

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RATING: HOLD

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Company Name	Ticker	Share Price 10/30/2003	LTM Hi/Lo	Equity Mkt Value	Enterprise Value	P/E Multiples TTM	P/E Multiples 2004
COCA COLA	KO	46	37.01 - 48.34	112,770M	114,470M	26.09	22.12
COCA COLA ENT.	CCE	20.13	16.85 - 24.49	9,060M	20,800M	14.77	14.3
PEPSI	PEP	48.17	36.24 - 48.88	82,100M	82,560M	22.99	19.6
PEPSI BOTTLING GROUP	PBG	22.07	17.00 - 29.50	5,800M	10,260M	15.01	12.85
ANHEUSER BUSCH	BUD	48.89	45.30 - 53.84	40,080M	46,690M	20.2	17.55
COORS	RKY	55.15	45.85 - 69.90	2,020M	3,460M	12.78	11.49
CONSTELLATION BRANDS	STZ	31.15	21.90 - 31.80	3,270M	5,490M	15.53	11.33

Company Name	Profit Margin	EBIT Margin	Return on Assets	Return on Equity	EV as a multiple of TTM Revenue	EV as a multiple of TTM EBITDA	Book Value Multiple
COCA COLA	21.07%	26.25%	16.54%	34.74%	5.54	18.32	8.34
COCA COLA ENT.	3.50%	8.28%	2.50%	17.45%	1.16	14.05	2.25
PEPSI	13.92%	16.69%	15.22%	36.70%	3.12	15.41	7.55
PEPSI BOTTLING GROUP	4.10%	9.03%	4.11%	21.96%	1.03	7.1	3.12
ANHEUSER BUSCH	12.18%	22.51%	12.00%	68.73%	3.33	11.6	15.25
COORS	4.02%	6.71%	3.78%	15.00%	0.88	6.91	1.82
CONSTELLATION BRANDS	4.71%	14.12%	4.71%	14.12%	1.79	11.2	1.73

- We rate the Beverage Industry a HOLD due to recent upward moves in some stocks within our coverage universe. We maintain a BUY recommendation on PBG and BUD while maintaining HOLD ratings on all other covered stocks.

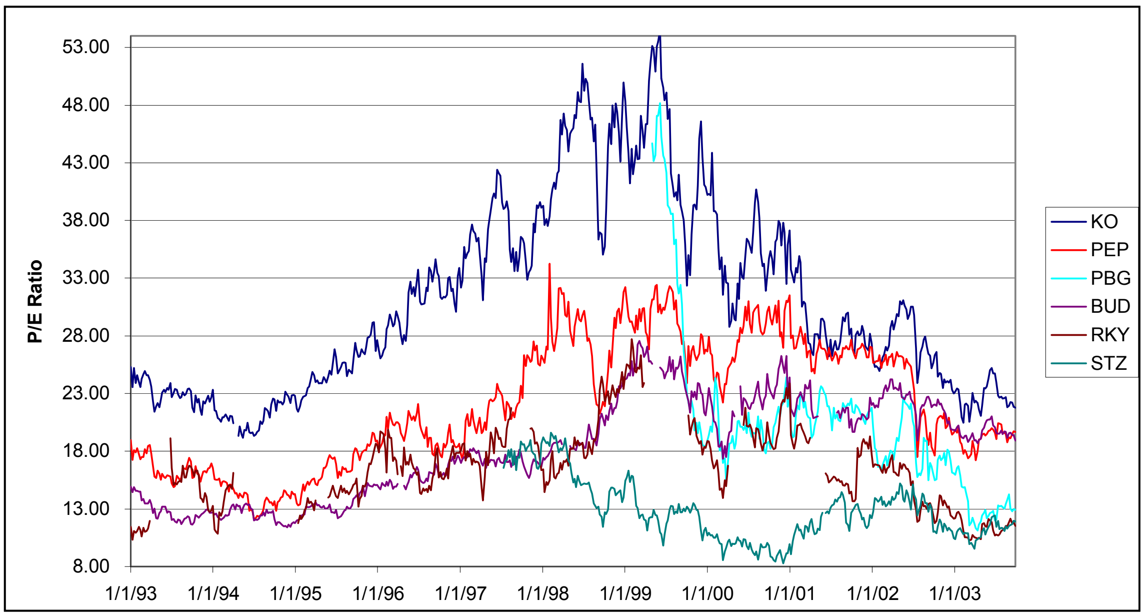
- We expect BUD's announcement this month of a 2-part price increase amounting to roughly 2.7% to be followed by price increases from RKY and SAB Miller within 6 months as has become usual. We have seen recent concerns about future pricing misbehavior by SAB Miller reflected in BUD and RKY stock prices but we believe, as has been the case before, that such behavior will not yield any share gains for Miller.

- We continue our positive stance on PBG mainly due to valuation against the backdrop of a friendly pricing environment within the bottler segment. 2004E free Cash flow yield currently stands at 7.1% well above its historic mean and short term treasury rates. This is an important value driver as the company is mainly valued as a bond with little or no present value of growth opportunities embedded in its stock price. To this effect we have spent much time assessing the stability of PBG's future cash flows especially those stemming from its Mexican operations and believe them to be accurate.

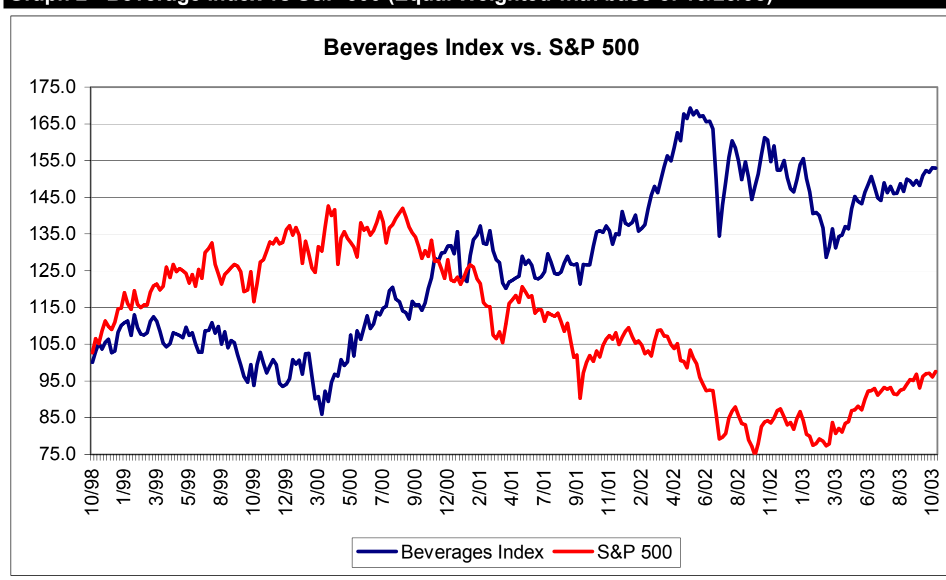
SECTOR OUTLOOK

We expect, in the case of North America non-alcoholics, to see CSD (Carbonated Soft Drinks) volume trends to increase 1-1.5%. We also expect brander's trend to increase emphasis on water and other alternatives to core CSD brands continuing. For North American Alcoholics, we see beer consumption growth returning to a 1%-1.5% annual run rate by year end, Beer CPI remaining in and around 2% well into 2004 due largely due to expected consumer acceptance of another round of brewers increases, brewer relative share continuing to shift in favor of Anheuser-Busch but at a slowing rate, and Constellation Brands building competitive strength in a deteriorated (consumer and supplier) wine market.

Graph 1 - P/E Ratios (NTM) For Beverage Coverage Universe

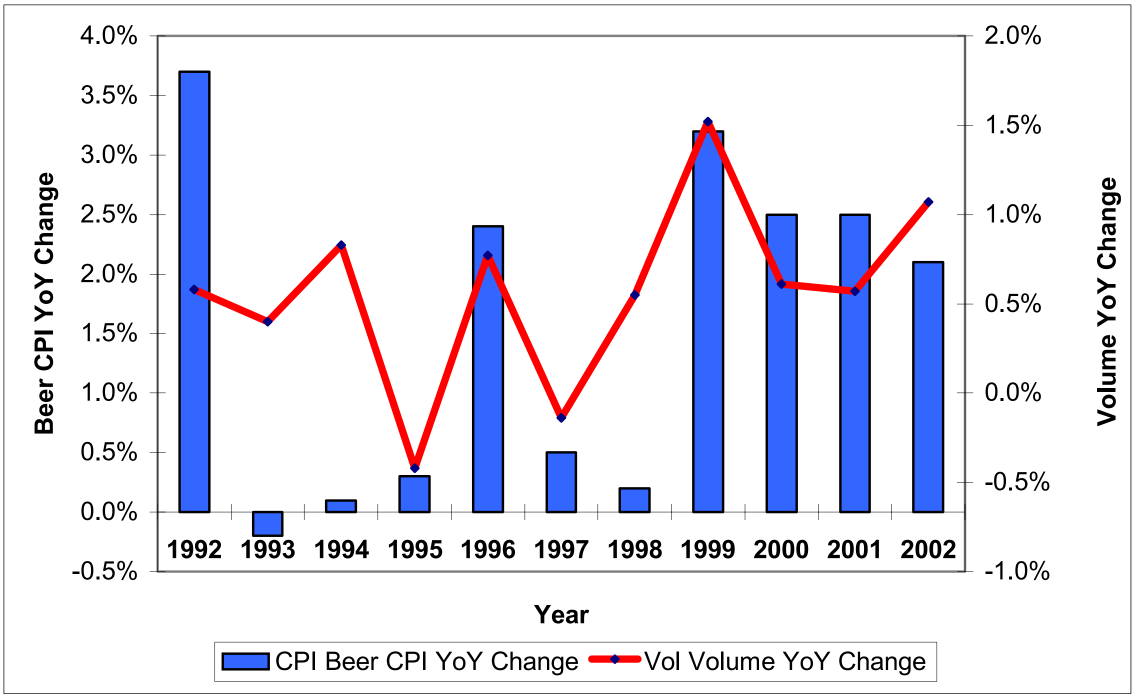


Graph 2 - Beverage Index vs S&P 500 (Equal Weighted with base of 10/23/98)



Our assumption regarding the acceptance of these price increases is based on the belief that Beer is a fairly inelastic commodity with price elasticity estimated at -.23[1]. Furthermore, history shows that these price increases have largely "stuck" in the past. This leads us to believe that the beer industry should continue to grow at roughly 2-3%, capping any one company's top line at this level unless share is traded from one participant to another. Next year, volume should show a higher than average growth rate year on year due to the rainy summer and the easy comparison it provides.

Comparison of Oricing Changes and Volume Changes



Within the bottler segment we believe that pricing conditions remain benign, mainly due to major bottler commitments discipline on pricing:

> *"We expect U.S. pricing in the marketplace to continue to be solid, up about 2% for the second half and full year,"* PBG CFO Al Drewes, July 8, 2003.
>
> *"In North America, we achieved pricing growth of 2.5% in the second quarter, which brings our year-to-date pricing performance in line with our full year target of approximately 2% growth. We remain fully committed to achieving continued pricing increases throughout the year and believe that the industry mindset for pricing enhancement remains very positive,"* CCE CEO Lowry Kline, July 16, 2003.
>
> *"We have in place a more consistent pricing architecture, which drove a 3.1% increase in net pricing in the second quarter. We expect to continue to improve our pricing comparisons over the balance of the year…Pricing should be at the high-end of the 2.5% to 3.5% range,"* PepsiAmericas CEO Bob Pohlad, July 23, 2003.

[1] X. M. Gao, E. J. Wiles, and G. L. Kramer, "A Microecono- metric Model of the U.S. Consumer Demand for Alcoholic Beverages," Applied Economics, January 1995, pp. 59-69.

Given this unprecedented spirit of cooperation among the major bottlers, representing 50% of the market, we believe that the CPI of Carbonated Soft Drinks will continue its recent trend of 0.75–1.25% annual growth. It is also our belief that the concentrate makers will not stick bottlers with price increases that they don't believe bottlers will be able to realize in the marketplace, further contributing to a benign environment.

This environment improves the predictability of cash flows and allows us to value companies in the space in terms of free cash flow yield. As we can see in the return analysis below, the two major bottlers do not create value and are thus appropriately valued on the basis of free cash flow yields with no component of growth opportunities. We can thus identify trough valuations when free cash flow yields increase above the appropriate risk free rate by more than the cash flow risk premium would suggest.

Beverage Company Return Analysis

Company	Ticker	ROIC 2004 E	WACC	Value Creation / Destruction
The Coca Cola Company	KO (NYSE)	28.7%	10.3%	18.4%
Anheuser-Busch Companies	BUD (NYSE)	21.6%	8.4%	13.2%
PepsiCo, Inc.	PEP (NYSE)	16.3%	8.5%	7.8%
Constellation Brands	STZ (NYSE)	8.9%	7.5%	1.4%
Pepsi Bottling Group	PBG (NYSE)	7.9%	7.8%	0.1%
Adolph Coors Company	RKY (NYSE)	7.9%	6.9%	1.0%
Coca-Cola Enterprises	CCE (NYSE)	5.8%	7.3%	-1.5%

As logic would suggest, what's good for the bottlers is good for the concentrate makers, and as such we believe KO and PEP will benefit from this environment, a fact, which we believe has been incorporated into their stock prices during their recent run-up.

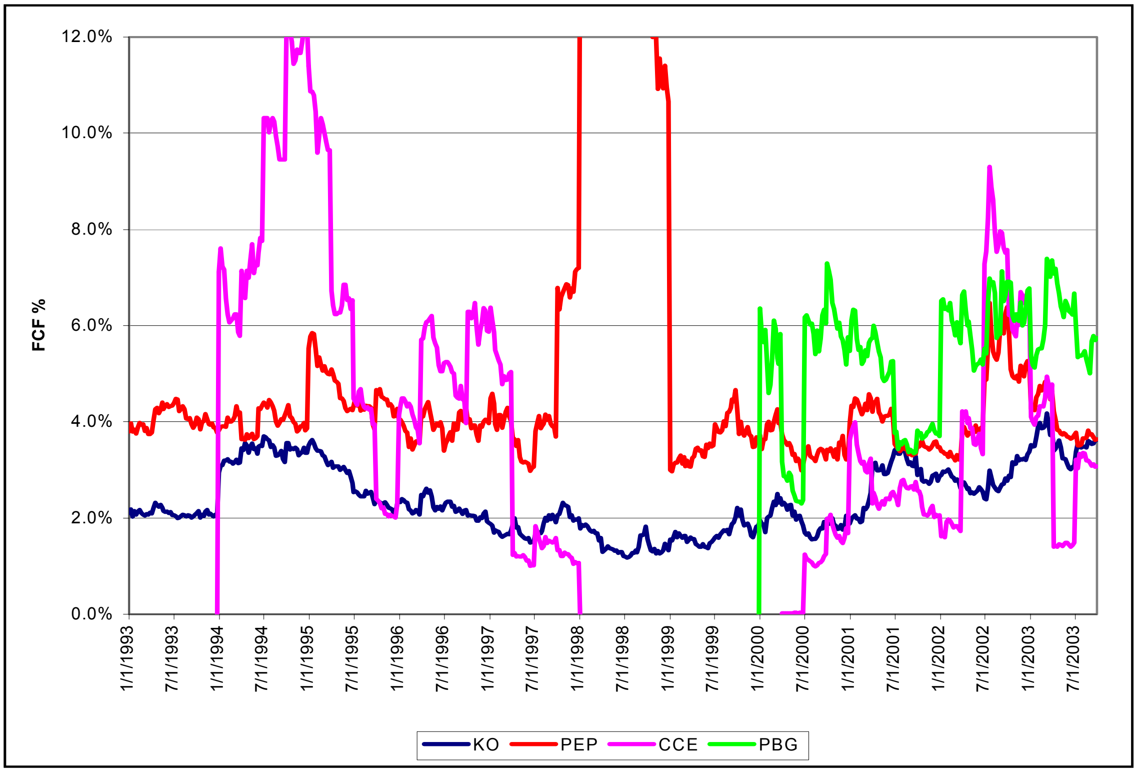
We have chosen some key metrics in assessing the relative valuation of the industry and have come to the conclusion that the industry is fairly valued at current prices.

Beverage Company Valuation Metrics

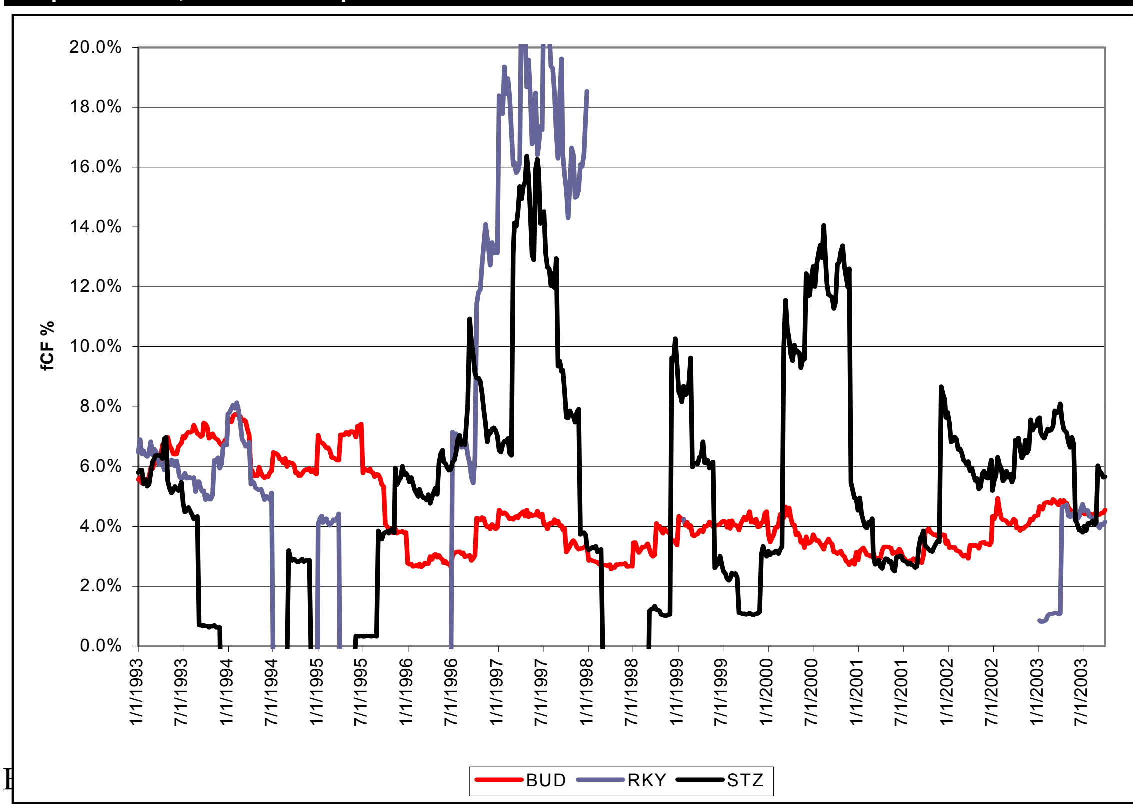
	Free Cash Flow Yield				EV/EBITDA				Price to Forward 12 Mo. Earnings			
Company	High	Low	Current	Mean	High	Low	Current	Mean	High	Low	Current	Mean
The Coca Cola Co.	4.18%	1.17%	3.60%	2.40%	35.51	14.34	16.29	22.01	54.47	19.16	21.77	31.03
Anheuser-Busch Co.	7.75%	2.57%	4.50%	4.40%	15.26	6.26	11.43	10.19	48.20	11.13	12.89	20.56
PepsiCo, Inc.	18.20%	2.97%	3.60%	5.00%	20.21	7.21	12.39	12.33	34.24	12.10	19.67	22.13
Constellation Brands	16.38%	-3.28%	5.70%	4.70%	18.91	6.44	10.15	10.1	19.58	8.26	11.93	12.87
Pepsi Bottling Group	7.39%	-6.46%	5.70%	3.70%	10.97	6.47	7.95	8.78	48.20	11.13	12.89	20.56
Adolph Coors Co.	23.87%	-9.57%	4.20%	4.80%	12.51	3.34	6.06	5.93	27.73	10.24	11.54	16.51
Coca-Cola Entprs.	12.95%	-6.27%	3.10%	2.50%	18.80	7.26	8.58	9.99	210.44	14.10	15.22	54.92

As one can appreciate from the above table and the graphs below, the market currently values the space, with the exception of PBG, fairly according to the historical ranges. In absence of any clearly identifiable catalyst we maintain our HOLD on the industry.

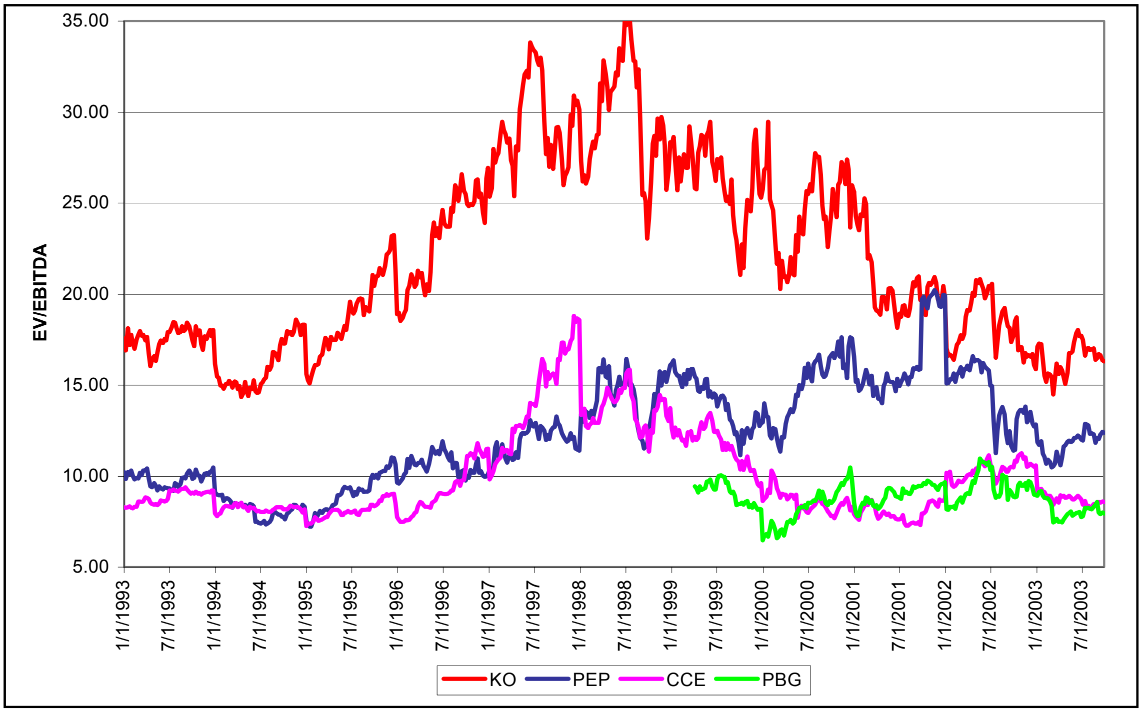
Graph 3 - Major Non Alcohoic Company Free Cash Floow Yield



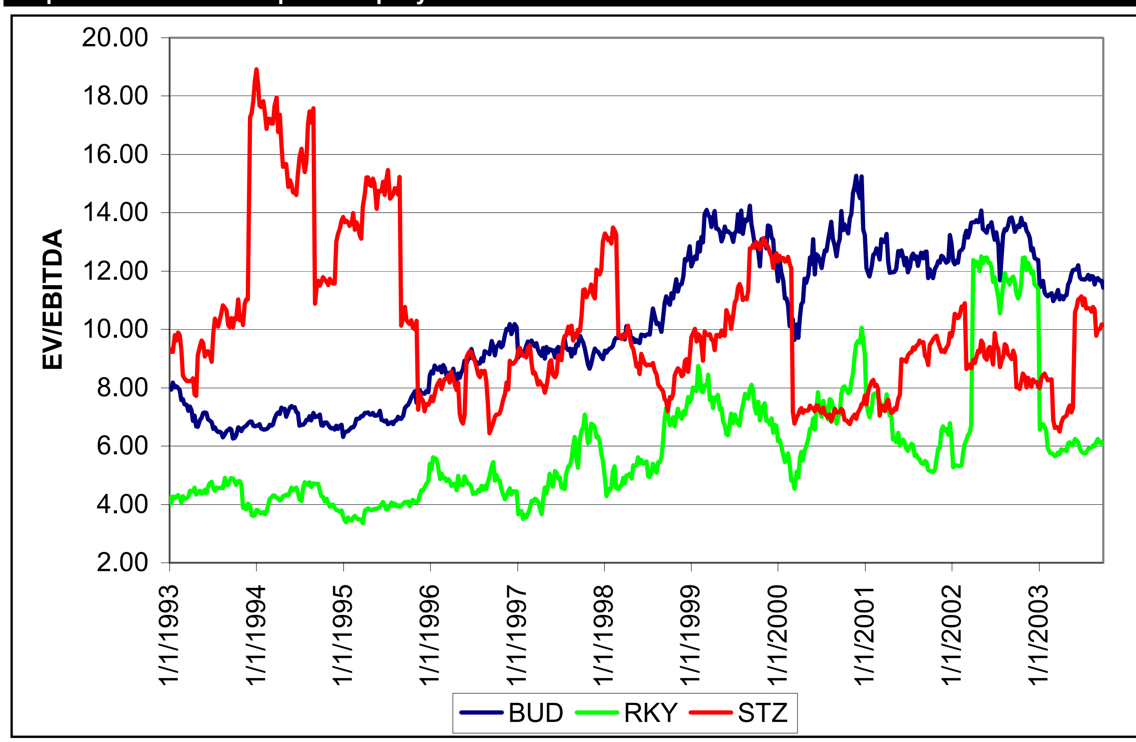
Graph 4 - Beer, Wine and Liquor Co. Free Cash Flow Yield



Graph 5 - Major Non Alcoholic Company EV/EBITDA Ratio



Graph 6 - Beer Wine & Liquor Company EV/EBITDA



SECTOR PROFILE

We include a succinct statistical profile of North America's beverage market. The worlds 6.2 billion[2] consumers drink an estimated 91 billion[3] gallons of non-alcoholic beverages, 30 billion gallons[4] of beer, 6.04 billion gallons[5] of wine and 768,586 million[6] gallons of spirits. The table below shows the factors that drive beverage company top lines.

Beverage Industry Top Line Drivers		
Sector	**Drivers**	**Explanation**
Non Alcs	**Pricing**	The CPI of Cabonated Beverages has been growing at a compounded annual growth rate of 1.18% for the last 20 years. This is lower than Beer usually by close to a full percentage point reflecting the higher price elasticity of Carbs.
	Innovation	Vanilla Colas and tropical flavored carbs address the needs of the growing ethnic population, while juice and milk based drinks take advantage of the growing health and wellness trend in America. Packaging innovations are also important with the recently introduced fridge packs reflecting the satisfacition of an important cusrtomer need thus driving sales.
Beer	**Demographics**	Consumption began growing again, at roughly 1%-1.5% in the late 1990's as the effect of the echo boom more than outstripped the declining baby boomer consumption. In our view this population segment continues to reach drinking age at a pace supporting 1%-1.5% annual growth through 2010.
	Pricing	There is virtually no private-label beer segment; the sizable import segment is priced at a 40% or greater premium to domestic brands, providing a tall umbrella under which domestic beer prices can rise; beer is less substitutable than other staples products such as CSD's, translating into a more inelastic demand curve. A high concentration ratio also contributes to a higher pricing power.
	Innovation	Innovation in this segment is led by introductions of new brands or product types addressing sppecific customer needs. For example AB recently launched Michelob Ultra addressing the growing low calorie concerns of young adults, a growing percentage of the beer consumer segment.
Wine	**Demograhics**	An aging population underpins wine consumption, where peak consumer demographics lie between the ages of 30 and 65.
	Pricing	Excess supply worldwide has led to a loss of pricing power by suppliers, with consumer prices running close to flat during the last two years. With an improving economy and a small crop in California this fall, the supply/demand imbalance seems to be abating, but this is unlikely to change the pricing outlook during the next 6 to 12 months.
	Innovation	Innovation in this segment takes the form of trends in consumptions of new varital flavors, wines from different origins, new wine based products, and packaging changes. The most recent innovation is the introduction of 3 liter premium box wines from both California and Australia.

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[2] Population Reference Bureau
[3] Beverage Digest Fact Book 2003
[4] World Book Encyclopedia 2001
[5] Adams Handbook Advance 2003, Wine Institute Statistics 1999
[6] Reuters Datamonitor Drinks Database

Table one displays the share and growth of different beverage types and, in conjunction with the beverage CPI data introduced earlier, helps calculate future growth trends and market size.

Table 1 - US Consumer Per Capita Liquid Intake, Share & Growth, 2002

	Per Capita Volume	Volume Share	Volume CAGR (96 - 02)
Carbonated Soft Drinks	52.5	28.77%	0.14%
Beer	21.8	11.95%	0.00%
Milk	20.4	11.18%	-1.51%
Coffee	16.8	9.21%	-2.60%
Bottled Water	15.4	8.44%	4.92%
Juices	10.8	5.92%	1.55%
Tea	7	3.84%	0.21%
Sports Drinks	2.5	1.37%	7.57%
Powdered Drinks	2.4	1.32%	-7.68%
Wine	2	1.10%	1.52%
Distilled Spirits	1.2	0.66%	0.00%
Tap Water, Hybrids, Other	29.7	16.27%	0.05%
Total	182.5	100.00%	0.173% ***

*** Weighted Average Volume CAGR*

Source: Beverage Dymamics, Beer Marketers Insight, Adams Handbook

MARKET SEGMENTS

Non-Alcoholics

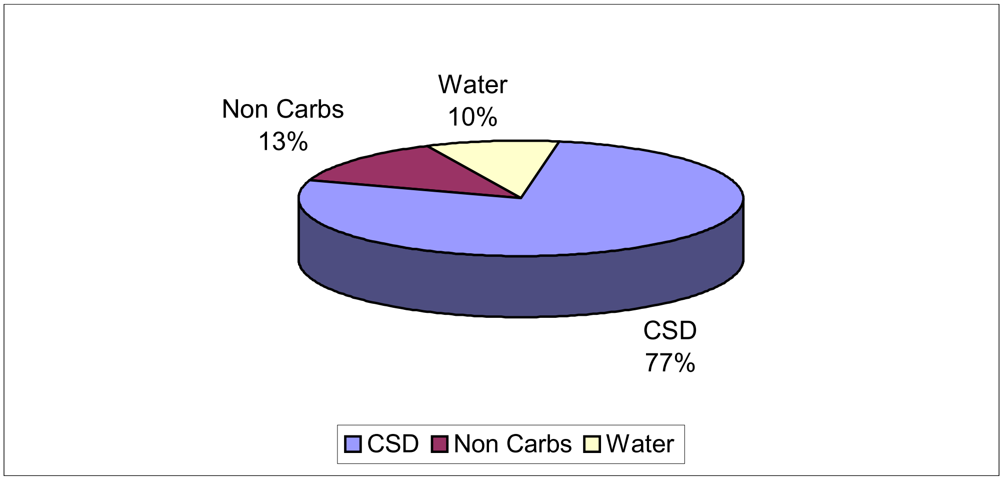
Americans consumed 19.6 billion gallons of refreshment beverages in 2002, 77.2% of which was made up of carbonated soft drinks. The non-carbonated accounted for 13% of total volume and the category is comprised of teas, juices, sport drinks, and shelf stable dairy drinks. The remaining 9.8% of the volume is made up by single-serve bottled water.

Table 2 - Non Alcoholic Market Share

Rank	Company	Total	Carbs	Water	Non Carb
1	The Coca-cola Co.	39.40%	44.30%	13.80%	29.80%
2	PepsiCo. Inc.	31.40%	31.40%	15.10%	43.70%
3	Cadbury	13.10%	15.00%	na	11.80%
4	Nestle Waters	3.70%	na	38.00%	na
5	Cott	3.60%	4.20%	3.60%	na
	Other	8.80%	5.10%	29.50%	14.70%
	Total	100.00%	100.00%	100.00%	100.00%

Table 3 - Largest Non Alcholic Brands, By Company And By Segment 2002 E	Carbonated Soft Drink	Bottled Water	Sports Drink	Juice Drinks
Coca-Cola Company				
Coke Classic	19.30%			
Diet Coke	9.00%			
Sprite (all)	6.80%			
Caffeine Free Diet Coke	1.70%			
Barq's Root Beer (all)	1.20%			
Vanilla Coke (all)	1.00%			
all other	5.30%			
Dasani		13.80%		
PowerAde			16.80%	
Minute Maid				40.00%
Segment Share	**44.30%**	**13.80%**	**16.80%**	**40.00%**
PepsiCo, Inc				
Pepsi-Cola	12.60%			
Mountain Dew (all)	8.40%			
Diet Pepsi	5.50%			
Sierra Mist	0.80%			
all other	4.10%			
Aquafina		15.10%		
Gatorade			82.30%	
Fruitworks				5.40%
Tropicana				4.60%
all other				13.40%
Segment Share	**31.40%**	**15.10%**	**82.30%**	**23.40%**
Cadbury				
Dr. Pepper (all)	7.30%			
7 Up (all)	2.40%			
Sunkist	0.90%			
all other	4.40%			
Segment Share	**15.00%**			
Nestle				
Poland Spring		11.50%		
Arrowhead		6.80%		
Aberfoyle		4.50%		
Deer Park		4.10%		
Ozarka		3.90%		
all other		7.20%		
Segment Share		**38.00%**		
Danone				
Evian		2.40%		
Dannon		2.50%		
all other		4.10%		
Segment Share		**9.00%**		

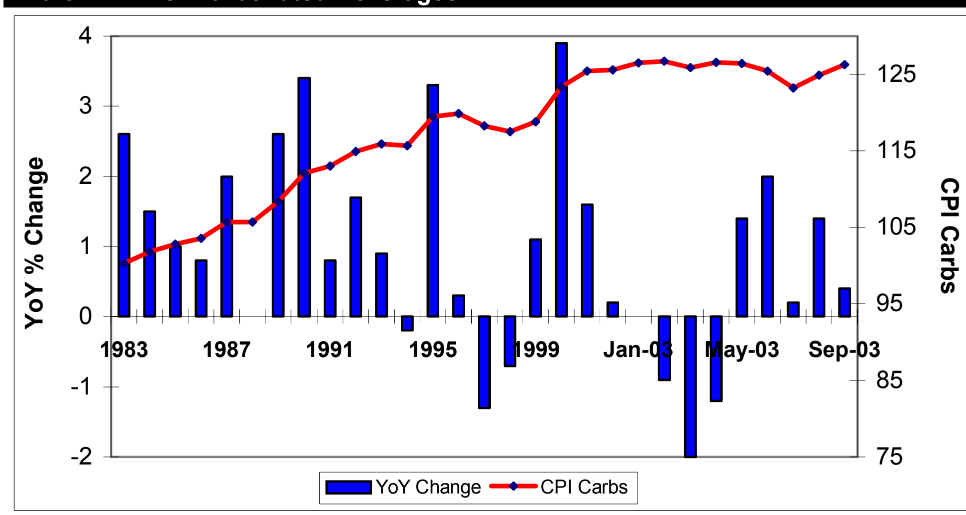
Chart 3 - Refreshment Beverages By Type in 2002



We can separate the non-alcoholic beverage segment into concentrate makers and bottlers. Concentrate makers manufacture the key ingredients that impart product differentiation and branding to a finished product. Their business is characterized by high margins, low capital requirements, and a reasonable amount of growth. In contrast, bottlers generate substantially lower returns, with significantly lower margins. Their business is substantially more capital intensive as a result of producing and distributing the finished beverage product.

As previously mentioned, we expect a benign pricing environment during the coming year yielding price increases of close to 1%. This price increase will be accompanied by volume growth of between 1% and 1.5% as has been the case in the recent past.

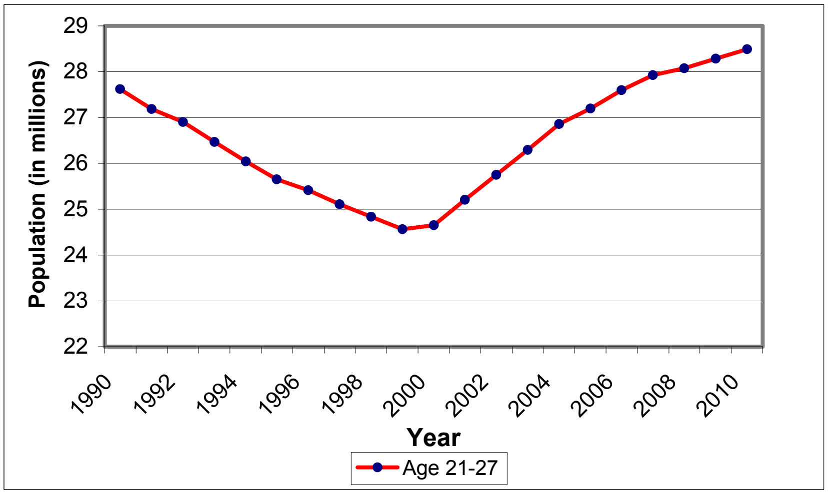
Chart 2 - CPI of Carbonated Beverages



Beer

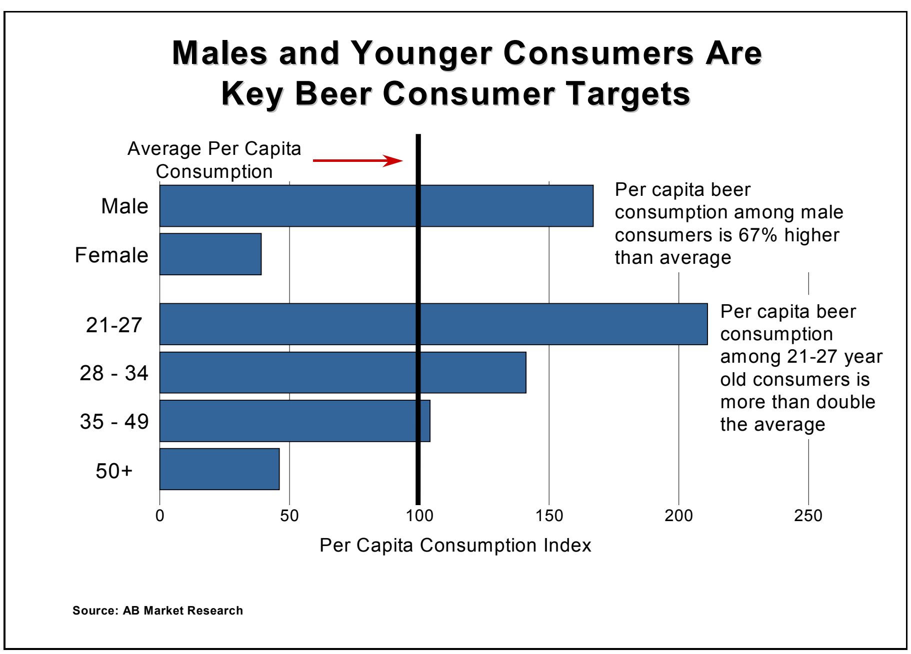
Beer began growing again in the late 1990's, at roughly 1% to 1.5% annualized, due to the onset of the echo boom effect, which more than offset the declining consumption from baby boomers as a group. This demographic group ranging in ages from 21 to 27 years of age is set to grow 13% from 2001 to 2010, and consumes slightly over twice the average per capita amount of beer.

Popultaion Between The Ages of 21 and 27



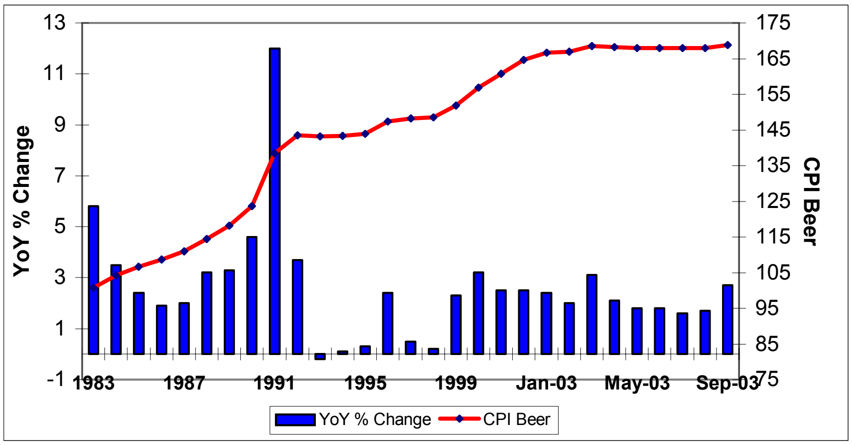
In contrast the population over 50 years of age is set to grow at a rate of 25% between 2001 and 2010, but since its consumption is less than half the average per capita consumer, as seen on table 2. Nevertheless, even though the younger age group grows at half the rate, they consume 4 times as much beer on average, thus underpinning consumption growth by 1% to 1.5% annually, in our view.

Table 2 - Consumption index by demographic group



Low single digit annual percentage increases in the price consumers paid for beer resumed in late 1998. We expect the recent trend of annual year-on-year rate increases to continue for the foreseeable future. More importantly, we believe the price increases will not have an adverse effect on volumes consumed in the foreseeable future.

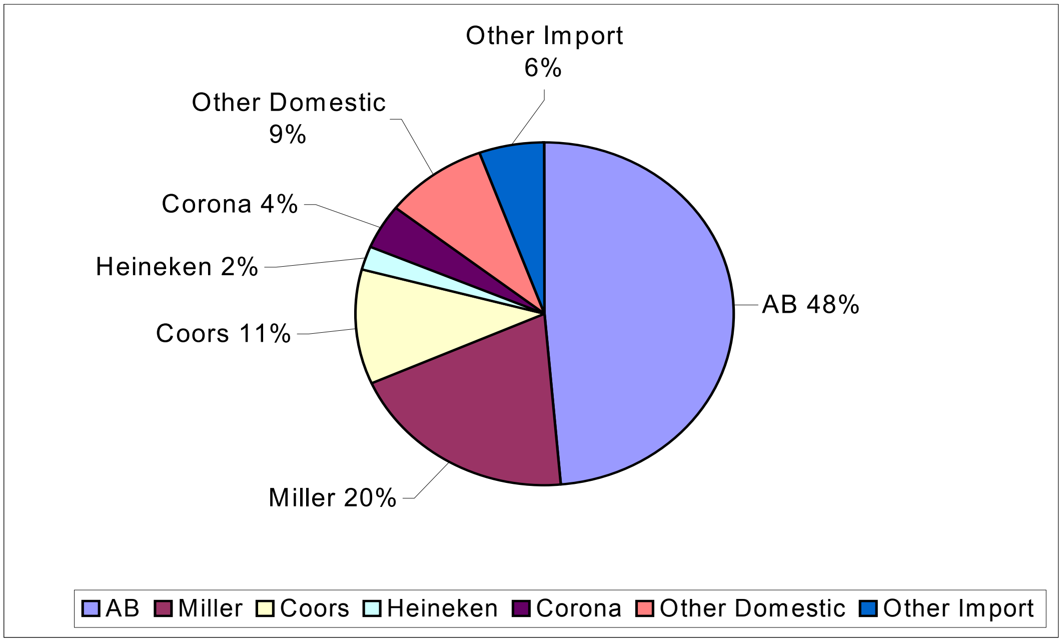
Chart 1 - CPI Of Beer



Historically market demand for beer has been inelastic, -0.23 as estimated from U.S. Department of Agriculture individual and household food-consumption survey data for 1987-1988. This means that a 1 percent increase in the price of beer results in a 0.23 percent reduction in the quantity of beer demanded by U.S. consumers. In contrast the demand for individual brands appears to be quite elastic. This places an important limitation on the market power of any one brewer to raise prices unilaterally. It is thus important for brewers to remain disciplined on pricing as before, AB leading the move with their October price increase and SAB Miller and Coors following suit within 6 months. We performed a regression analysis on the above data and found that the R-squared was 0.29, meaning that changes in price are weakly correlated to changes in volume, further proving the inelasticity of beer demand.

Table 4 - Largest Beer Brands, By Company And By Segment 2001	Light	Premium Regular	Popular Regular	Imports
Anheuser Busch				
Bud Light	38.00%			
Natural Light	9.20%			
Busch Light	6.20%			
Michelob Light	3.24%			
Budweiser		79.08%		
Busch			33.44%	
Segment Share	**56.64%**	**79.08%**	**33.44%**	**0.00%**
Miller Brewing				
Miller Light	17.95%			
Milwakee's Best Light	2.25%			
Miller Gen Draft		12.23%		
Miller High Life			25.32%	
Milwakee's Best			13.14%	
Red Dog			3.82%	
Meister Brau			0.48%	
Segment Share	**20.20%**	**0.00%**	**0.48%**	**0.00%**
Adolph Coors				
Coors Light	17.47%			
Keystone Light	2.70%			
Original Coor's		3.86%		
Coors Extra Gold		0.36%		
Keystone			0.86%	
Segment Share	**20.17%**	**4.22%**	**0.86%**	**0.00%**
Heineken				
Heineken				19.01%
all other				2.80%
Segment Share	**0.00%**	**0.00%**	**0.00%**	**21.81%**
Grupo Modelo				
Corona Extra & Light				28.59%
all other				5.93%
Segment Share	**0.00%**	**0.00%**	**0.00%**	**34.52%**
Labatt				
Labatt Blue				5.31%
all other				7.11%
Segment Share	**0.00%**	**0.00%**	**0.00%**	**12.42%**
Diageo				
Guiness Stout				3.40%
all other				3.49%
Segment Share	**0.00%**	**0.00%**	**0.00%**	**6.89%**
Becks				
Becks				3.91%
all other				
Segment Share	**0.00%**	**0.00%**	**0.00%**	**3.91%**

Chart 4 - Major Brewers & Importers Market Share In 2001

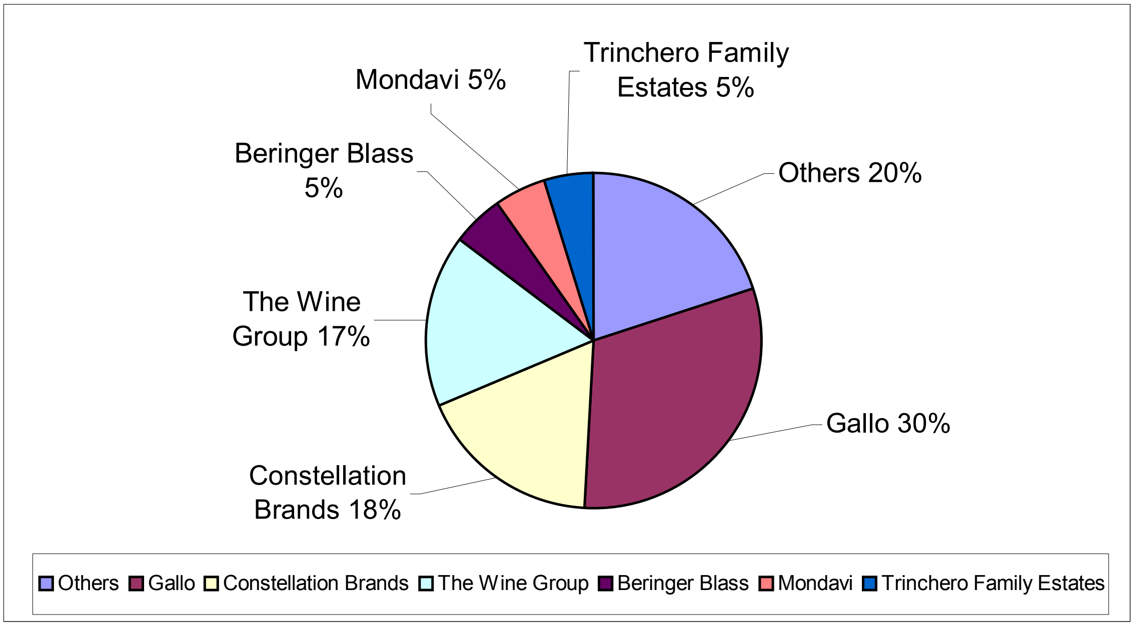


Wine

Although consumption continues trending upwards and baby boomers reach peak wine demographics, the continued oversupply of wine will have a negative effect on wine pricing for the foreseeable future. Last year in particular we saw a 12.5% increase in the harvest from 2001 levels according to the California Agricultural Statistics Service, in addition to a slew of cheap imports from Europe and Australia. Australia export volumes in particular, have increased by 76% within the last 2 years alone.

Furthermore the success of $1.99 wines in CA is sure to maintain negative pressure on margins for some time to come. The economic slowdown has also contributed to consumer's frugality and further pressured suppliers to enhance their brand management efforts. We believe that companies with solid brand management will be able to endure the current cyclical trough, while weaker players will be forced to consolidate in order to survive.

Chart 5 - Wine Market By Segment

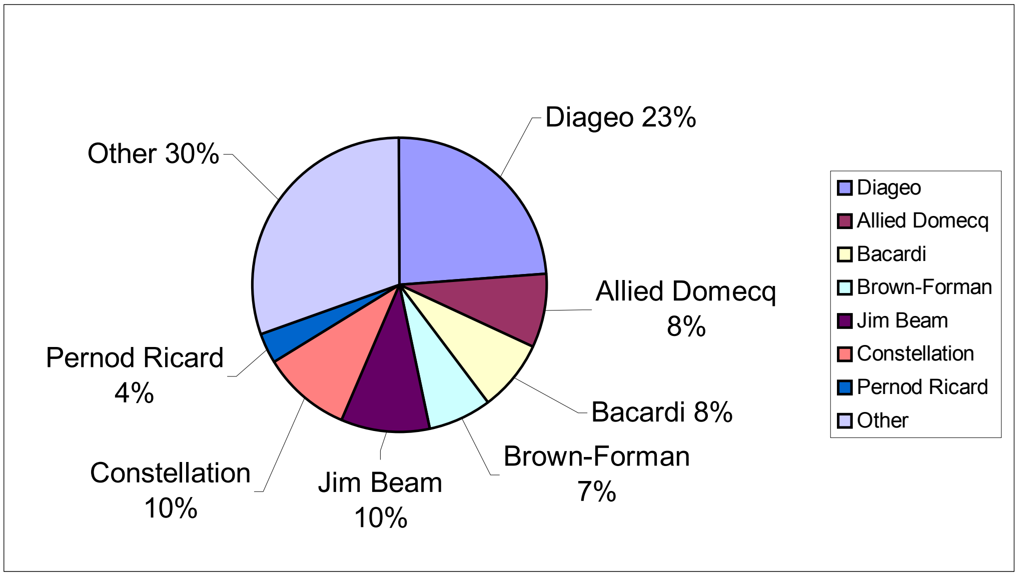


Liquor

Distilled spirits consumption rose 1.8% in 2002, to 153.0 million 9-liter cases according to Adams handbook advance 2003, the fifth consecutive year of gains. Most spirits categories posted gains in 2002, with the non-whiskey segment (up 2.5%) outperforming the total whiskies (up 0.2%).

Chart 6 - Distilled Spirits Consumption By Category 2002

Charts 7 - Leading Distilled Spirits Suppliers 2002



Value Chain

Since the repeal of Prohibition in 1933, alcoholic beverages have been made available to the consumer through what is known as the three-tier system. The 21st Amendment to the constitution repealed Prohibition, but sought to preserve some of its objectives (e.g., the promotion of temperance). It did so by declaring “the transportation into any state, territory, or possession of the United States for delivery or use therein of intoxicating liquors, in violation of the laws thereof, is hereby prohibited. The Amendment, in short, provided each state the freedom to regulate the commerce of alcoholic beverages within its borders as it deemed fit. This has led to a Byzantine mix of laws regulating alcoholic beverage sales from state to state, sometimes reflecting vested interest politics. The two most important reasons for the current existence of the three-tier system is the collection of federal and state excise taxes as well mitigating the risk of sales to minors. The Alcoholic beverage three-tier system works as follows:

Exhibit 1 - Alcoholic Beverage 3 Tier System

Tier 1: Producers
Wineries / Brewers / Distilleries
Excise taxes are collected on the transaction between producers & wholesalers
BUD, RKY, STZ, MOND

Tier 2: Wholesalers
Liquor / Wine / Beer wholesalers
Excise taxes are collected on the transaction between wholesalers & retailers
Southern Wines & Spirits, Charmer Industries

Tier 3: Retailers
Convenience stores / Package stores / Grocery stores Bars / Restaurants / Private clubs / Airlines
Sales taxes are collected on the transaction between retailer & consumer
Stop & Shop, Shaws, Chili's, Costco, TGI Fridays

The states in the union are divided into Control states, those where alcoholic beverages are sold by the state itself, i.e. NH, PA, WA, license limitation states, where retailers are permitted to hold retail licenses up to a specified limit, i.e. 1 license per person in NY, 2 licenses per family (to the third degree) in CT, and finally Open states, where retailers can carry any product and there are no limitations on the number of licenses they can hold, i.e. FL, CA. These are important issues as the fragmented nature of the retail tier hints at why price increases are more easily passed on in the alcoholic market in contrast to the non-alcoholic beverage market.

In contrast, non-alcoholic beverages are not subject to these regulations, and although most companies in the space conduct business using the aforementioned tiers, they can and do have varying degrees of participation in other tiers. In the case of all non-alcoholic beverages, all three Tier 1 participants own substantial minority stakes in their largest Tier 2 counterparts. KO owns a 40% stake in CCE (and large minority stakes in several other major bottlers around the world). PEP owns a 40% in PBG.

Covered Companies

KO and PEP: Overview of Non-Alcoholic Beverages Sub-Industry[7]

Coca-Cola Co. (KO) and PepsiCo (PEP) make up over 75% of market capitalization of S&P 500's beverages index. Of the broader S&P 500 index, the two companies represent about 2%.

Even though the two are classified as beverage companies, only KO can be considered as a true beverage company. They derive 100% of their revenues from their portfolio of beverage products. In contrast, PEP earns only 35% of its revenues from this segment. The remaining 65% comes from its Frito-Lay line of snack foods and other food products.

In the 1980's and early 90's, the two companies were able to earn double-digit growth in operating profit from expanding volume. This strategy came to be unsustainable as new consumer preferences and segments began to emerge. Health and wellness considerations played a larger role in the consumer's purchase decisions. Demographic trends (ex. growing minority population, aging population) could not justify anymore a simple strategy to offer carbonated beverages.

As such, their target market has been changing. The market definition has evolved from "Carbonated Soft Drinks" to "Non-Alcoholic Ready to Drinks" (NARTD), which includes bottled water, isotonics, and juices in addition to the carbonated beverages that has been the mainstay. Bernstein research estimates that the size of global NARTD (measured in cases[8]) will grow from current levels of 60 billion to 80 billion over the next five years. This represents a CAGR of roughly 5~6%.

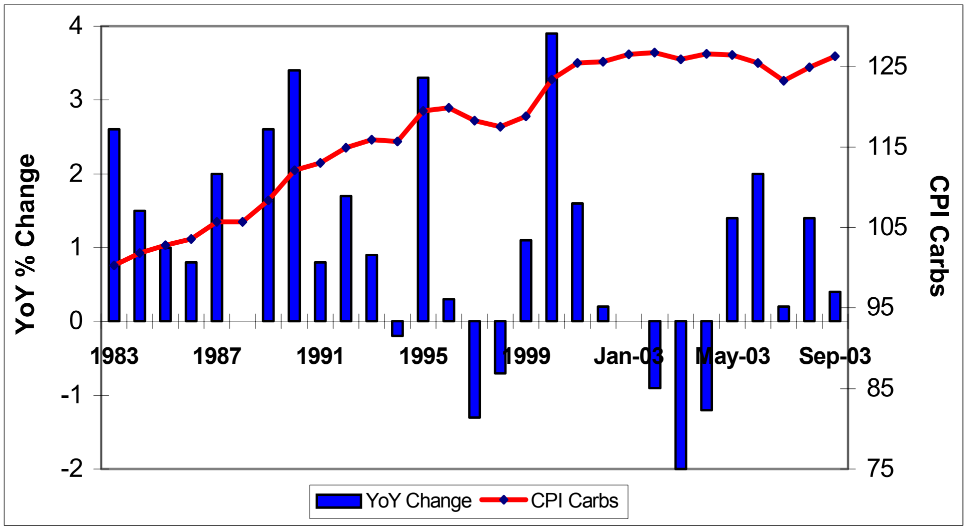
With the diversification in consumer tastes, there has been a migration by the two companies toward a "Total Beverage Company Strategy," where their offerings would be expanded beyond the traditional carbonated soft drinks. Over the last six years, KO and PEP have re-mixed their portfolio of products by launching new brands in search for growth.

The evolution in the market definition has significantly eroded the pricing power that KO and PEP used to enjoy with their beverage products. Diversification in consumer tastes and the expansion in product lines to keep up with it have made the prices for non-alcoholic beverages more elastic. The firms are also facing a low-inflation environment. Using the CPI index for carbonated beverages as a proxy, the graph below illustrates how the pricing power has fallen:

[7] Primary Sources for this section – Prudential Equity Group, Bernstein Research Call, Legg Mason, 2002 10-K of KO and PEP

[8] 1 case = twelve 16oz. Bottles of beverage

Chart 2 - CPI of Carbonated Beverages



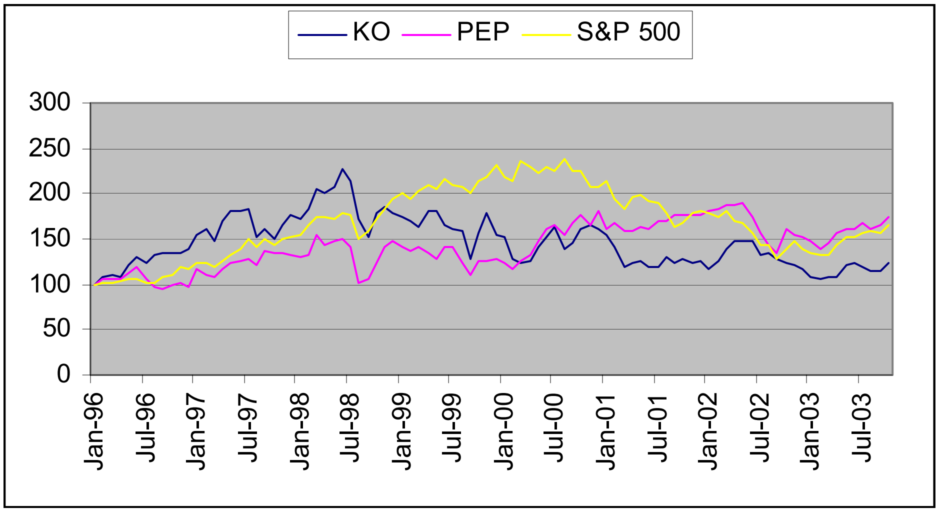
Source: Bureau of Labor Statistics
(all figures prior to 2003 are annual; 2003 figures are monthly)

Another factor that mitigates pricing power is new sources of competition. With the diversification of product lines, KO and PEP are inevitably competing with other global food and beverage giants, such as Nestle, Danone, and Cadbury. The overlap is very evident in the bottled water market, currently a $1.7 billion industry annually. The market share table below shows that Nestle and Danone are competing head-to-head in this market:

Market Share Breakdown	
Bottled Water	
Nestle	35%
PepsiCo	26%
Coca-Cola	15%
Danone	13%
Other	12%

Source: Prudential Equity Group

While we have not done an in-depth DCF for this report, we see a consensus view on the street that both KO and PEP appear to be fairly valued at where they are ($46 and $48.17 respectively as of 10/30/2003). Of the two, PEP has been more in favor with the market this year than KO.



The gap in performance year to date (+5.8% for KO, +13.3 for PEP) can be attributed largely to the difference in product mix between the two companies. Unlike KO, which derives revenues from beverages only, PEP earns more than half of its revenues from its food business (Frito-Lay, Quaker Oats). PEP also leads KO in market share of new growth beverage segments of bottled water and isotonics. Furthermore, the market perceives the growth opportunities in food to be better than that of NARTD beverages. PEP commands market-leading shares in nearly all of its Frito-Lay businesses (#2 in snack bars, #1 in salty snacks – Bernstein Research Call). After spending more than two years, the Quaker foods businesses (for which it outbid Coke in 2001) finally appear well-integrated into PEP.

Apart from the sub-industry dynamics discussed above, additional risks to the stock valuation of KO and PEP stem from the following:

- Weather: Weather like this years could impact volume sales.
- Economy – there is a perception that KO and PEP are consumer staple stocks. With the current perception that US economic recovery is underway or imminent, investors have bid down stock prices of PEP and KO by rotating out of this sub-sector and moving into those that are more tied to economic cycles.
- Currency fluctuation – This is more a risk for KO than PEP. The former derives 70% of its revenues from outside the US, whereas the latter receives only 30% of the same.
- Product Mix – After nearly six years of re-mixing the product portfolio, Will KO's bet to remain a 100% beverage company pay off? Likewise, will it prove prudent for PEP to diversify its product line by growing its presence in foods?
- Future Corporate Activity – When PEP first acquired Quaker Oats in 2001 it was viewed with skepticism, as investors believed that PEP was overpaying for it. Will they acquire more brands? Will they divest laggard food brands (ex. Quaker Oats' cereal segment is #5)? How will KO respond to PEP?

Supplement: Market Share Tables for KO and PEP's Beverage Product Segments (Source: Prudential Equity Group)

Isotonics ($1B in annual revenues)	
PepsiCo	85.62%[9]
Coca-Cola	13.07%
Other	1.31%

Carbonated Soft Drinks ($12B)	
Coca-Cola	38%
PepsiCo	33%
Dr Pepper/Seven-Up	18%
Other	7%
Snapple	0%

Low Calorie Carbonated Soft Drinks ($3.8B)	
Coca-Cola	44.50%
PepsiCo	32.90%
Dr. Pepper/Seven-Up	16.90%
Other	3.80%
Snapple	0.10%

Orange Juice ($2.7B)	
PepsiCo (Tropicana)	48%
Coca-Cola (Minute Maid)	23%
Other	18%
Citrus World	11%

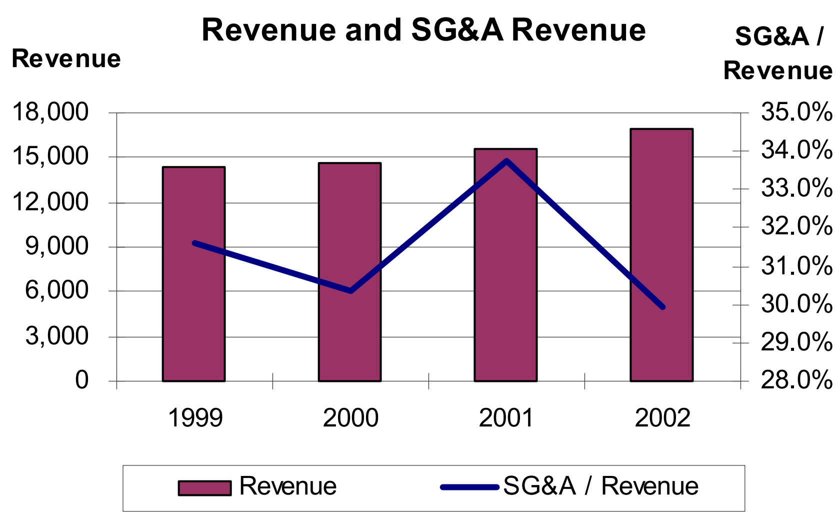
[9] PepsiCo's overwhelming leadership in this market is as a result of its Gatorade acquisition in 2001.

Coca Cola Enterprises (CCE)

Coca Cola Enterprises (CCE) was incorporated in 1946 as a wholly owned subsidiary of Coca Cola (KO), the parent still owns 38% of CCE's outstanding stock. CCE distributes Coke products in 46 states, the District of Columbia, Canada, France, Great Britain, Belgium, Luxemburg, France and the Netherlands. North America generates more than three-fourths of CCE's revenues. Like PBG, CCE has benefited from product innovations of its licensor. KO's new products, such as Dasani and Vanilla Coke have helped fuel CCE's revenue growth.

Operating Results

CCE's YTD results paralleled its turnaround in 2002. During both periods, revenue increased by 8%. The firm also registered slight improvements in gross margin, and in 2003 it maintained the lower SG&A ratio established in 2002. These results are in sharp contrast to the loss reported in 2001. CCE's results suffered due to turmoil at KO following the succession of Douglas Daft to CEO. Europe's heat wave strengthened the results for 2003. For the remainder of 2003, CCE plans to focus on pricing strategies, but it will begin revenue enhancing initiatives in 2004. Most of the revenue growth in 2002 and 2003 has been driven by increases in case volume because CCE continues to lack pricing power, especially in the US.



	1999	2000	2001	2002	03 YTD	02 YTD
Revenue	14,406	14,659	15,605	16,889	13,018	12,028
Source 2	0	0	0	0	0	0
Source 3	0	0	0	0	0	0
Revenue	**14,406**	**14,659**	**15,605**	**16,889**	**13,018**	**12,028**
Source 1	9,015	9,083	9,740	10,417	7,616	7,081
Source 2	0	0	0	0	0	0
COGS	9,015	9,083	9,740	10,417	7,616	7,081
Gross Profit	**5,391**	**5,576**	**5,865**	**6,472**	**5,402**	**4,947**
SG & A	4,552	4,450	5,264	5,054	4,172	3,834
Operating Income	**839**	**1,126**	**601**	**1,418**	**1,230**	**1,113**
Interest Expense	751	791	753	662	446	495
Other Expenses	0	2	300	51	(2)	(1)
Taxes	29	97	(131)	211	241	205
Net Income	**59**	**236**	**(321)**	**494**	**545**	**414**
Diluted Shares	436	429	432	458	460	457
Diluted EPS	**$0.14**	**$0.55**	**($0.74)**	**$1.08**	**$1.18**	**$0.91**
Revenue Growth		1.8%	6.5%	8.2%	8.2%	
Gross Margin	37.4%	38.0%	37.6%	38.3%	41.5%	41.1%
SG & A / Revenue	31.6%	30.4%	33.7%	29.9%	32.0%	31.9%
Tax Rate	33.0%	29.1%	29.0%	29.9%	30.7%	33.1%
Net Margin	0.4%	1.6%	-2.1%	2.9%	4.2%	3.4%
EBIT	839	1,126	601	1,418	1,230	1,113
EBITDA	1,631	1,899	1,404	2,224	2,052	1,880
NOPLAT	563	798	427	994	853	744
FCF	2,852	1,109	2,136	1,373	N/A	N/A

Projections

- We expect CCE to continue to execute well, but this means maintaining the level of profitability it has achieved.
- The stagnant gross margins demonstrate that CCE lacks pricing power due to the relatively high price elasticity of carbonated beverages.
- Since the company aggressively cut costs in 2002, there is little opportunity for further improvements. The flat expense ratio in YTD 2003 was the best case scenario.
- The recent increase in CCE's price (+22% since August 2003) has left the shares fairly valued.

Pepsi Bottling Group (PBG)

Pepsi Bottling Group was spun off from Pepsi in January 1999. Pepsi still owns 40% of PBG. It has the exclusive rights to manufacture and distribute all Pepsi beverage products in 41 US states, the District of Columbia, most of Canada, most of Mexico, Spain, Russia, Greece and Turkey. PBG generates 82% of its revenues in the United Sates. The company has made a number of acquisitions since in recent years. The Pepsi-Gemex acquisition is viewed as critical to PBG's future growth. John Cahill has progressed from COO in 2001 to Chairman and CEO. This culminates a series of senior management moves. Although most restaurants continue to serve Coke products, PBG has been successful in winning several contracts to provide beverages at sport stadiums.

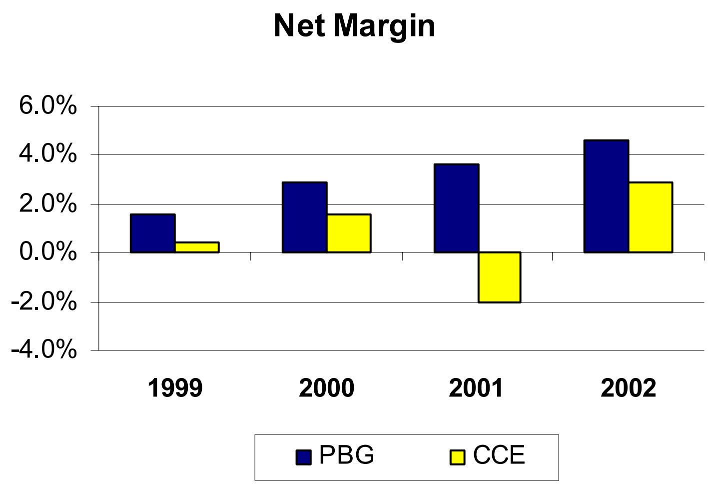
2003	**2002**	**2001**	**2000**
Olean Bottling Works	Pepsi-Gemex (Mexico)	Pepsi Bottling Macon	Multisodas
Cassidy's Beverages	Kitchener Beverages	Pepsi Bottling Elmira	
Pepsi Bottling Buffalo	Seamans Beverages	Pepsi Bottling North CA	
	Pepsi Bottling Aroostock		
	Fruko A		

Results of Operations

PBG's results have improved significantly since its inception. Revenues increased 9% in 2002. The change was due to both higher case volume and higher revenue per case. The growth in cases was primarily due to acquisitions, but PBG did expand case volume from existing territory. PBG also benefited from Pepsi's product innovations, such as Mountain Dew Code Red and Pepsi Vanilla. Aquafina also continues to report strong growth. The heat wave in Europe was also windfall, but it was partially offset by mild weather in the US. The following exhibit demonstrates the sources of revenue:

Case Volume from Existing Area	+2%
Case Volume from Acquisitions	+6%
Revenue per Case	+1%
Total Revenue	+9%

PBG has consistently improved its gross margin, and it significantly reduced its SG&A ratio in 2002. As a result of these factors, PBG enjoys a healthy net margin advantage over CCE.



	1999	2000	2001	2002	03 YTD	02 YTD
Revenue	7,505	7,982	8,443	9,216	7,216	6,436
Source 2	0	0	0	0	0	0
Source 3	0	0	0	0	0	0
Revenue	**7,505**	**7,982**	**8,443**	**9,216**	**7,216**	**6,436**
Source 1	4,296	4,405	4,580	5,001	3,655	3,464
Source 2	0	0	0	0	0	0
COGS	4,296	4,405	4,580	5,001	3,655	3,464
Gross Profit	**3,209**	**3,577**	**3,863**	**4,215**	**3,561**	**2,972**
SG & A	2,813	2,987	3,187	3,317	2,812	2,228
Operating Income	**396**	**590**	**676**	**898**	**749**	**744**
Interest Expense	202	192	194	191	166	136
Other Expenses	6	34	41	58	52	48
Taxes	70	135	136	221	184	189
Net Income	**118**	**229**	**305**	**428**	**347**	**371**
Diluted Shares	257	299	296	293	280	294
Diluted EPS	**$0.46**	**$0.77**	**$1.03**	**$1.46**	**$1.24**	**$1.26**
Revenue Growth		6.4%	5.8%	9.2%	12.1%	
Gross Margin	42.8%	44.8%	45.8%	45.7%	49.3%	46.2%
SG & A / Revenue	37.5%	37.4%	37.7%	36.0%	39.0%	34.6%
Tax Rate	37.2%	37.1%	30.8%	34.1%	34.7%	33.8%
Net Margin	1.6%	2.9%	3.6%	4.6%	4.8%	5.8%
EBIT	396	590	676	898	749	744
EBITDA	1,188	1,363	1,479	1,704	1,135	1,040
NOPLAT	249	371	468	592	489	493
FCF	(321)	(17)	241	226	N/A	N/A

Projections

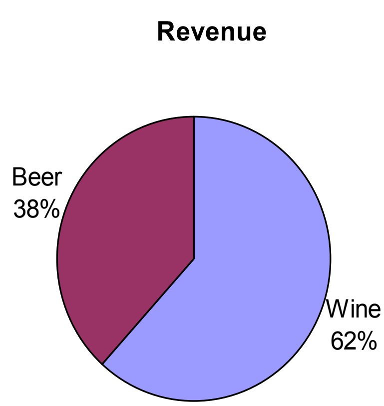
The recent release of CSD CPI by the Department of Labor shows the Year to September year on year prices have increased 1.1%. This confirms our belief that PBG has significant upside for the following reasons:

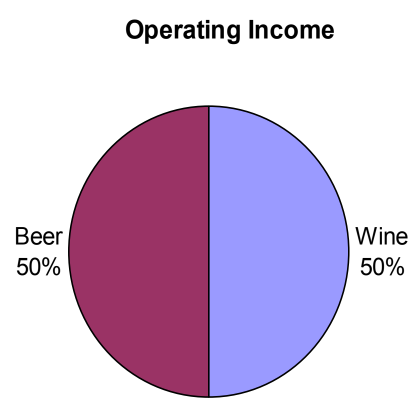
- US soft drinks are entering a period of improved profitability due to an unprecedented pricing discipline among bottlers. Bottlers are singing from the same hymnal and have desisted from previous strategies of "volume at all costs".
- Investor sentiment is decidedly negative mainly due to quality of recent announcements and the lackluster performance of Mexican operations. In our view, the investment in the Mexican subsidiary has already been substantially written off.
- The company stands to benefit from the sequential acceleration is U.S. topline growth, its largest market, as well as easy comparisons in both the U.S. and Mexico.
- On valuation, we note the shares' 2004E free cash flow yield of 7.1% is well above its mean historical forward yield of approximately 5.8%, with a regression to the mean implying a 22% appreciation in price.

Constellation Brands (STZ)

Products

Constellation has two divisions wine and beer & spirits. The wine segment, which also includes the firm's wholesaling activities, generates 61% of revenue, but it comprises only 50% of operating income. This phenomenon is due to the low margin earned by the wholesaling unit. The wholesaling unit focuses on the UK, where it has 16,000 on-premise accounts.





Wine Summary

The outlook for the wine industry is negative because the oversupply and frugality induced by the economic downturn will overshadow the favorable demographics created by the aging baby-boomers. Constellation has been using the difficult environment as an opportunity to acquire smaller vineyards. This strategy enabled Constellation to broaden its product line. A diversified product line is essential in the wine industry because premium wines earn higher margins, but they are extremely vulnerable to economic downturns. Fine wines also require significant investment in fixed assets relative to the revenues they produce.

Wine Quality Matrix

Type	Popular	Premium	Super-Premium	Ultra-Premium
Table				
Dessert				
Sparkling				

Recent Acquisitions

2003	**2002**	**2001**	**2000**	**1999**
BRL Hardy	St. Francis Winery	Blackstone Winery Ravenswood Corus Brands Turner Road Vintners	Fort Wines Limited	Franciscan Vineyards Brands from Diageo Simi Winery

Beer Summary

Constellation's beer division features six of the top 25 imported brands in the US, such as Corona Exra, Corona Light, Modelo Especial, Negro Modelo, St. Pauli Girl and Pacifico. The beer division also includes some mid-priced and low-priced spirits. Although the division is a collection of unrelated brands that lack a consistent theme, it has performed well. Both revenue and margin have increased in the last few years.

	Revenue	**Operating Income**	**Operating Margin**	**Fixed Asset Turnover**
Wine Division:				
Popular/Premium	749	108	14.4%	3.9
Ultra-Premium	156	57	36.5%	0.9
Wholesaling	790	56	7.1%	5.3
Total	1,695	221	13.0%	3.2
Beer Division	1,058	218	20.6%	13.2
Constellation	2,753	439	15.9%	4.6

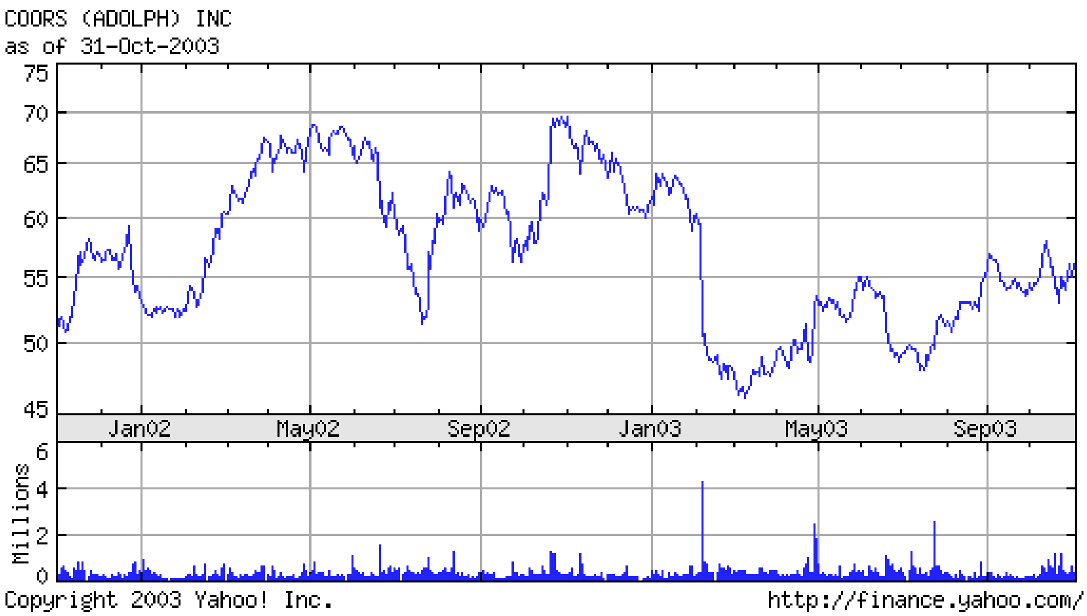
Operating Results

Due to the challenging environment for wine producers, acquisitions have been the primary driver for Constellation's revenue growth, but the CAGR for revenue is still 18%. Constellation has benefited from a decline in excise taxes as a percentage of gross revenue. SG&A as a percentage of revenue increased in 2001 due to acquiring companies with higher SG&A ratios and expenses related to those acquisitions. SG&A also increased in 2003 because of the Hardy acquisition. The results reflect Constrellation's effectiveness in integrating acquisitions into its existing operations. However, the revenues for Hardy were below expectations in the most recent results, but an acquisition should not be judged based on one quarter.

	1999	2000	2001	2002	03 YTD	02 YTD
Revenue	2,910	2,984	3,420	3,583	2,137	1,759
Excise Taxes	748	758	814	852	457	419
Product Costs	1,627	1,647	1,912	1,971	1,234	970
COGS	2,375	2,405	2,725	2,822	1,691	1,389
Gross Profit	**535**	**579**	**695**	**761**	**446**	**370**
SG & A	281	311	643	550	232	178
Operating Income	**254**	**268**	**52**	**211**	**214**	**192**
Interest Expense	106	109	114	105	80	54
Other Expenses	19	(3)	(291)	(229)	18	(5)
Taxes	52	65	92	132	42	56
Net Income	**77**	**97**	**136**	**203**	**74**	**87**
Diluted Shares	74	75	88	93	99	93
Diluted EPS	**$1.05**	**$1.30**	**$1.55**	**$2.19**	**$0.75**	**$0.94**
Revenue Growth		2.5%	14.6%	4.8%	21.5%	
Excise Tax/Revenue	25.7%	25.4%	23.8%	23.8%	21.4%	23.8%
Cost of Product/Revenue	55.9%	55.2%	55.9%	55.0%	57.7%	55.1%
Gross Margin	18.4%	19.4%	20.3%	21.2%	20.9%	21.0%
SG & A / Revenue	9.6%	10.4%	18.8%	15.3%	10.9%	10.1%
Tax Rate	40.0%	40.0%	40.3%	39.3%	36.2%	39.2%
EBIT	254	268	52	211	214	192
NOPLAT	153	160	31	128	136	117
EBITDA	319	338	137	271	267	223
FCF	144	476	(62)	309	N/A	N/A

Adolph Coors (NYSE: RKY)

Company Description: Adolph Coors Company, incorporated in 1913, is primarily engaged in the manufacture, marketing and sale of beer and other beverage products. RKY categorizes its operations into two operating segments: the Americas and Europe. The Americas segment primarily consists of production, marketing and sales of the Coors family of brands in the United States and its territories. This segment also includes the Coors Light business in Canada that is conducted through a partnership investment with Molson, Inc. and the sale of Molson products in the United States that is conducted through a joint venture investment with Molson. The Americas segment also includes the small amount of Adolph products that are exported and sold outside of the United States and its territories, excluding the Europe segment. The Europe segment consists of the RKY's production and sale of the Coors Brewers Limited (CBL) brands principally in the United Kingdom, but also in other parts of the world, and its joint venture arrangement relating to the production and distribution of Grolsch in the United Kingdom and Republic of Ireland. The Europe segment was established when Adolph completed its acquisition of CBL in February 2002.[10]



Americas Operations: Coors Canada is the RKY's partnership with Molson that manages all marketing activities for Adolph's products in Canada. RKY owns 50.1% of this partnership and Molson owns 49.9%. The partnership contracts with a Molson subsidiary for the brewing, distribution and sale of products. Coors Light has an approximately 8% market share.

In Puerto Rico, RKY markets and sells Coors Light through an independent local distributor. A local team of RKY's employees manages marketing and promotional efforts in this market. RKY also sells its products in several other Caribbean markets, including the United States Virgin Islands, through local distributors.

Coors Japan Company, Ltd., RKY's Tokyo-based subsidiary, is the exclusive importer and marketer of Adolph's products in Japan. The Japanese business is focused on Zima and Coors Original. Coors Japan sells RKY's products to independent distributors in Japan.

[10] www.yahoo.com

In August 2001, RKY formed a new subsidiary, Coors Beer & Beverages (Suzhou) Co., Ltd., to market and distribute Coors products in China. In October 2001, RKY commenced a brewing agreement with Lion Nathan Beer and Beverages (Suzhou) Co. Ltd. to supply the China market.

RKY's Coors Light brand, a premium beer, and its other products in the United States include an additional 11 brands. RKY's other premium beers include Coors Original and Coors Non-Alcoholic. RKY also offers a selection of above-premium beers including George Killian's Irish Red Lager and Blue Moon Belgian White Ale. In addition, RKY offers Zima and Zima Citrus alternative malt-based beverages that have long competed in the flavored-alcohol beverage (FAB) brands category. RKY also offers products for the lower-priced segment of the beer market such as Extra Gold and its Keystone family of beers, including Keystone Light, Keystone Premium and Keystone Ice. Coors Light accounted for more than 70% of RKY's Americas sales volume in each of the last four years (from 1998 to 2002), while premium and above-premium products accounted for more than 85% of RKY's total Americas volume. Adolph competes with Anheuser-Busch and Miller.[11]

Europe Operations. CBL had volume sales of approximately 9.2 million United States barrels in 2002. The CBL sales are primarily in England and Wales, with the Carling brand (a mainstream lager) representing approximately two-thirds of CBL's total beer volume. CBL also manufactures FABs, which it sells in the United Kingdom and export markets. Total FABs volume is less than 4% of its overall volume. CBL's products are exported to over 25 countries, with these exports accounting for less than 3% of total CBL volume.

The Company's United Kingdom brand portfolio consists of 21 domestic beer brands and six non-beer brands. Adolph has representation in each of its product categories. Caffrey's, a premium ale, makes up approximately 3% of the Company's volume and Worthington makes up approximately 11% of Adolph's volume. Grolsch's volume has increased more than six times since 1994. In addition, the Company has a successful range of FAB brands that it owns, including Reef. During 2002, CBL launched Worthington's 1744, a premium cask ale; Breaker Superbrew Lager, an extra strong lager, and Screamers, a vodka-based shots drink. RKY's competitors are Scottish Courage Ltd., Interbrew U.K. Ltd. and Carlsberg-Tetley Ltd.[12]

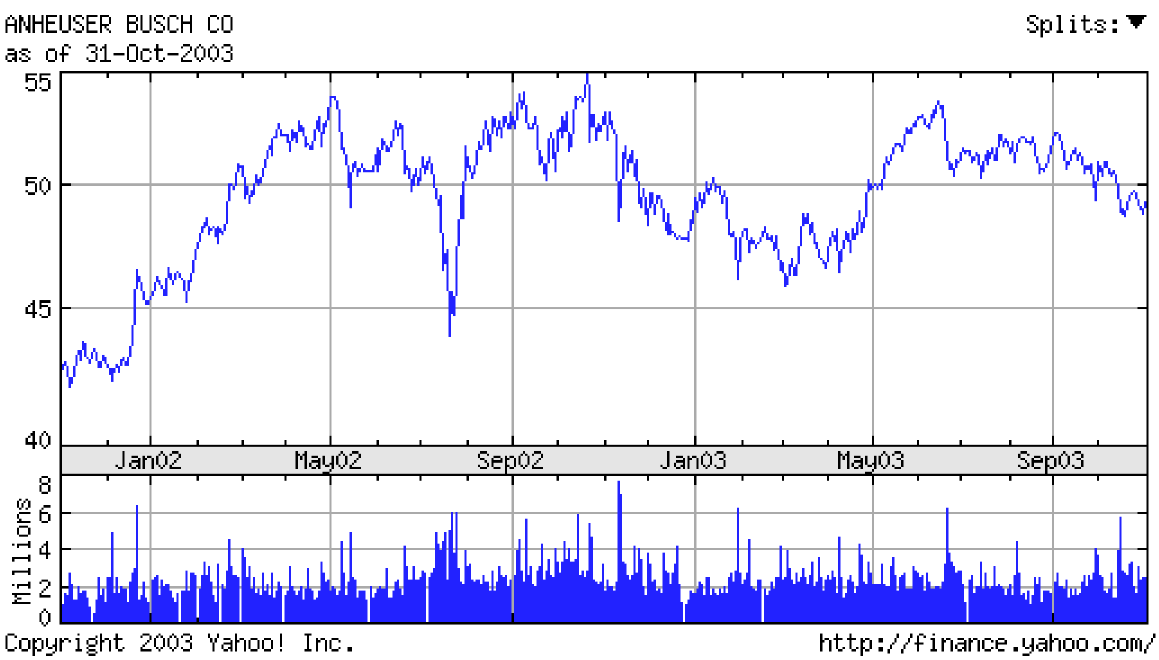
Investment Thesis. Recently RKY reported 3Q:03 EPS of $1.62, well ahead of the consensus forecast. Total revenue increased 3.9% to $1.041 bn, largely on the strength of European volume which rose 6.2%. RKY also indicated that 4Q:03 total revenue growth, which was essentially flat in the Americas in 3Q:03, is likely to decelerate. In addition, implementation of RKY's new SAP system is bringing unintended costs. RKY's comment on 4Q:03 is not particularly surprising, since they had previously indicated that destocking would occur in 4Q:03. RKY has generated incremental 4Q:03 costs of roughly $0.02-$0.05 thus far for 4Q:03 due to the implementation of a new SAP system. RKY may be at the front of a sustained period of downward earnings revisions due to a deteriorating competitive position and anticipated 4Q:03 results which are unlikely to inspire sustained incremental buying above current prices over the near-term. We believe the likelihood is that the stock is heading into the $40s again over the coming

[11] www.yahoo.com
[12] www.yahoo.com

months and expect to find support in the upper $40s, again due to valuation. Accordingly we rate shares of RKY HOLD.[13]

Anheiser-Busch Companies Inc. (NYSE: BUD)

Company Description: Anheuser-Busch Companies, Inc., incorporated in 1979, is the holding company parent of Anheuser-Busch, Incorporated (ABI). BUD is also the parent corporation to a number of subsidiaries that conduct various other business operations. Anheuser-Busch's operations are comprised of domestic beer, international beer, packaging, entertainment and other. The domestic beer segment consists of the United States beer manufacturing and wholesale operations. The international beer segment consists of BUD's export sales and overseas beer production and marketing operations. The packaging segment is comprised of its aluminum beverage can and lid manufacturing, aluminum recycling, label printing, crown and closure liner material manufacturing and glass manufacturing operations. The entertainment segment consists of adventure park operations. The other segment is comprised of real estate development and transportation businesses.[14]



Domestic Beer Operations. BUD's principal product is beer, produced and distributed by its subsidiary, ABI, in a variety of containers, primarily under the brand names Budweiser, Bud Light, Bud Dry, Bud Ice, Bud Ice Light, Michelob, Michelob Light, Michelob Golden Draft, Michelob Golden Draft Light, Michelob Black & Tan Lager, Michelob Amber Bock, Michelob Honey Lager, Michelob Hefe-Weizen, Michelob Marzen, Busch, Busch Light, Busch Ice, Natural Light, Natural Ice, King Cobra, ZiegenBock Amber, Hurricane Malt Liquor, Hurricane Ice, Pacific Ridge Ale, Doc's Hard Lemon, and Tequiza. ABI's products also include three non-alcohol malt beverages, O'Doul's, Busch NA and O'Doul's Amber. During 2002, ABI introduced Bacardi Silver, Michelob ULTRA and American Red and discontinued Red Wolf Lager, Doc's Hard Apple, Killarney's and Red Label.

[13] Legg Mason research.
[14] www.yahoo.com

Anheuser-Busch brews Kirin Light, Kirin Lager and Kirin-Ichiban through a joint venture agreement with Kirin Brewing Company, Ltd. of Japan for sale in the United States. ABI owns a 29.5% equity interest in Seattle-based Redhook Ale Brewery, Inc. Through this alliance, Redhook products are distributed by many ABI wholesalers and exclusively by ABI wholesalers in all new United States markets entered by Redhook since 1994. ABI also owns a 36% interest in Portland-based Widmer Brothers Brewing Company. Widmer products are distributed by many ABI wholesalers and exclusively by ABI wholesalers in all new United States markets entered by Widmer since 1997.

Budweiser, Bud Light, Bud Dry, Bud Ice, Bud Ice Light, Michelob, Michelob Light, Michelob Black & Tan Lager, Michelob Golden Draft, Michelob Golden Draft Light, Michelob Amber Bock, Michelob Honey Lager, Michelob Hefe-Weizen, Michelob ULTRA, Busch, Busch Light, Natural Light, Natural Ice, Doc's Hard Lemon, ZiegenBock Amber, Kirin-Ichiban, O'Doul's, O'Doul's Amber, Bacardi Silver, Widmer beer products and Redhook Ales are sold in both draught and packaged form. Busch Ice, King Cobra, Michelob Marzen, Hurricane Malt Liquor, Tequiza, Hurricane Ice, Kirin Lager, Kirin Light, and Busch NA are sold only in packaged form. Pacific Ridge Ale and American Red are sold only in draught form.[15]

International Beer Operations. International beer volume was nearly eight million barrels in 2002, compared with 7.5 million barrels in 2001. Anheuser-Busch International, Inc. (ABII), a wholly owned subsidiary of Anheuser-Busch, oversees the marketing and sale of Budweiser and other ABI brands outside the United States, operates breweries in the United Kingdom and China, negotiates and administers license and contract brewing agreements on behalf of ABI with various foreign brewers and negotiates and manages equity investments in foreign brewing partners. ABI's beer products are being sold in more than 80 countries and United States territories.

Through Anheuser-Busch Europe Limited (ABEL), an indirect, wholly owned subsidiary of BUD, certain ABI beer brands are marketed, distributed and sold in 29 European countries. In the United Kingdom, ABEL sells Budweiser, Bud Ice, Michelob and Michelob Golden Draft brands to selected on-premise accounts, brewers, wholesalers and directly to off-premise accounts. Budweiser, Bud Ice and Michelob are brewed and packaged at the Stag Brewery near London, England, which is managed and operated by ABEL. Michelob Golden Draft continues to be imported into the United Kingdom by ABEL.

In Canada, Budweiser, Bud Light, Busch and Busch Light are brewed and sold through a license agreement with Labatt Brewing Co. In Japan, Budweiser is brewed and sold through a license agreement with Kirin Brewery Company, Limited. Budweiser is also brewed under license and sold by brewers in Korea (Oriental Brewery Co., Ltd.), the Republic of Ireland and Northern Ireland (Guinness Ireland Limited), Italy (Birra Peroni Industriale) and Spain (Sociedad Anonima Damm). BUD has an agreement with Brasseries Kronenbourg, a brewer in France, for sale and distribution of Bud in France.

Competitors include Scottish Courage, Coors Brewers, Interbrew, Carlsberg-Tetley and Molsen.[16]

Packaging Operations. Anheuser-Busch's packaging operations are handled through the following wholly owned subsidiaries of BUD: Metal Container Corporation, which manufactures beverage cans and beverage can lids; Anheuser-Busch Recycling

[15] www.yahoo.com
[16] www.yahoo.com

Corporation, which buys and sells used beverage containers and recycles aluminum cans; Precision Printing and Packaging, Inc., which manufactures metalized and paper labels, and Eagle Packaging, Inc., which manufactures crown and closure liner materials for ABI. Through a wholly owned limited partnership, known as Longhorn Glass Manufacturing, L.P., BUD owns and operates a glass manufacturing plant in Jacinto City, Texas, which manufactures glass bottles for Anheuser-Busch's nearby Houston brewery.

Family Entertainment and Other. BUD is active in the family entertainment field, primarily through its wholly owned subsidiary, Busch Entertainment Corporation (BEC), which owns, directly and through subsidiaries, nine theme parks. BEC operates Busch Gardens theme parks in Tampa, Florida, and Williamsburg, Virginia, and SeaWorld theme parks in Orlando, Florida, San Antonio, Texas, and San Diego, California. BEC operates water park attractions in Tampa, Florida (Adventure Island), and Williamsburg, Virginia (Water Country, United States), and Langhorne, Pennsylvania (Sesame Place), as well as Discovery Cove in Orlando, Florida, a reservations-only attraction offering interaction with marine animals. Through a Spanish affiliate, Anheuser-Busch also owns a 16.1% equity interest in Port Aventura, S.A., which is a theme park near Barcelona, Spain. Competitors include Walt Disney Co. and Six Flags Parks. Through its wholly owned subsidiary, Busch Properties, Inc. (BPI), Anheuser-Busch is engaged in the business of real estate development. BPI also owns and operates The Kingsmill Resort and Conference Center in Williamsburg, Virginia. In addition, through a wholly owned subsidiary, BUD also owns and operates Manufacturers Railway Co., a company engaged in the transportation service business.[17]

Investment Thesis. BUD recently reported 3Q:03 EPS in-line with the consensus estimate ($0.80). U.S. total revenue per barrel rose a healthy 3.5%. Management comments indicate that the latest round of price increases is being well received. Considering the relatively in-line U.S. pricing and limited U.S. volume upside, we do not think upside exists to consensus EPS forecasts. BUD reiterated earnings expectations for 2003 and 2004, implying 12%-13% EPS growth. 2004 estimated free cashflow yield is approximately 5%, and compares favorably to a 10-year Treasury yield of roughly 4.3%. However, current valuation and limited upside in the U.S. market opportunity spur us to rate shares of BUD HOLD.[18]

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[17] Ibid.
[18] Legg Mason research.