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Mixed outlook for 2003

The near-term outlook for the U.S. alcoholic beverage industry remains positive, despite continued economic weakness in the United States. Consumer demand for these products tends to remain relatively consistent in good times and bad. Standard & Poor's believes that the U.S. brewing industry in particular will benefit from an extremely favorable pricing environment for beer, improving demographic trends, and rising consumption of premium products. In addition, a relatively benign commodity cost environment, continued productivity improvements, and high industrywide capacity utilization rates should aid profits.

Given these factors, we project that operating profits for the domestic brewing industry will advance 8% to 10% in 2003. This follows the strong performance in 2002, when operating profits for the domestic brewing industry rose more than 10%, by our estimate.

Overall, the wine and spirits sectors should also hold up well through the current economic weakness in the United States. For 2003, we expect their operating profits to grow in the 4%–5% range, reflecting modest price increases and favorable cost trends. In addition, many participants will benefit from global acquisition activity, which can boost volume, leverage distribution channels, and provide economies of scale. For 2002, operating profits for companies in the wine and spirits sectors rose by 3%–4%, on average.

For the tobacco industry, fundamentals deteriorated rapidly during the second half of 2002, as sluggish economic conditions, state excise tax hikes, and a price increase early in the year encouraged consumers to trade down to cheaper smokes. A series of price hikes by the major domestic cigarette manufacturers in recent years to cover payments to the government for smoking-related healthcare costs under the 1998 Master Settlement Agreement (MSA) has widened the price gap between premium and discount cigarettes. This has allowed manufacturers of deeply discounted brands to steadily gain share. Their cigarettes now command 9% to 10% of the U.S. market, up from approximately 3% in 1998.

We expect the price gap between premium and deep discount cigarettes to narrow in 2003. This is primarily because annual payments under the MSA will decrease substantially for the major cigarette manufacturers, while smaller manufacturers will have to begin paying their share. As a result, prices for the majors' premium cigarettes are likely to fall, while prices for discount and deep discount cigarettes will probably rise. Vector Group Ltd., the largest deep discount manufacturer, recently announced price increases for 2003. We expect more discount manufacturers to follow. Meanwhile, the majors should end up with ample cash to invest in support of their brands without hurting margins.

For 2003, Standard & Poor's projects total tobacco industry operating profit growth in the 4%–5% range.

Brewers tapping into profits

Despite modest price increases and a sluggish economy, the U.S. brewing industry is likely to see volume growth of 1.0%–1.5% in 2003, consistent with normalized trendline growth. Standard & Poor's believes that continued strong growth of premium light beers and imported beers will fuel the gains. Alternative malt beverage products, such as flavored alcoholic beverages and hard lemonades, appear to have peaked after two years of blistering growth. These products now command approximately 3.0% to 3.5% of the U.S. brewing market. We believe that modest growth in this segment should continue through 2003, despite an expected rationalization of weaker performing brands.

The domestic beer industry continues to benefit from the realization of higher net revenues per barrel, reflecting increased consumption of high-margin premium products, the successful implementation of price hikes, and reduced discounts by Anheuser-Busch Cos. (A-B, the domestic industry leader), and the leading import beer makers. The most recent price hikes went into effect during the fourth quarter of 2002, and most major competitors quickly followed A-B's lead. The company has announced that it plans to implement another round of price hikes and to reduce discounts beginning in the first quarter of 2003, which should allow for continued margin improvement for the industry through 2003. On average, a 1% increase in pricing generates twice as much profit for brewers than does a similar increase in volume.

Premium domestic beer brands will continue to face stiff competition from fast-growing import beers as European brewers consolidate and gain marketing and distribution muscle in the United States. Consumption trends for import beers should benefit from higher disposable incomes and a narrowing of the price gap with domestic premium beers. With U.S. beer volumes expected to increase by only 1.0%–1.5% in 2002 and into 2003, domestic brewers will likely continue to seek foreign investments and export opportunities in an effort to enhance international growth of their brands.

New wave of consolidation in global beer market

While consolidation in the global beer industry is nothing new, the pace has accelerated in the last few years. Europe has been the primary focus of activity, with nine of the 14 largest deals over the past two and a half years involving brewers based in Western Europe. Merger and acquisition opportunities continue to attract brewers eager to improve distribution capabilities, realize cost savings, increase diversification, enhance growth prospects, and reduce competition.

In July 2002, Philip Morris Cos. Inc. completed the sale of its Miller Brewing subsidiary to South African Breweries plc for $5.4 billion. The new company, known as SABMiller plc, became the second largest brewer in the world, behind Anheuser-Busch; it now has strong market positions in the United States, Africa, China, Russia, Eastern Europe, and Central America. Over time, we believe that this deal will make SABMiller a stronger competitor in the United States, while providing a solid distribution platform for the company's international brands.

In February 2002, Adolph Coors Co. acquired the Carling business portion of Bass Brewers from Belgium's Interbrew N.V. This deal made Coors the second largest brewer in the United Kingdom (behind U.K.-based Scottish & Newcastle plc) and gave it nearly 19% of the U.K. beer market. British regulators had ordered Interbrew to sell Carling after it acquired Bass Brewers and Whitbread plc in mid-2000 and gained dominance in the U.K. beer market.

In August 2001, Interbrew beat out Scottish & Newcastle and U.S. giant Anheuser-Busch in a bidding war for Germany's Beck GmbH & Co., the maker of Beck's, the top German export brand. Interbrew agreed to pay $1.58 billion for Beck's in order to gain entry into Germany's lucrative and highly fragmented beer market. Given the competitive nature of the global beer market, Interbrew's aggressive pursuit of acquisitions in Europe, and the emergence of a new global player in SABMiller, pressure will only increase for companies to continue getting bigger.

Wine and spirits: healthy profit gains

U.S. distilled spirits shipments are likely to post only modest gains in 2003, reflecting weakness in the business travel and entertainment segments of the economy, competition from malt-based flavored alcoholic beverage products, and a continued trend toward moderation in alcohol consumption.

Wine products, however, may buck this latter trend: wine shipments in recent years have benefited from favorable publicity touting the health benefits of moderate consumption. Economic weakness has hurt ultrapremium and luxury wines, but we believe that most other wine segments will show strong growth. In the popular-priced segment of the market, lower grape costs should allow for lower wine prices, supporting volumes in this industry segment for 2003.

Profit growth should remain strong in the wine and spirits sectors, reflecting favorable raw material costs, modest price increases, and lower interest rates. In addition, profitability should benefit from synergies and cost savings resulting from the high level of merger and acquisition activity in recent years. For 2003, operating profits for both the distilled spirits and wine industries should advance at a 4%–5% rate.

Like the beer industry, the spirits and wine industries have also seen an acceleration of merger and acquisition activity in recent years, with large companies positioning themselves to attain improved economies of scale. Standard & Poor's believes that this activity will encourage more international alliances and acquisitions, resulting in increasing globalization of the alcoholic beverages industry over the next few years.

Tobacco: fundamentals should improve

The major tobacco companies began making payments to state governments under the Master Settlement Agreement in 2000. These large payments have forced the manufacturers to raise prices aggressively to protect their bottom lines. This in turn has hurt cigarette sales volumes.

The 1998 agreement, between the tobacco industry and attorneys general of 46 U.S. states, Washington, D.C., and five U.S. territories, resolved the class-action lawsuit against the tobacco industry that four U.S. states initiated in 1994 and 1995. Intended to reimburse states for healthcare costs of smoking-related ailments, the MSA required tobacco companies to pay $250 billion over 25 years. That sum includes separate settlements reached with the industry by four states — Florida, Minnesota, Mississippi, and Texas.

Standard & Poor's believes that the litigation risks now facing the U.S. tobacco industry are manageable, and that the aggregate level of risk will likely recede over time. Nonetheless, court action on various other lawsuits bears watching. Over the next 12 to 18 months, the three key areas of concern will be the *Engle* class action lawsuit, the litigation environment in California, and the Department of Justice lawsuit against the industry (all discussed below).

In addition, the industry faces longer-term regulatory concerns, as tobacco may some day fall under the jurisdiction of the Food and Drug Administration (FDA). Some industry participants favor FDA regulation that would spell out good manufacturing practices and standardize warning labels, among other items. Over the long term, we believe the industry thinks such changes will reduce the threat of lawsuits. However, there is always the risk that the agency's rules would be unfavorable to the industry's business interests.

Engle appeal decision expected in 2003

The largest damage award in U.S. history was leveled against the tobacco industry by a Florida jury in July 2000. *Engle et al. v. R.J. Reynolds Tobacco Co. et al.* was the first class action case against the tobacco industry to go to trial. It hit the five biggest cigarette makers — Philip Morris Cos. Inc., R.J. Reynolds Tobacco Holdings Inc., Brown & Williamson Tobacco Corp., the Lorillard Tobacco Co. unit of Loews Corp., and Liggett Tobacco Co. — with a $145 billion punitive damage award to some 500,000 individual Floridians.

The industry is appealing the verdict. The funds that have to be set aside to satisfy the bonding requirement during the appeals process should not have a material impact on these cash-rich companies. However, liability for the full damages would cause financial hardship. In November 2002, the appellate court heard oral arguments, and Standard & Poor's believes that a ruling could come during the second quarter of 2003.

In its appeals court brief, the industry claims that the judge in the original trial committed several errors and has centered its arguments around five key points. First, it contends that a final judgment should not have been entered, since technically the judgment in this case cannot be final until all class members have been adjudicated. Second, the industry has been denied its right to defend itself from punitive damage claims. Third, the punitive damage trial occurred prematurely, and fourth, much of the plaintiff's evidence was inadmissible. Finally, the industry contends that the class should never have been certified.

Legal precedents appear to favor the industry. Most courts thus far have rejected tobacco class actions, finding that the reasons for which people smoke and the diseases that they contract are too dissimilar for their cases to be bundled together. Fourteen federal courts and a number of state courts have refused to allow smoking injury suits to go forward as class actions. All told, state and federal courts have rejected approximately 40 tobacco class actions.

With *Engle*, two years were spent on trying three individual cases that were the lead plaintiffs for the class. Hearing the compensatory claims for an estimated 500,000 Floridians could take decades, making the trial unworkable.

California remains a litigation threat

Even though the number of claims currently filed against the U.S. tobacco industry is staggering — more than 4,600 — the industry has been, and will likely continue to be, extraordinarily successful in defending itself against the claims of individuals. Except, that is, in California, where lawsuits are proving to be more difficult for the industry. This may reflect a variety of factors, including strong antismoking and anticorporate sentiment among residents, and the state's requirement that in civil cases only three-fourths of the jurors need to agree for a verdict to be reached.

In October 2002, a California jury ordered Philip Morris Cos. to pay more than $28 billion to a 64-year-old woman with lung cancer — the largest judgment ever awarded to an individual. The jury awarded the plaintiff, Betty Bullock, $850,000 as compensation for the harm she had suffered from smoking, plus $28 billion in punitive damages. In December 2002, a California Superior Court judge ruled the verdict excessive and reduced the punitive damage award to $28 million.

A year earlier, a California jury ordered Philip Morris to pay more than $3.0 billion to a 56-year-old man with lung cancer. The jury awarded the plaintiff, Richard Boeken, $5.5 million in compensatory damages plus $3 billion in punitive damages. In August 2001, a California Superior Court judge cut the punitive damage award to $100 million.

Despite substantial reductions in the awards, Philip Morris is nonetheless appealing these verdicts, which it considers unconstitutional under California and federal law. Under California law, punitive damages must bear a reasonable relationship to compensatory damages. In the past, California courts have generally held punitive damage awards to approximately three times compensatory awards, while the U.S. Supreme Court has suggested a 4-to-1 ratio as the constitutional limit. In the Bullock case, the ratio was 33,000 to 1. Even with the reduction, the ratio is 33 to one, well above these limits.

The Bullock verdict is troubling for both the company and the industry, in part because it marked Philip Morris's fourth straight loss in California. The Boeken case and two previous losses (*Henley v. Philip Morris Inc. et al.* in February 1999 and *Whiteley v. Philip Morris et al.* in March 2000) are currently on appeal. In eight consecutive individual smoker cases prior to the Boeken case, the industry had prevailed in a variety of jurisdictions outside of California. The juries in those cases had reviewed essentially identical information and uniformly returned verdicts in favor of the industry.

There is some question as to whether many of the existing lawsuits filed in California against tobacco companies, including the Boeken case, are valid. Beginning in 1988, a California statute protected the tobacco companies from product liability claims under the rationale that the harmful effects of cigarettes were commonly known. The statute was repealed in 1998, but the California Supreme Court recently issued a decision that grants tobacco companies limited immunity for their conduct between 1988 and 1998, the period covered by the statute. While it is still too early to assess the full impact of this ruling, it may improve the ability of tobacco companies to defend themselves in California courtrooms and could be grounds for overturning the four California verdicts that have gone against the tobacco industry.

DOJ lawsuit: no settlement in sight

In June 2001, the Bush administration indicated that it wanted to settle the federal government's lawsuit against the tobacco companies. Filed by the U.S. Department of Justice (DOJ) in September 1999, *United States of America v. Philip Morris Inc. et al.* alleges that cigarette companies conspired to defraud and mislead the public about the risks of smoking. The government is seeking to recover $20 billion in healthcare costs for Medicare patients, veterans, and federal employees with tobacco-related illnesses.

However, while DOJ officials and tobacco industry lawyers have met, it appears that the two sides are far from reaching a settlement. The industry regards the lawsuit as lacking merit and continues to prepare its defense. Given that the industry has shown little desire to settle the lawsuit and that the Bush administration has not proposed enough funding to keep the case alive, the Department of Justice may be forced to abandon the case.

The government's case was severely weakened in late 2000, when U.S. district judge Gladys Kessler dismissed two of its three claims against the industry. Judge Kessler ruled that the government could not seek reimbursement for medical expenses paid out under Medicare and the Federal Employees and Health Benefits Act because it had long ignored that avenue for refunds. However, the suit could proceed under the Racketeer Influenced and Corrupt Organization (RICO) Act. According to Judge Kessler, the government's allegations that the industry had concealed and deceived the public on the dangers of smoking met the threshold of a RICO claim.

A trial date has been set for September 2004, but if the suit goes forward, the DOJ will have a tough case to prove. It will be difficult for the federal government to claim ignorance of tobacco's risks, given the 1964 Surgeon General's report linking cigarette smoking to cancer and other diseases, along with the results of other government research dating back to the 1950s. In addition, the federal government has benefited from billions of dollars in tobacco excise taxes collected in the past century. In the past, the federal courts have tended to favor the industry.

Congress to consider FDA tobacco regulation

In June 2002, a bipartisan group of senators proposed legislation creating a new chapter of the Food, Drug and Cosmetic Act of 1938 that would give the FDA the power to regulate tobacco products. A companion bill was also introduced in the House of Representatives. Previous attempts to pass bills granting the FDA regulatory authority over tobacco failed to reach a consensus on the scope of authority that the FDA would be granted.

The Food and Drug Administration had previously claimed that the 1938 law gave it the right to regulate tobacco. In its view, nicotine is a drug, and a cigarette is a drug delivery system. In 1996, the FDA asserted its authority to regulate tobacco, but the industry challenged it in court. Although the FDA won the first round, an appeals court found for the industry, as did the U.S. Supreme Court. In March 2000, the Supreme Court ruled in a 5-4 decision that the FDA did not have authority to regulate tobacco products. Congress could grant such authority, but had not done so, the court found.

The tobacco industry, led by Philip Morris and some other large manufacturers, is pushing for a bill that would allow the FDA to regulate tobacco as tobacco products rather than as drugs, set guidelines for new products, and define acceptable practices going forward. These companies may hope that some form of government oversight will reduce their own litigation exposure in the long term. While agreeing that FDA oversight could serve the public interest in some areas, R.J. Reynolds believes that any additional regulation should be reasonable and not restrain legitimate industry competition for adult smokers' brand choices.

Meanwhile, the healthcare community is pushing for legislation that gives the FDA full authority to regulate tobacco under the same chapter of the Food, Drug and Cosmetic Act of 1938 that covers drugs and medical devices. Such authority would empower the agency to change and enforce future marketing and advertising restrictions.

Alcohol and tobacco companies see growth

In the United States, alcoholic beverages and tobacco products are big businesses. Combined retail sales (inclusive of all sales and excise taxes) for these industries reached approximately $193.5 billion in 2001, according to estimates from Standard & Poor's and other industry sources. Alcoholic beverages accounted for about $114.5 billion of the total, and tobacco products for about $79 billion. Cigarettes represented about 93% of all tobacco sales. Beer accounted for more than half of alcoholic beverage revenues, with consumers downing about $57.5 billion worth of brew in 2001.

Tobacco

Total cigarette shipments in the United States declined an estimated 3.2% in 2001 from the previous year to approximately 406.3 billion cigarettes (20.3 billion packs, each containing 20 cigarettes). This drop followed a scant 0.1% gain in 2000. The decline in cigarette shipment volumes for 2001 primarily reflects reduced consumption due to higher retail prices and tobacco wholesalers' decisions to reduce inventory before a federal excise tax increase took effect on January 1, 2002.

Measured in dollars, however, sales trends showed gains in 2001. U.S. cigarette retail sales rose more than 4% in 2001, to approximately $73.5 billion, primarily reflecting a federal tax increase and price increases instituted to pay annual obligations under the 1998 Master Settlement Agreement. (For discussion of this legal settlement, see this survey's "Current Environment" section.)

The global market for cigarettes is more than 10 times larger than the U.S. market. Excluding the United States, world cigarette shipments by all manufacturers totaled approximately 4.8 trillion units (individual cigarettes) in 2001, a year-to-year increase of more than 2% according to estimates by Standard & Poor's. The Philip Morris Cos. Inc., the largest producer of American-style cigarettes for foreign markets, shipped 698.9 billion units outside the United States in 2001. This volume was up 3.5% from the previous year and was far greater than its U.S. total of 207.1 billion units.

Four companies control U.S. cigarette market

The U.S. cigarette industry is an oligopoly. Approximately 92% of domestic sales are controlled by the four leading cigarette producers: Philip Morris (with shipment market share of 51.0% in 2001), R.J. Reynolds Tobacco Co. (or RJR, with 22.6%), Brown & Williamson Tobacco Corp. (10.9%), and Lorillard Inc. (9.5%).

Philip Morris U.S.A. (PM) has been the nation's largest tobacco company since 1983. In 2001, its U.S. cigarette shipments totaled 10.35 billion packs, down 2.3% from 2000. A wholly owned subsidiary of the Philip Morris Cos., PM sells Marlboro, Benson & Hedges, Merit, Virginia Slims, and Parliament as its major premium brands. Its principal discount brands are Basic and Cambridge.

PM's Marlboro is the largest-selling cigarette brand in the United States. In 2001, shipments totaled nearly 7.9 billion packs,

DOMESTIC CIGARETTE PRODUCERS' MARKET SHARES
(In percent)

COMPANY	1998	1999	2000	2001
Philip Morris	49.4	49.6	50.5	51.0
R.J. Reynolds	24.0	23.0	23.0	22.3
B&W/American Brands	15.0	13.4	11.7	10.9
Lorillard	9.1	10.4	9.6	9.5
Other	2.5	3.6	5.2	6.3
Total	100.0	100.0	100.0	100.0

Source: Philip Morris Inc.

TOP ALCOHOLIC BEVERAGE PRODUCERS AND THEIR BRANDS*

BEER (PRINCIPAL BRANDS IN COMPANY-DEFINED SEGMENTS)	
Anheuser-Busch Cos.	
"Premium"	The Budweiser family (includes Bud Light, Bud Ice, and Bud Ice Light) and Michelob (Michelob Light, Michelob Golden Draft, Michelob Golden Draft Light, Michelob Classic Dark, Michelob Honey Lager, Michelob Amber Bock, Michelob Ultra and Michelob HefeWeizen), Bacardi Silver, Killarney's Red Lager.
"Subpremium"	Busch (Busch Light, Busch Ice) and Natural Light (Natural Light Pilsner, Natural Light Ice).
Miller Brewing Co.	
"Premium"	Miller Beer, Miller Genuine Draft, Miller Lite, Miller Genuine Draft Light; Icehouse; Henry Weinhard's; Skyy Blue, Sauza Diablo, and Stolichnaya Citrona flavored malt beverages.
"Near-premium"	The Miller High Life family (includes Miller High Life, Miller High Life Light); Red Dog.
"Below-premium"	Meister Brau; Milwaukee's Best; Magnum Malt Liquor.
Coors Brewing Co.	
"Above-premium"	Zima Clearmalt (a malt-based beverage), Zima Citrus.
"Premium"	The Coors family (includes Coors Light, Original Coors, Coors Extra Gold, and Coors NA, a nonalcoholic brew); Blue Moon; George Killian's.
"Subpremium"	Keystone, Keystone Light, Keystone Ice.
SPIRITS (PRINCIPAL PRODUCTS BY COMPANY)	
Diageo plc	Smirnoff, Popov, Stolichnaya, and Gordon's vodkas; Johnnie Walker scotch whiskies; Jose Cuervo tequila; Tanqueray, Seagram's, and Gordon's gins; Crown Royal and Seagram's V.O. whiskies; Captain Morgan rum.
Allied Domecq	Ballantine's scotch; Beefeater's gin; Canadian Club whiskey; Kahlua liqueur; Sauza tequila.
Jim Beam Brands Co.	Jim Beam bourbon; Windsor Supreme Canadian and Kessler whiskies; DeKuyper cordials; Kamchatka, Wolfschmidt, and Gilbey's vodkas.
Brown Forman	Jack Daniels and Canadian Mist whiskies; Southern Comfort; Finlandia vodka; Glenmorangie scotch.
WINE	
E.&J. Gallo Winery	Carlo Rossi; Gallo Livingston Cellars; the Wine Cellars of Ernest & Julio Gallo.
Constellation Brands	Almaden; Arbor Mist; Inglenook; Paul Masson; Richards Wild Irish Rose; Ravenswood; Taylor California Cellars; Simi; Franciscan Oakville Estate; Estancia.
The Wine Group	Franzia; MD 20/20.

*As of January 2003.
Source: Company reports.

level with the prior year. Marlboro claimed a record 38.8% share of U.S. cigarette shipments in 2001.

The nation's second-largest tobacco company is R.J. Reynolds. RJR's largest-selling premium cigarette brands in the United States are Winston, Salem, and Camel, and its principal discount brands are Doral, Monarch, and Vantage.

Brown & Williamson Tobacco Corp. is the nation's third largest manufacturer and marketer of tobacco products. The company's major brands include Kool, Pall Mall, Lucky Strike, GPC, Misty, and Capri.

SALES OF LEADING U.S. BREWERS
(In millions of 31-gallon barrels)

COMPANY	SHIPMENTS 2000	SHIPMENTS 2001	DOMESTIC MARKET SHARE (%)† 2000	DOMESTIC MARKET SHARE (%)† 2001
1. Anheuser-Busch Cos. Inc.	98.3	99.5	49.3	49.6
2. Miller Brewing Co.	41.3	40.2	20.7	20.0
3. Coors Brewing Co.	23.0	22.7	11.5	11.3
4. Pabst Brewing Co.	10.5	9.2	5.3	4.6
5. Boston Beer Co.	1.2	1.2	0.6	0.6
6. Latrobe Brewing Co.	1.2	1.1	0.6	0.5
7. D.G. Yuengling & Son	0.9	1.0	0.5	0.5
8. Genesee Brewing Co.	1.1	1.0	0.6	0.5
9. Sierra Nevada Brewing Co.	0.5	0.5	0.3	0.3
10. Leinenkugel Brewing	0.3	0.3	0.2	0.2
			% of total sales	
Total domestic*	179.2	178.8	87.9	87.2
Imports	20.0	21.8	9.8	10.6
Exports	4.6	4.5	2.3	2.2
Total sales	203.8	205.1	100.0	100.0

†Estimated by Standard & Poor's, based on company barrelage figures and total domestic sales plus imports as shown. *Total is for all brewers, not just top 10, and does not include nonalcoholic sales, although brewers may include nonalcoholic sales in their barrelage reports.
Source: *Modern Brewery Age.*

Lorillard, a subsidiary of Loews Corp., is the fourth largest U.S. cigarette company. The company's flagship Newport brand is the No. 1 menthol-flavored cigarette brand and the No. 2 premium cigarette brand in the United States behind Marlboro.

Cigars on the decline

Cigars experienced strong growth during the 1990s, but consumption peaked in 2000 and is now starting to edge down. According to the U.S. Department of Agriculture (USDA), total consumption of large cigars (weighing more than three pounds per 1,000) declined slightly to 3.8 billion cigars in 2001, from 3.9 billion in 2000. Consumption of small cigars (weighing less than three pounds per 1,000) increased slightly to 2.48 billion in 2001, from 2.47 billion in 2000. Estimated retail expenditures on cigars totaled $2.15 billion in 2001, down 2.3% from 2000.

Up to snuff

According to the USDA, snuff production in 2001 was an estimated 70.1 million pounds, up 0.9% from 2000. Of this total, about 95% is considered moist snuff (or moist smokeless tobacco, which is chewed), with the remainder dry snuff (which is inhaled). Use of dry snuff continues to decline,

TOP 20 BEER BRANDS
(Ranked by 2001 sales, in millions of 31-gallon barrels)

BRAND	BREWER	SALES 2000	SALES 2001	% CHANGE
1. Bud Light	Anheuser-Busch Inc.	32.1	34.7	8.1
2. Budweiser	Anheuser-Busch Inc.	34.5	33.7	(2.3)
3. Coors Light	Coors Brewing	16.7	16.9	1.1
4. Miller Lite	Miller Brewing Co.	15.9	15.7	(0.9)
5. Natural Light	Anheuser-Busch Inc.	8.0	8.1	1.8
6. Busch	Anheuser-Busch Inc.	7.7	7.6	(1.4)
7. Corona Extra	Barton/Gambrinus	5.4	6.2	14.9
8. Busch Light	Anheuser-Busch Inc.	5.3	5.4	3.4
9. Miller Genuine Draft	Miller Brewing Co.	5.2	5.1	(1.9)
10. Miller High Life	Miller Brewing Co.	5.0	5.1	1.4
11. Heineken Lager	Heineken USA	3.9	4.2	7.4
12. Michelob Light	Anheuser-Busch Inc.	2.8	2.9	2.6
13. Milwaukee's Best	Miller Brewing Co.	3.0	2.7	(9.3)
14. Keystone Light	Coors Brewing	2.3	2.4	4.8
15. Milwaukee's Best Light	Miller Brewing Co.	2.1	2.2	4.1
16. Natural Ice	Anheuser-Busch Inc.	2.1	2.2	1.7
17. Icehouse	Miller Brewing Co.	2.2	2.0	(6.8)
18. Old Milwaukee	Pabst Brewing	2.1	2.0	(3.4)
19. Original Coors	Coors Brewing	1.8	1.7	(3.8)
20. Michelob	Anheuser-Busch Inc.	1.7	1.6	(8.3)
Total Top 20		159.9	162.6	1.7

Source: *Adams Handbook Advance 2002.*

TOP 20 PREMIUM DISTILLED SPIRIT BRANDS WORLDWIDE

(In thousands of nine-liter case sales)

BRAND	MARKETER	TYPE	CASE SALES 2000	2001
Bacardi*	Bacardi U.S.A.	Rum	7,400	7,660
Smirnoff**	UDV N. America (Diageo)	Vodka	5,783	6,340
Absolut**	Absolut Co.	Vodka	4,500	4,450
Jack Daniels	Brown-Forman Beverages	Whiskey	3,652	3,698
Captain Morgan	Seagram Americas	Rum	3,200	3,650
Jose Cuervo	UDV N. America (Diageo)	Tequila	3,495	3,250
Jim Beam	Jim Beam (Fortune Brands)	Bourbon	3,110	3,141
Crown Royal	Seagram Americas	Whiskey	2,675	2,900
Seagram's Gin	Seagram Americas	Gin	2,900	2,786
E&J	E&J Gallo Winery	Brandy	2,600	2,700
7 Crown	Seagram Americas	Whiskey	2,680	2,610
DeKuyper	Koninldijke De Kuyper BV	Cordial	2,563	2,565
Canadian Mist	Brown-Forman Beverages	Whiskey	2,314	2,322
Black Velvet	Constellation Brands	Whiskey	1,831	1,832
Popov	UDV N. America (Diageo)	Vodka	1,910	1,830
McCormick	McCormick Distilling	Vodka	1,595	1,700
Hennesey	Schieffelin & Somerset	Cognac	1,500	1,665
Gordon's	UDV N. America (Diageo)	Vodka	1,759	1,590
Stolichnaya	Allied Domecq	Vodka	1,350	1,490
Barton Vodka	Constellation Brands	Vodka	1,383	1,459

*Includes full line. **Includes all flavors.
Source: *Adams Handbook Advance 2002.*

TOP 20 U.S. WINE BRANDS

(In thousands of nine-liter cases)

BRAND	COMPANY	DEPLETIONS 2000	2001	% CHG.
1. Franzia	The Wine Group	20,550	19,728	(4.0)
2. Carlo Rossi	E&J Gallo Winery	13,600	13,500	(0.7)
3. Twin Valley	E&J Gallo Winery	10,100	10,500	4.0
4. Almaden	Canandaigua Wine	9,380	9,730	3.7
5. Livingston Cellars	E&J Gallo Winery	7,530	7,510	(0.3)
6. Sutter Home	Trinchero Family Estates	7,215	7,011	(2.8)
7. Woodbridge	Robert Mondavi	6,376	6,563	2.9
8. Beringer	Beringer Wine Estates	5,850	6,000	2.6
9. Boone's	E&J Gallo Winery	4,500	4,650	3.3
10. Inglenook	Canandaigua Wine	4,770	4,520	(5.2)
11. Peter Vella	E&J Gallo Winery	4,200	4,350	3.6
12. Arbor Mist	Canandaigua Wine	4,050	4,230	4.4
13. Vendage	Turner Road Vintners	4,600	3,910	(15.0)
14. Kendall-Jackson	Kendall-Jackson Wine Estates	3,144	3,721	18.4
15. Turning Leaf	E&J Gallo Winery	2,750	3,025	10.0
16. Corbett Canyon	The Wine Group	3,010	2,850	(5.3)
17. Wild Vines	E&J Gallo Winery	2,500	2,350	(6.0)
18. Glen Ellen	UDV Wines (Diageo)	2,636	2,299	(12.8)
19. Fetzer	Brown-Forman Beverages	2,396	2,237	(6.6)
20. Paul Masson	Canandaigua Wine	1,830	1,610	(12.0)
Total Top 20		120,987	120,294	(0.6)

Source: *Adams Handbook Advance 2002.*

while consumption of moist snuff may be getting a boost from increased restrictions on smoking in public places.

More than $3.1 billion was spent in 2001 on retail purchases of chewing tobacco and snuff products, up approximately 7.0% from 2000, according to Standard & Poor's estimates. UST Inc. dominates the moist snuff category. With brands such as Copenhagen, Skoal, Red Seal, and Rooster, UST commanded about a 77% market share in 2001, according to Standard & Poor's estimates.

Alcoholic beverages

Total U.S. combined alcoholic beverage volume increased 1.5% in 2001 to more than 7.1 billion gallons, worth some $114.5 billion at retail, according to industry sources and Standard & Poor's estimates. Retail sales were split evenly between off-premise (at home) and on-premise consumption. Beer claimed the most sales, in terms of both dollars and gallons: the retail value of U.S. beer shipments totaled approximately $57.5 billion in 2001, on volume of more than 6.2 billion gallons. The second largest segment within the industry was spirits, with total sales of $38.0 billion on 359.0 million gallons. Wine made up the third group, racking up sales of $19.0 billion on 550.0 million gallons.

Three companies dominate U.S. beer market

Three producers dominate the beer industry in the United States, according to estimates by industry trade publication *Beer Marketer's Insights*. Anheuser-Busch Cos. Inc. (A-B) held a leading 48.6% share in 2001, while Miller Brewing Co. claimed 19.6% and Adolph Coors Co. got 11.1%. Together, these firms supplied nearly 80% of the nation's beer market in 2001. (Miller Brewing Co., formerly a unit of Philip Morris, was sold to South African Breweries in July 2002 to form SABMiller plc.)

U.S. beer shipments for Anheuser-Busch totaled 99.5 million barrels in 2001, about 1.2% more than in 2000. (One barrel contains 31 gallons.) A-B brews its beer through a system of 12 breweries in the United States and sells it through more than 700 independent wholesalers.

Miller sold 39.6 million barrels of beer in 2001, down 2.4% from 2000. Miller owns and operates eight U.S. breweries, along with a majority interest in the Celis Brewery in Austin, Texas, and the Shipyard Brewery in Portland, Maine.

Coors Brewing Co. (the principal holding of Adolph Coors Co.) sold 22.7 million barrels of malt beverages in 2001, down 1.2% from the preceding year. Coors has three domestic production facilities: the world's largest single-site brewery in Golden, Colorado; a packaging and brewing facility in Memphis, Tennessee; and a packaging and distribution facility near Elkton, Virginia.

Spirits industry restructures

The U.S. distilled spirits market is relatively concentrated, with the top five marketers accounting for more than 60% of depletions (volume), and the top 10 accounting for some 80%. Following its December 2001 purchase of Seagram, Diageo plc of Great Britain has strengthened its hold as the U.S. market leader. According to Standard & Poor's estimates, Diageo now holds some 22% of the U.S. distilled spirits market, selling more than 33 million cases of distilled spirits. (A case contains nine liters of beverage product.)

The second and third largest players are Jim Beam Brands Worldwide Inc. and Constellation Brands Inc. (formerly Canandaigua Brands), which each held approximately 10% of the market in 2001, with sales volume of approximately 15 million cases each.

In recent years, the distilled spirits industry has been beset by consolidations and reorganizations, by the moderating drinking habits of a generally mature customer base, and by a heightened social consciousness about drunken driving and alcohol abuse. The industry may continue to experience heavy price competition, which could lead to further consolidation.

Wine market more fragmented

The U.S. wine industry's sales totaled approximately $19 billion in 2001, according to estimates by Standard & Poor's. Combined, the top 100 brands generated approximately $10 billion in retail sales — more than half of the total.

Compared with many other consumer product categories, the U.S. wine market is fairly concentrated, though less so than either the beer or distilled spirits industries. According to Standard & Poor's estimates, the top five U.S. wine marketers in 2001 accounted for nearly 60% of wine category volume. They were E.&J. Gallo Winery, Constellation Brands, the Wine Group Inc., Robert Mondavi Corp., and Beringer Blass Wine Estates (a subsidiary of Foster's Brewing Group of Australia).

U.S. industry leader E.&J. Gallo Winery accounted for approximately 27% of domestic table wine unit case sales in 2001. (A case contains nine liters of wine.) Constellation Brands, the nation's second-largest wine producer, accounted for an estimated 18% of the industry total. The No. 3 producer — the Wine Group, with about 12% of the industry's shipments — produced the nation's most popular wine, Franzia.

INDUSTRY TRENDS

The major companies in the U.S. tobacco and alcoholic beverage industries currently face uninspiring domestic growth prospects. As a result, they have pursued two primary strategies in recent years: they have reorganized their business structures via acquisitions and/or restructurings, and have aggressively pursued faster-growing international markets while also developing new products.

Mature but profitable businesses

Although the U.S. alcoholic beverage and tobacco industries are mature, they remain very profitable. This is particularly noteworthy because consumption has been growing slowly (or declining, in the case of tobacco) as legal and regulatory restrictions have increased.

Moderation in alcohol consumption

The U.S. alcoholic beverage industry is a highly profitable business. Although net sales growth in recent years has been relatively slow (about 2% to 4% a year), profitability as measured by operating margins is high relative to most other consumer goods. On average, Standard & Poor's estimates that operating margins for U.S. alcoholic beverage companies are about 20%, well above the 12%–14% range typical of packaged food companies.

However, strains are visible from an extended decline in consumption. A trend toward moderation in alcohol consumption has colored the national mood for a generation now. In the 1960s, the nation's alcoholic beverage industry sales grew at an appreciable rate of approximately 5% annually. In the 1970s, sales slowed a bit, particularly for bourbons, which were the first major casualty of the move toward white spirits and lighter alcoholic beverages in general.

The 1980s were a mixed bag. The early part of the decade benefited from good growth in white spirits, while light beer's increased popularity brought on new beer drinkers. In the mid-1980s, however, the nation's move toward alcohol moderation accelerated. Many states changed their laws to raise the minimum drinking age. Federal excise taxes on alcoholic beverages were increased sharply in 1985 and then again in 1991.

In the early 1990s, these factors, combined with the onset of a national recession, took a toll on the industry's unit sales growth, which came to a virtual stop. However, the late 1990s saw a surge in consumption due to favorable demographic trends and rising levels of disposable income.

Demographic trends turn favorable

The number of consumers reaching legal drinking age has risen steadily in recent years, according to the U.S. Census Bureau. Beginning in 1999, the 21-to-24 age group increased in size for the first time in two decades. This increase in legal-age drinkers is expected to contribute an additional 1% annual gain in beer volume for the next few years, as beer tends to be the alcoholic beverage of choice for this age group.

In addition, premium wine sales should benefit from increasing numbers of consumers in the over-55 age group, who tend to consume more wine, especially premium wine, than beer.

U.S. RESIDENT POPULATION PROJECTIONS*

(In thousands)

AGE GROUP	2003	2010	2015	% CHANGE 2003–10	% CHANGE 2003–15
Under 5 yrs.	19,012	20,099	21,179	5.7	11.4
% of total	6.7	6.7	6.8		
5 to 14 yrs.	39,995	39,345	40,549	(1.6)	1.4
% of total	14.1	13.1	13.0		
15 to 19 yrs.	20,312	21,668	20,892	6.7	2.9
% of total	7.2	7.2	6.7		
20 to 24 yrs.	19,825	21,151	21,748	6.7	9.7
% of total	7.0	7.1	7.0		
25 to 34 yrs.	36,880	38,851	41,248	5.3	11.8
% of total	13.0	13.0	13.2		
35 to 44 yrs.	43,666	39,442	38,787	(9.7)	(11.2)
% of total	15.4	13.2	12.4		
45 to 64 yrs.	67,476	79,590	81,905	18.0	21.4
% of total	23.9	26.5	26.2		
65 yrs. & over	35,634	39,715	45,959	11.5	29.0
% of total	12.6	13.2	14.7		
Total population	282,798	299,862	312,268	6.0	10.4
Median age	36.3	37.2	37.3		
Racial composition (%):					
White	81.7	80.6	79.9		
Black	13.0	13.3	13.6		
American Indian	0.9	0.9	1.0		
Asian	4.4	5.1	5.6		
Hispanic (any race)	12.7	14.6	15.8		

*Based on 1990 census.
Source: U.S. Department of Commerce, Population Series P-25.

TOBACCO PRODUCTS — U.S. PER CAPITA CONSUMPTION

YEAR	*CIGARETTES	†LARGE CIGARS & CIGARILLOS	†SMOKING TOBACCO	†CHEWING TOBACCO	*SNUFF	*TOTAL TOBACCO PRODUCTS
	UNITS		POUNDS			
2001	2,051	39.6	0.15	0.47	0.3	4.2
2000	2,092	38.9	0.15	0.49	0.3	4.2
1999	2,136	39.5	0.14	0.52	0.3	4.3
1998	2,320	38.0	0.12	0.64	0.3	4.5
1997	2,423	36.9	0.12	0.64	0.3	4.6
1996	2,482	32.7	0.12	0.64	0.3	4.7
1995	2,505	27.5	0.13	0.67	0.3	4.7
1994	2,524	25.3	0.16	0.67	0.3	4.9
1993	2,543	23.4	0.17	0.70	0.3	5.4
1992	2,647	24.5	0.18	0.75	0.3	5.3

*Consumption per capita, 18 years and over. †Consumption per male, 18 years and over.
Source: U.S. Department of Agriculture.

Tobacco use declining

The U.S. tobacco industry remains one of the most profitable industries, despite years of legal battles, increased government regulations, and declining rates of consumption. Cigarette consumption in the past decade has averaged an approximate 2% annual rate of decline, reflecting sharply higher prices and increased awareness of the health risks of smoking. Standard & Poor's estimates that, on average, operating margins for U.S. tobacco companies are about 30%, well above the range for packaged foods and for alcoholic beverage companies.

Industry reorganization

In response to slowing growth rates, the multinational corporations that dominate the alcoholic beverage industry — particularly those in distilled spirits — have reorganized in recent years to consolidate their corporate structures. At least a half-dozen major companies — including Seagram, Fortune Brands Inc., Allied Domecq Spirits & Wine, Heublein Inc., and Anheuser-Busch — have realigned their businesses by selling some divisions and/or buying others.

The major U.S. tobacco companies have continually streamlined their operations over the years. Like most other packaged goods producers, they've sought to sustain profit margins in a mature domestic market. Additionally, because of the complexities of operating in various international markets, tobacco companies face challenges in the ways they source, manufacture, and market their products. Constant fine-tuning is necessary for these companies to operate at optimal levels of efficiency.

Still searching for growth

For cigarettes, unit volumes are declining while prices are up, leading to net revenue gains, although the growth rate is generally below that of a decade ago. For alcohol, generally modest volume growth with some pricing increases has led to a moderate rise in revenues. In an effort to counteract the slowdown within their highly mature industries, alcoholic beverage and tobacco companies continue to expand into markets where population growth is faster and governmental restriction less pronounced than at home. In addition, to the extent that they can, these companies are also seeking to create new products.

Alcoholic beverage business goes global

U.S. brewers and alcoholic beverage makers are rushing to establish a presence in the potentially lucrative developing markets of Asia, Eastern Europe, and Latin America. In recent years, domestic brewers have extended their reach abroad in a variety of ways: through exports, joint ventures with local brewers and distributors, and purchases of equity interests in local brewers.

U.S. companies are hardly going unchallenged in this race. Foreign brewers, confronting similar issues in their home markets, are also expanding beyond their borders. One result has been rising concentration in global sales. In 1980, the world's top 10 brewers produced less than a quarter of total international sales volume; as of 2000, they accounted for more than 35%, according to *IMPACT*, a trade publication covering the alcoholic beverage industry.

In this regard, the brewing business resembles most other consumer goods sectors. Markets for beer and food-related products tend to be relatively provincial, reflecting local taste preferences, distribution networks, and trade barriers between countries. Despite the essentially regional nature of demand, however, the brewing business is becoming more international in terms of ownership as well as markets.

In terms of market expansion, the most aggressive U.S. brewer in recent years has been Anheuser-Busch, the world's largest beer maker. Since 1993, A-B has made deals in China, Japan, Brazil, India, Italy, France, Switzerland, and Spain. The company also has established joint ventures in South America with Chile's Compania Cervecerias Unidas S.A. and Argentina's Buenos Aires Embotelladora S.A. (BAESA). In September 1998, A-B raised its ownership interest in Grupo Modelo S.A., Mexico's largest brewer, to 50.2%. These investments augment A-B's already-strong positions in its main export markets (Canada, the United Kingdom, and Japan) and complement its activities in numerous other markets.

A-B's home rivals have been busily going abroad as well. In the past few years, Miller Brewing Co. formed a number of alliances with brewers and other beverage companies in Japan, Brazil, China, and Great Britain. One promising deal is a joint venture with Brazil's Companhia Cervejaria Brahma, the world's fifth-largest brewer, according to *IMPACT*. After its sale to South African Breweries plc in July 2002, Miller is now part of the world's second largest brewer.

For many years, Adolph Coors Co. has exported its products to numerous countries, including Australia, Holland, Ireland, Japan, and the Caribbean islands. The company, which has U.S. and foreign production facilities, has stepped up its international activities in recent years by establishing licensing agreements with foreign brewers, including Molson Breweries of Canada Ltd.

While foreign sales historically have been a small part of its total sales (4% in 2001), Coors is aggressively trying to expand its international presence. In February 2002, the company completed its acquisition of the Carling business of U.K.-based Bass Brewers from Interbrew S.A. International sales now represent nearly 30% of Coors's total sales.

◆ **China.** With a population of 1.4 billion and a rapidly growing economy, China is becoming an attractive place for brewers to do business. Although annual per capita beer consumption is only 17.2 liters (compared with 83.5 liters for the United States, 97.5 liters for the United Kingdom, and 123.9 liters for Germany), growth has been swift in recent years. China is currently the world's second largest beer market, consuming more than 180 million barrels annually. If current growth trends continue, China will likely pass the United States as the world's largest beer market by 2004.

In the past three years, China has seen more than 35 joint ventures formed between local and international breweries. These include deals by Anheuser-Busch, Heineken N.V., San Miguel Corp., Beck GmbH & Co., Kirin Beverage Corp., Asahi Breweries Ltd., Miller, Interbrew S.A., Lion Nathan Ltd., and Pabst Brewing, some of which are subsidiaries of larger international firms.

◆ **Eastern Europe.** While growth prospects in mature Western European markets are uninspiring, Eastern Europe is viewed by the brewing multinationals as fertile ground. Unlike other developing regions, Eastern Europe is already an established beer-drinking stronghold, adding to its attractiveness. In terms of per capita consumption, five Eastern European markets place among the top 20 global markets. Annual per capita consumption in the Czech Republic is the highest in the world, at an astounding 175 liters.

◆ **Mexico and Latin America.** Benefiting from favorable demographics, a temperate climate, and in recent years, improving economic conditions, Latin America is viewed by the large global brewers as a very promising region. Beer consumption has been rising, helped principally by strong economic activity in many key markets. While pockets of economic weakness remain in several Latin American countries, market reforms and rising levels of prosperity could make the region even more attractive over the long term.

Another positive factor is a marked shift in consumer preference toward beer in traditional wine-drinking countries such as Argentina and Chile. Many of the markets within Latin America have only a few local brands, so this could be an opportunity for imports.

Although not a major export market at present, Mexico holds much future promise for U.S. wine companies due to the country's rising per capita income. The near-term potential is dampened, however, by the current 16% tariff on U.S. wine sales in Mexico. However, the North American Free Trade Agreement (NAFTA), which took effect on January 1, 1994, called for these wine duties to be eliminated within 10 years.

A notable development is the formation of partnerships between U.S. and South American wineries. In recent years, several domestic wineries have made investments in Chile, responding in large part to the U.S. grape shortage of 1996 and 1997.

Tobacco companies also look abroad

To compensate for bleak growth prospects at home, U.S. cigarette companies have looked abroad for growth for many years. Their success has reflected many factors, including rising incomes in developing markets; high per capita cigarette consumption; and a growing preference for American-style cigarettes, with their high flue-cured tobacco content.

The foreign market for American-style cigarettes appears to provide the greatest growth potential for tobacco companies. Standard & Poor's estimates that the American-style segment of the international market has grown at a compound annual rate of more than 3% since 1990. In 2001, this segment constituted approximately 33% of the international market.

In recent years, Philip Morris International has increased manufacturing capacity and improved productivity through various acquisitions and capital projects. In recent years, capital expenditures included modernization and expansion of facilities in Germany, the Netherlands, Switzerland, Poland, Romania, Russia, Lithuania, Ukraine, Turkey, Malaysia, and Brazil, as well as the construction of new manufacturing plants in Russia and Kazakhstan.

HOW THE INDUSTRY OPERATES

The U.S. cigarette and alcoholic beverage industries are wide reaching, mature, and consolidated. Apart from these similarities, they have many differences. For this reason, we'll consider the operations of each industry separately.

Tobacco: a Native American crop

Tobacco use has been traced to the indigenous peoples of North America, who were growing and using tobacco by the time Europeans began exploring the continent in the sixteenth century.

Once immigrants began to settle on the continent's eastern coast, they employed the land's rich soil, temperate climate, and vast amounts of arable land in the cultivation of crops, including tobacco. Workers, both paid and enslaved, were abundant. By the mid-1800s, the United States had become the world's heaviest per capita grower and user of tobacco.

Although tobacco was a big trading product in the 1800s, Americans who used it either chewed it or smoked it in a pipe. A domestic commercial industry for tobacco products did not evolve for many years; brand-name goods had not yet been created.

In the early 1900s, cigarette smoking gradually became the preferred way to enjoy tobacco, while cigar smoking and tobacco chewing became socially unacceptable in many places. The growing popularity of mass-produced branded consumer goods also helped the cigarette industry. In addition, the introduction of cigarette-making machines let manufacturers meet the nation's growing demand for cigarettes.

Tobacco typology

The two most common types of tobacco produced in the United States today are flue-cured and burley. Together, they account for about 95% of total U.S. production. Other types include dark air-cured, dark fire-cured, Maryland, and cigar filler.

Most of a cigarette's tobacco taste comes from flue-cured tobacco. This tobacco is made from a relatively light species of tobacco leaf, which is prepared for use by being aired over heat. It's produced in North Carolina (the largest producing state), as well as in Virginia, South Carolina, Georgia, and Florida.

Burley tobacco is a relatively dark species of tobacco leaf, which requires very little preparation before use. Kentucky is the largest producer of burley, which is also grown in Tennessee, Virginia, North Carolina, Ohio, Indiana, West Virginia, and Missouri.

From farmer to smoker

Three groups form the backbone of the U.S. tobacco industry: farmers, dealers, and manufacturers.

◆ **Farmers.** The nation's crop of leaf is grown by tobacco farmers located mainly in the southeastern United States, whose climate is favorable for this crop. Tobacco farmers generally sell their flue-cured and burley tobacco at public auction to the highest bidder.

Leaf prices are supported under an industry-funded federal program that originated with the Agricultural Adjustment Act of 1933. Amended many times over the years (for instance, a 1938 bill authorized marketing quotas, and a 1949 act introduced price supports), the program's basic components remain in place. Specifically, in exchange for limiting production via allotments and quotas, U.S. tobacco growers are guaranteed minimum prices through price supports. The price-support system has made U.S.-grown tobacco more expensive than most non-U.S. tobacco, resulting in a declining trend in exports.

◆ **Dealers.** Tobacco dealers act as the intermediaries between farmers and manufacturers. They select, buy, ship, process, pack, store, and finance leaf tobacco either for manufacturers' accounts or for resale to them. Tobacco dealers are generally paid fees and commissions for their services.

Although tobacco product manufacturers occasionally purchase leaf tobacco at auction, dealers have increasingly taken over this function. To U.S. manufacturers, tobacco dealers are a necessity. Dealers let manufacturers withdraw capital from the labor-intensive tobacco leaf processing business and put it toward the more profitable business of marketing finished tobacco consumer products.

◆ **Manufacturers.** Following the manufacturer's purchase of tobacco leaf, the tobacco is graded, cleaned, stemmed, and redried. Then it is stored for aging for up to three years. Manufacturers maintain large inventories of leaf tobacco to support their production requirements.

For leading producers, the manufacture of cigarettes is highly automated. Finished products are sold principally to wholesalers (including distributors), large retail organizations, vending machine operators, the armed services, and others. International sales are often handled by either company subsidiaries or licensees, which market the products directly or through export sales organizations.

Alcoholic beverages

Beer, wine, and distilled spirits have the common traits of competing in a highly regulated marketplace. However, there are significant differences among them, which we'll consider briefly here.

Overview of U.S. beer industry

Crude versions of beer have been in existence almost as long as recorded civilization. It has long been a popular drink in many countries, partly because it is relatively easy to make. Beer consists chiefly of malted barley flavored with hops (a grain) and/or other ingredients.

Given the large number of brewed beverages produced over the years, "beer" today is an umbrella term covering a wide range of related drinks distinguished by the type of yeast used. Beer varieties include bitter (a beer brewed with more hops and a lighter malt than mild beer), lager (a light beer that matures for a longer time at a low temperature), ale (similar to, but heavier than, lager), and stout or porter (dark ales produced from the brewing of roasted malt).

In the United States, beer drinkers have long preferred lagers because of their lighter taste. The most popular U.S. beer brands are lagers such as Budweiser, Miller High Life, and Coors Original. Since the health-conscious 1980s, reduced-calorie or "light" beers have grown in popularity, mostly at the expense of full-calorie brews.

In the past few years, however, beer drinkers have become increasingly fickle in their tastes. Perhaps tiring of mass-produced U.S. lagers (both full- and reduced-calorie), they have thirsted for variety in the form of imported and "craft" beers. Industry observers define craft beers as brews produced by small breweries (called "microbreweries") that typically specialize in full-calorie porters.

The brewing process is generally uniform among beer companies. However, the level of vertical integration among the largest U.S. brewers varies by company. The most vertically integrated is Anheuser-Busch (A-B), the nation's leading brewer in terms of both volume and revenue. Through its ownership of subsidiaries that perform many tasks other than brewing, A-B minimizes the impact of raw material supply shortages and helps the company's brewing activities to operate at optimal efficiency levels.

For example, A-B obtains its raw materials both internally and from independent sources. Through its Busch Agricultural Resources subsidiary, A-B conducts rice drying and milling, along with research activities; operates numerous grain elevators throughout the country; and conducts farming activities for important grain ingredients in various parts of the country. Its Metal Container Corp. subsidiary manufactures beverage cans for use by A-B and others, while its Precision Printing subsidiary produces folding cartons, metallized labels, and paper labels. Another wholly owned subsidiary, Anheuser-Busch Recycling Corp., recycles aluminum cans and nonrefillable bottles.

The nation's two other major brewers — SABMiller plc (formerly the Miller Brewing unit of the Philip Morris Cos.) and Adolph Coors Co. — also use wholly owned subsidiaries to perform some of their nonbrewing functions, though not to the degree that A-B does.

Wine

Wine, like beer, has been enjoyed by humankind for many centuries. Wines are produced around the world, with varieties differing by the kinds of grapes used and flavorings added. Flavorings are typically derived from the type of barrel (often oak) used to store the wine but can also be derived from spices.

White wines, made from light-colored grapes, are generally lighter in taste than red and blush wines. Red wines are typically produced with darker grapes and often their stems are included in the crushing process.

Today, industry observers categorize wines as follows: table wine (comprising about 84% of U.S. production), sparkling wine (6%), special natural (5%), dessert wine (4%), vermouth (1%), and specialty (less than 1%).

Table wines are the most popular and fastest-growing type of wine in the United States. They contain 7% to 14% alcohol by volume and are traditionally consumed with food. Domestically produced table wines, which account for about two-thirds of all U.S. consumption, comprise varietals (made from a single variety of grape) and nonvarietals (made from a blend of two or more kinds of grapes). Varietals constitute the bulk of U.S. consumption, with chardonnay being the most popular of the white wines. Of the reds, cabernet sauvignon is the most popular variety, and white zinfandel is the most popular of the blush wines.

Table wines that retail at less than $3.00 per 750 milliliter (ml.) bottle are generally considered to be generic or "jug" wines, while those that retail at $3.00 or more per bottle are considered premium wines. The premium wine category is generally divided into three segments: popular premium ($3.00 to $7.00 per bottle at retail), superpremium ($7.01 to $14.00), and ultrapremium (more than $14.00).

During the 2001 harvest, California winegrowers crushed some 3.0 million tons of grapes, down 9% from the 3.3 million tons in 2000, but up 15% from the 2.6 million tons in 1999, according to the Wine Institute, a California trade group. In accordance with purchasing agreements, wine companies normally buy grapes from many different suppliers each year to minimize the impact of a poor harvest at any one supplier. Most of the grapes required for production by U.S. wine companies are grown domestically, principally in California and New York. Sourcing from Chile, a significant grape producer, is common in times of grape shortages.

Once grown or obtained by the winery, grapes are crushed at company facilities and prepared for storage as wine. The wine is normally bottled and sold within 18 months after the grape crush. Wine inventories are usually at their highest levels in November and December, immediately after the crush of each year's grape harvest.

To have a vintage date, a table wine must be made at least 95% from grapes harvested, crushed, and fermented in the calendar year shown on the label, and the wine must be labeled with an appellation of origin. For an appellation of origin, such as California's Napa Valley, to appear on the label, at least 75% of the wine must be derived from grapes grown in the appellation area indicated. Wine is normally distributed through wholesalers or state-level alcoholic beverage control agencies.

U.S. spirits industry

Distilled spirits manufacturers normally obtain their raw materials — principally grains — through purchases from various sources via contractual arrangements. They also make purchases in the open market. Grains are mashed at company distilleries, and the finished products — like Jim Beam bourbons and Jack Daniel's whiskeys — are aged for varying amounts of time, depending on the product. Like wine, distilled spirits are normally distributed through wholesalers or state-level alcoholic beverage control agencies.

Distilled spirits products are generally classified as white goods, brown goods, and specialties.

◆ **White goods.** Named for their clear or nearly clear color, white goods include vodka, gin, rum, and tequila. Vodka claims the majority of total industry sales of white goods — typically about 50%. Rum is the second-largest category at about 20%, followed by gin and tequila.

◆ **Brown goods.** Also named for their color, brown goods consist of whiskeys, bourbon, and blends. The majority of brown goods sold in the United States consist of imported whiskeys (typically around 60% of the total), followed by domestic bourbon (about 25%) and domestic blends.

◆ **Specialties.** This catchall category includes both high-priced products such as cognacs and imported liqueurs and some of the industry's least expensive offerings, such as domestic cordials, cocktails, and mixed drinks. The three major specialty categories are brandy, cordials and liqueurs, and cocktails and mixed drinks.

What drives demand?

Although the tobacco and alcoholic beverages industries differ in many ways, they are similarly affected by the consumer-related factors discussed below.

Price and value

The quantity of alcoholic beverages and tobacco products that a nation consumes tends to remain steady during periods of both recession and prosperity. In contrast, the quality of the products purchased — as gauged by the comparative per unit cost — is related directly to real disposable personal income. A decline in disposable income puts downward pressure on the prices of consumer products, as people shift away from buying premium-priced brand-name products in favor of lower-priced brands and private-label goods.

In the tobacco sector, discount cigarette brands had captured nearly one-third of the market by early 1993. Then Philip Morris slashed the price of its popular Marlboro cigarette brand by 20%. (The day on which the cut took place was dubbed "Marlboro Friday.") Following Philip Morris's lead, most other branded cigarette producers instituted price cuts of their own. Soon after these went into effect in mid-1993, discount cigarettes' market share plummeted to below 20% of the entire market, according to estimates by Standard & Poor's. Price hikes on premium brands in recent years, however, have given discount cigarettes an approximate 26.5% share of all cigarettes currently sold in the United States.

The alcoholic beverage industry experienced a similar scenario in the early 1990s, as value-priced beer brands like Busch and Natural Light cut into the market shares of such premium-priced beers as Budweiser, Michelob, and Molson. Unlike their counterparts in the tobacco industry, however, private-label beers have not established a significant presence in the brewing industry.

Nonetheless, virtually all of the major brewers market beer products that target most price points. Although low-priced beers generally reap lower profit margins than high-priced brews, they help maintain production efficiency by keeping brewing capacity utilized at high levels. As the U.S. economy gradually improved in the early 1990s, the leading brewers successfully encouraged consumers to trade up by implementing wholesale price increases on the lower-priced beers.

Foreign markets

With the U.S. population increasing at an annual rate of only about 1%, the domestic market for all alcoholic beverages has limited growth potential. However, fast-rising populations in developing markets outside the United States do offer opportunities for growth.

According to Department of Commerce projections, the world's developing countries will expand much more rapidly in the future than developed countries. In 1950, approximately two-thirds of the world's population was located in less-developed countries; now the figure is 80%. Future growth in human population is expected to occur almost entirely in Africa, Asia, and Latin America, according to the Census Bureau's *World Population Profile*. Accordingly, U.S. alcoholic beverages and tobacco companies have expanded abroad rapidly in recent years.

U.S. demographic trends

Demographic changes affect the demand for consumer goods in general, and alcoholic beverages and tobacco products are particularly sensitive. Principal among these changes in the United States is the aging of the population. It's a positive development for wine and distilled spirits producers, whose customers tend to be older.

Beer and tobacco products, however, tend to be consumed in greater quantities by young adults. Over the next decade, the 21- to 27-year-old age group is expected to show strong growth, something that did not happen in the 1980s and 1990s. This increase in the number of individuals reaching legal drinking age is positive for beer and tobacco producers.

Consumer attitudes

America's increased interest in healthy living, largely attributable to the baby boom generation (those born between 1946 and 1964), has hurt the consumption of alcoholic beverages and tobacco products in recent years. It has also encouraged the public to call for increased government regulation of these industries.

The business of tobacco and alcoholic beverages

The tobacco and alcoholic beverage industries are distinguished by their degree of concentration, high profitability, and high barriers to entry. In addition, they're subject to considerable taxes and regulation.

Concentrated and profitable

The U.S. alcoholic beverage and tobacco industries have undergone substantial consolidation over the years. Prompted mainly by declining domestic consumption trends, a highly mature marketplace, and a steady rise in legal and regulatory burdens, many manufacturers have either joined forces with competitors or perished. This market condition has bestowed upon these producers the benefits that oligopolists typically enjoy: cartel-like pricing practices and abnormally high profit margins, cash flows, and investment returns.

Ironically, government regulations imposed on the tobacco industry over the years have helped make the business more profitable. For example, all forms of electronic media advertising were banned in 1971; these restrictions have kept cigarette producers' marketing costs well below the levels they would have otherwise been.

High barriers to entry

The barriers to entry in the U.S. alcoholic beverages and tobacco industries are high. The level of sales needed to justify the enormous legal costs associated with these controversial industries has become prohibitive for newcomers. In addition, the costs associated with operating virtually any consumer packaged-goods business on a national scale are substantial.

The capital needed to build manufacturing facilities, together with the high costs of advertising and distribution, are other substantial barriers to entry in these industries. Although microbreweries and small wine makers may achieve local success, such firms often have difficulty attaining profitability with such a level of operations and may find it virtually impossible to go national.

Brand awareness

The relatively saturated U.S. market for alcoholic beverages and tobacco products acts to limit manufacturers' pricing flexibility. As packaged consumer goods companies, they realize that one of the best ways to enhance their restrained pricing power is to develop customer loyalty through brand awareness. However, tightened advertising restrictions placed on these industries in recent years have forced companies to become more creative in their marketing campaigns.

The challenges have been especially great for tobacco companies. As noted earlier, a federally imposed ban on all electronic media advertising of tobacco went into effect in 1971. To build brand awareness within these limitations, it became common for manufacturers to use incentive programs that allowed smokers to earn points toward merchandise bearing company or brand logos. However, under the November 1998 Master Settlement Agreement (MSA) between the tobacco companies and 46 U.S. states, manufacturers agreed to stop these incentive programs. (See the "Current Environment" section of this survey for more details on the MSA.)

A long history of regulation

The U.S. government's oversight of the alcoholic beverage industry goes back to the earliest days of the country's formation. Faced with debts incurred during the Revolutionary War, Congress imposed the first federal tax on distilled spirits on March 3, 1791. This tax proved to be very unpopular, inciting the famous Whiskey Rebellion in 1794. To restore order, President George Washington mustered 15,000 militiamen to establish the new federal government's authority to levy such taxes.

For the next six decades, taxes on distilled spirits were alternately enacted and repealed to meet federal revenue needs. In 1862, to finance the Civil War, Congress passed a law that imposed a tax on distilled spirits. This legislation also created the Office of Internal Revenue (later the Internal Revenue Service, or IRS), which has become a permanent part of the federal revenue system.

In 1919, the Eighteenth Amendment to the U.S. Constitution was ratified, banning alcohol and ushering in the Prohibition era. This amendment took effect in 1920, and

ALCOHOLIC BEVERAGE FEDERAL EXCISE TAX COLLECTIONS
(In millions of dollars)

CATEGORY	1995	1996	1997	1998	1999	2000	2001
Distilled Spirits	3,647.3	3,624.2	3,614.8	3,539.7	3,733.4	3,860.3	3,896.5
Domestic	2,995.0	2,955.4	2,927.6	2,857.4	2,974.7	3,043.4	3,004.3
Imported	652.3	668.8	687.2	682.3	758.7	816.9	892.2
Wine	589.0	627.4	639.3	634.1	658.9	692.1	667.1
Domestic	469.1	493.0	479.7	480.3	504.0	517.8	498.5
Imported	119.9	134.5	159.6	153.9	154.9	174.3	168.7
Beer	3,367.1	3,384.0	3,387.9	3,420.5	3,489.5	3,567.3	3,555.2
Domestic	3,174.8	3,164.3	3,146.5	3,147.8	3,168.2	3,216.4	3,171.4
Imported	192.3	219.7	241.4	272.6	321.3	350.9	383.8
Total excise taxes	7,603.4	7,635.5	7,641.9	7,594.3	7,881.8	8,119.8	8,118.9

Source: Internal Revenue Service.

while demand for liquor did decline, illicit markets sprung up to satisfy the remaining demand, spawning organized criminal activity, violence, and government corruption. One source estimates sales of bootlegged liquor at $3.5 billion in 1926. In 1933, the Twenty-first Amendment was passed, repealing the Eighteenth Amendment and ending Prohibition. The act also created the Alcohol Tax Unit (ATU) to collect alcohol-related taxes for the Internal Revenue Service.

In 1934, the National Firearms Act was passed, increasing the federal government's role in regulating the firearms industry; regulatory responsibility was given to the ATU. In 1951, tobacco tax duties were also delegated to the ATU. Reflecting these new duties, the unit's title was changed in 1952 to Alcohol and Tobacco Tax Division (ATTD) of the Internal Revenue Service. The division was responsible for enforcing the laws for alcohol, tobacco, and firearms.

With the call for greater regulation of firearms in the midst of increased crime rates in the 1960s, the ATTD was given even greater responsibilities in its regulatory role over the firearms business. It was again renamed; this time it was called the Alcohol, Tobacco, and Firearms Division (ATFD) of the Internal Revenue Service.

In July 1972, the ATFD was separated from the IRS and given full bureau status in the Treasury Department, becoming the Bureau of Alcohol, Tobacco & Firearms (ATF). Today the ATF, headquartered in Washington, D.C., regulates and enforces the collection of taxes on these industries, which collectively amount to more than $10 billion annually.

In April 1997, a federal court determined that the Food and Drug Administration (FDA), which supervises the food and pharmaceutical product industries, also had the authority to oversee the U.S. tobacco industry, due largely to the court's interpretation of cigarettes as "nicotine-delivery devices." However, the extent of the FDA's power remains a subject of debate. In November 1998, a federal appeals court struck down FDA oversight of the U.S. tobacco industry, and the Supreme Court has upheld this ruling. The 108th Congress is likely consider legislation that would grant the FDA the ability to regulate tobacco during 2003. (See this Survey's "Current Environment" section.)

Taxes

Cigarettes are subject to substantial excise taxes in the United States, and to similar taxes in most foreign markets. U.S. federal excise taxes (FETs) raise revenues of more than $5.8 billion annually. The federal excise tax on cigarettes increased to 34 cents per pack on January 1, 2000, from 24 cents in 1999. On January 1, 2002, the FET increased to 39 cents per pack, with other tobacco product taxes keeping pace.

All U.S. states also impose excise taxes on cigarettes, which totaled nearly $8.4 billion in the 12 months ending June 2001. These taxes currently range from a high of $1.50 per pack in New York and New Jersey, to a low of three cents in Kentucky and 2.5 cents in Virginia. Overall, 23 states and the District of Columbia currently impose excise taxes of 50 cents per pack or more, with 14 states having cigarette excise taxes of $1.00 or more per pack. New York City imposes an additional excise tax of $1.50 per pack. Forty-three states also impose sales taxes on cigarettes.

Alcoholic beverage products are likewise subject to high levels of taxation in the United States. The federal excise tax on these products was last increased in January 1991, doubling the tax on beer to $18.00 per barrel, or 32 cents per six-pack. The FET on wine increased more than fivefold that year, to $1.07 per gallon, and the FET on distilled spirits increased by 8% to $13.50 per gallon. In addition, all U.S. states also impose excise taxes on alcoholic beverages.

KEY INDUSTRY RATIOS AND STATISTICS

▶ **Real disposable personal income.** Reported each month by the U.S. Department of Commerce, this statistic is a measure of inflation-adjusted income after taxes.

Changes in disposable personal income influence how much consumers spend on alcoholic beverages and tobacco products. Although the quantity consumed tends to remain fairly steady during both good times and bad, during recessions consumers may trade down by purchasing less expensive brands. During prosperous economic times, consumers are likely to favor premium-priced products.

In 2001, Americans' disposable personal income increased 3.8%, year to year, on top of the 6.2% gain seen in 2000. Standard & Poor's estimates that disposable personal income will gain 5.8% in 2002 and 5.3% in 2003.

▶ **Producer price indexes (PPI).** Compiled monthly by the Bureau of Labor Statistics, a division of the Department of Labor, producer price indexes track price inflation (or deflation) for the raw materials used by the U.S. manufacturing sector (excluding excise taxes). They are helpful in assessing the cost pressures facing manufacturers, including those making tobacco and alcoholic beverage products.

A rise in the PPI can signal cost pressures that may hurt profit margins since many firms can't alter their selling prices quickly enough, if at all, to offset such pressures. This inflexibility may be caused by a high level of price competition or by contractual commitments with retailers. Both factors may restrict immediate manufacturer price increases. Although individual components may be volatile, overall cost pressures facing U.S. alcoholic beverages and tobacco manufacturers have been generally benign in recent years. This is likely to continue, at least in the near term.

The PPI for finished goods decreased 0.4% in November 2002, seasonally adjusted, following a gain of 1.1% in October and a 0.1% rise in September. Prices for finished goods other than foods and energy declined 0.3% in November, after gaining 0.5% in the prior month. Prices for intermediate goods fell 0.1%, following a 0.7% rise in October. From November 2001 to November 2002, the finished goods price index increased by 0.9%. Over the same period, prices for finished consumer foods declined 1.1%, finished alcoholic beverages gained 1.2%, and finished tobacco products increased 2.7%.

▶ **Consumer price index (CPI).** Also compiled monthly by the Bureau of Labor Statistics, the consumer price index tracks retail price inflation (or deflation) for products sold to consumers. The rate of price inflation in the general economy directly influences pricing trends in the alcoholic beverage and tobacco markets. In recent years, with overall price inflation low on most consumer goods, alcoholic beverage prices in the aggregate have also been held in check. However, overall tobacco prices have risen dramatically, fueled by higher cigarette pricing.

The CPI gained 2.8% in 2001, compared with a 3.4% gain in 2000. Standard & Poor's currently forecasts that the CPI will increase just 1.6% in 2002, followed by a 2.3% rise in 2003.

▶ **Interest rates.** The level of interest rates influences how active a company will be in making acquisitions and introducing new products. It also affects the amount of funds spent on capital expenditures, dividends, and stock repurchases. High or rising interest rates increase the cost of borrowing; this in turn tends to make companies less willing to make big outlays, such as those needed to undertake a sizable facility expansion or a share repurchase program. The reverse is also true: low or falling interest rates decrease the cost of borrowing, thus making financing more affordable.

Bond yields have dropped in recent months in response to slower economic growth and interest rate reductions by the Federal Reserve. In an effort to reduce the risk of recession, the Fed lowered the federal funds target 12 times (to 1.25%) between January 3, 2001, and November 6, 2002, and dropped the discount rate 13 times (to 0.75%) — a total reduction of 525 basis points for each rate.

Because of the Fed's actions, short-term interest rates have declined steadily. Standard & Poor's currently forecasts that the rate on Treasury bills (a proxy for short-term interest rates) will average 1.6% in 2002 and 1.1% in 2003, down from 3.4% in 2001. The interest rate on 10-year notes (a proxy for long-term interest rates) will also remain accommodating, falling from 5.0% in 2001 to an average of 4.6% in 2002, before rising a bit to 4.8% in 2003.

▶ **Currency exchange rates.** The exchange rates between the U.S. dollar and foreign currencies are increasingly important in predicting a company's profitability. This is due to the rising proportion of U.S. alcoholic beverages and tobacco industry sales derived from markets outside the United States.

For companies with significant operations in foreign markets, an increase in the value of the dollar compared with foreign currencies generally penalizes reported profits: after exchange translations, fewer dollars flow back to the United States. The reverse is also true. When the dollar is weak, foreign operations have enhanced profits and earnings. Multinational companies often use currency hedging techniques to minimize this impact, but they usually aren't sufficient to totally offset losses in periods of wide currency swings.

Many U.S. alcoholic beverage and tobacco products companies have sizable operations abroad. Consequently, significant appreciation or devaluation in key currencies (such as the euro, pound, or yen) can influence reported profits materially in a given year.

HOW TO ANALYZE AN ALCOHOLIC BEVERAGE OR TOBACCO COMPANY

Key factors to consider when assessing an alcoholic beverage or tobacco company include brand strength, market position, and business mix. Income statement, cash flow, and balance sheet data should also be scrutinized, as discussed below.

Brands reign supreme

For alcoholic beverage and tobacco firms alike, a strong brand name is key to maintaining a competitive advantage. A strong brand fosters consumer loyalty, creating opportunities for market share growth and above-average pricing flexibility and profitability. It also opens the possibility of extending product lines. In some cases, a brand can be licensed to other firms for use on their products, yielding royalties for the brand's owner.

Market position

Market leadership is especially important in the alcoholic beverages and tobacco industries, because advertising restrictions make it difficult to establish a new brand or to gain share from an existing leader. Once a firm attains market leadership, competitors will usually have a hard time trying to unseat it.

Market leadership offers a company many benefits, including the potential to realize substantial economies of scale and advantages over its rivals. For example, Anheuser-Busch (A-B) has been able to leverage its dominant share of the U.S. beer market — approximately 48.5% by volume in 2001 — into superior profitability levels. It currently reaps more than two-thirds of the industry's operating profits, in large part because of significant economies of scale.

Business mix

Business mix is a key factor in assessing a company's future prospects. In recent years, consolidation in the U.S. alcoholic beverages and tobacco industries has left few companies engaged exclusively in either tobacco or alcoholic beverages. Most firms within these industries also have other businesses, making it necessary to separate and analyze the often-unrelated operations.

Consider, for example, Philip Morris U.S.A., the leading U.S. cigarette producer with a market share of 50%. Its parent company, the Philip Morris Cos. Inc., also owns business interests in international tobacco (Philip Morris

International), food processing (Kraft Foods Inc.), and beer (an equity stake in SABMiller). Similarly, Anheuser-Busch has interests in metal can manufacturing and theme parks, although in recent years it has divested many nonbeer businesses, such as snacks, baking, and the St. Louis Cardinals baseball franchise.

Looking at the income statement

With an alcoholic beverage or tobacco company, an income statement analysis starts with net sales, which are sales minus excise taxes. Because excise taxes tend to rise more sharply in some years than in others, eliminating them from the analysis gives a fairer picture of actual sales growth.

Sales growth

Net sales growth is generally a sign of health for a business. However, one needs to look at how a company's sales growth compares with that of its market in general and with those of its specific competitors. It's also important to determine what's behind any sales growth. Is it pricing? Unit volume gains? Acquisitions? Is the company gaining market share, or is it just benefiting from market growth?

For alcoholic beverage companies, it's important to look at sales growth over a full year. Many factors can influence comparisons of quarter-to-quarter shipments, including weather, the timing of holidays, and prebuying by distributors in anticipation of occasional manufacturer price increases.

Profit margins

A company's gross profit margin normally depends on its product mix and operational efficiency. Gross profit margin (gross profit as a percentage of sales) can usually be enhanced by shedding low-margin businesses (improving product mix) or by cutting costs (achieving operational efficiency).

Gross margin should be judged on both an absolute and a relative basis. Trends in a company's gross profit margins on an absolute basis are important to observe; a number of factors — including acquisitions, fluctuations in important raw material costs, or pricing changes — can cause significant volatility. On a relative basis, if a company's margin is high compared with that of its competitors, it probably has strong brand names or other competitive advantages that are keeping its rivals at bay.

It's also essential to look at the company's operating margin performance, which reflects selling, general, and administrative expenses. Operating margin equals operating income (before deduction of items such as depreciation/amortization expense, interest, and/or other nonoperating expenses) divided by sales. An increase in the operating margin usually indicates that management is using its assets more efficiently. Conversely, a prolonged narrowing of a company's operating margin should raise warning signals.

Interest expense

Interest expense isn't normally a big line item for tobacco and alcoholic beverage companies. Capital requirements for these industries are relatively low, particularly for companies that aren't building an international presence. Most of their interest charges relate to borrowing costs associated with funding acquisitions or share repurchases and, to a lesser extent, with refinancing costs.

A substantial increase in interest charges should prompt the analyst to ask its cause. If due to an investment in new manufacturing facilities, it could be a bullish sign that the company predicts increased demand for its product. However, increased debt leverage and the attendant interest charges crimp near-term earnings while reducing the amount of funds available for other — and potentially more rewarding — purposes.

Net income

The bottom line is, of course, net income. Since this income statement item represents the residual income (or deficit) after all expenses are accounted for, it can be manipulated. For this reason, be on the lookout for special items that can distort net income.

For example, special (or "extraordinary" or "nonrecurring") credits might include a profit gain from an asset sale that isn't expected to be repeated in subsequent periods. A company can also derive special credits from favorable legal settlements or from a one-time change in accounting practices.

Special charges can result from business restructuring initiatives, losses derived from asset sales, unfavorable legal settlements, or a change in accounting practices.

In recent years, many major U.S. consumer products companies, including those in the alcoholic beverage and tobacco industries, have incurred such charges, mostly to restructure existing operations. These charges against retained earnings are often taken to consolidate facilities, reduce excess manufacturing capacity, dispose of underperforming or nonstrategic businesses, or lay off employees.

In recent years, tobacco companies have recorded substantial charges to cover litigation expenses and settlements. Given the number of tobacco cases pending and the recurring nature of litigation expenses, these charges shouldn't be considered as extraordinary. More appropriately, they should be considered part of the cost of doing business in the U.S. tobacco industry.

Settlement payments related to the November 1998 Master Settlement Agreement are treated a little differently, and are generally recorded as part of the cost of sales as cigarettes are shipped. This is because each cigarette manufacturer's portion of ongoing adjusted payments and legal fees is based on its share of domestic cigarette shipments in the preceding year.

Net profit margin

When assessing a company's net profit margin — net income divided by net sales — consider the company's primary business.

For companies primarily in the business of manufacturing and marketing tobacco products, net profit margins should be relatively high — 10% or more. From a pure earnings standpoint, very few businesses enjoy the attractive profile of the U.S. cigarette and smokeless tobacco industries. Thanks to significant barriers to entry and the minimal capital needed by established firms, these companies can show net profit margins substantially higher than those of other packaged goods makers.

The U.S. alcoholic beverage industry's high entry barriers have helped to limit new entrants and to support flexible pricing practices. Although net profit margins within the industry vary considerably by company, they're generally high compared with other consumer products companies.

The trend in net profit margins is also important because nonrecurring events can artificially inflate or deflate the figure in any given year. A three- or five-year trend is a more telling indicator of overall profitability than is a single year. Also, a trend up (or down) can signal an acceleration (or deceleration) in future earnings trends.

Earnings per share

Earnings per share (EPS) figures should be adjusted for special items to make comparisons between quarters or years meaningful. Although the EPS figure is a good indicator of company performance, one shouldn't place too much weight on a single quarterly, or even annual, performance. A company's adjusted EPS trend over the course of two or three years is a much better indicator of actual financial health.

Keep in mind that companies have substantial flexibility in propping up EPS figures, at least temporarily. By increasing stock repurchases, a company can reduce the denominator in the earnings/share equation, thus raising the ratio. Or by trimming its capital spending and/or advertising budget, the firm can allow more profits to flow to the net income line, raising the EPS figure. EPS can also be manipulated through the more elaborate use of different inventory valuation methods or depreciation schedules.

P/E ratio

When valuing a company's stock, a good place to start is the basic investment ratio of stock price to earnings per share, called the price/earnings (P/E) ratio. This ratio (or multiple) can be useful, since it allows a company to be compared with others in the same industry as well as with those in other industries.

In recent years, stocks of the major U.S. alcoholic beverages and tobacco companies have tended to have P/E ratios below those of stocks in other consumer products industries. This is due to the greater perceived investment risk by investors, given the legal and regulatory challenges facing the alcoholic beverages and tobacco industries. In the case of tobacco companies, P/E ratios tend to be substantially below most other industries, given the proliferation of class-action lawsuits against them in the United States. The low P/E ratios also reflect the slow revenue and earnings growth characteristic of these highly mature industries.

Cash flow

Cash flow figures, closely related to earnings, provide insight into how a company generates its profits and where it puts its funds. Excess cash flow is generally defined as net income plus depreciation/amortization charges minus capital expenditures and cash dividends.

Most U.S. alcoholic beverages and tobacco companies consistently generate excess cash flow that can be put to work beyond the upkeep of existing equipment. This excess cash flow arises mainly because companies within these mature industries don't have significant research and development activities. Nor do they normally face pressing needs to expand manufacturing capacity as do companies in other industries.

It's important for a company to try to find the optimal balance between reinvesting surplus cash in its business and using the cash to reward shareholders immediately. In recent years, most domestic alcoholic beverages and tobacco companies have given a relatively large portion of their excess cash back to shareholders through stock buybacks and dividends.

Balance sheet data

A number of balance sheet ratios can be examined to spot the beginnings of possible cash flow problems. A significant change in a company's current ratio (current assets to current liabilities) can signal a potential drain on the capital needed to run the business. Also, an unusual inventory increase could lead to an asset writedown, which could cause production to slow. The rate of inventory turnover (cost of goods sold divided by average inventories) can reveal changes in production or inventory bottlenecks.

Debt load

The ratio of long-term debt to total capital varies considerably among the major U.S. alcoholic beverages and tobacco companies. In general, most aim to maintain long-term debt ratios in the 40%–50% range. Because there's no optimal amount of long-term indebtedness that a company should carry, investors must weigh the benefits of high and low debt loads. An increased debt load can enhance near-term EPS growth and shareholder returns. A clean balance sheet, in contrast, allows for a high degree of safety, a potentially higher credit rating, and ready availability of funds for any potential opportunity. ■

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Beer Handbook 2002
Wine Handbook 2002
Liquor Handbook 2002
ACNeilsen/Adams Business Research
257 Park Ave. South, New York, NY 10010
(646) 654-2000
Web site: http://www.beveragenet.net
Annual reports covering alcoholic beverage sales and consumption trends.

Advertising Age
Crain Communications Inc.
711 Third Ave., New York, NY 10017
(212) 210-0100
Web site: http://www.adage.com
Weekly newspaper reporting on marketing trends in the United States and abroad.

Agricultural Outlook
USDA Economic Research Service
1800 M St. NW, Washington, DC 20036
(800) 999-6779
Web site: http://www.ers.usda.gov
Monthly periodical covering news and statistics related to global agriculture-related issues.

Beer Marketer's Insights
P.O. Box 264, W. Nyack, NY 10994
(845) 624-2337
Web site: http://www.beerinsights.com
Leading source of information on the U.S. beer industry.

Beverage Industry
Stagnito Communications Inc.
155 Pfingsten Rd., Deerfield, IL 60015
(847) 205-5660
Web site: http://www.bevindustry.com
Monthly trade magazine reporting on current trends and issues related to the U.S. beverage industry.

Beverage World
Beverage Aisle
VNU Business Publications USA
770 Broadway, New York NY 10003
(646) 654-4500
Web site: http://www.beverageworld.com
Monthly trade magazines covering current trends and issues related to the U.S. beverage industry.

IMPACT
M. Shanken Communications Inc.
387 Park Ave. South, New York, NY 10016
(212) 684-4224
Web site: http://www.mshanken.com
Bimonthly publication covering topics of interest in the U.S. alcoholic beverage industry.

Modern Brewery Age
Business Journals Inc.
50 Day St., Box 5550, Norwalk, CT 06856
(203) 853-6015
Web site: http://www.breweryage.com
Weekly newsletter reporting on developments within the U.S. brewing industry.

Tobacco Reporter
Speccomm International Inc.
3000 Highwoods Blvd., Raleigh, NC 27604
(919) 872-5040
Web site: http://www.tobaccoreporter.com
Monthly periodical covering recent global tobacco industry developments.

Tobacco Situation and Outlook Report
USDA Economic Research Service
1800 M St. NW, Washington, DC 20036
(800) 999-6779
Web site: http://www.ers.usda.gov
Semiannual publication covering current market conditions and the outlook for tobacco leaf and products.

TRADE ASSOCIATIONS

The Beer Institute
122 C St. NW, Ste. 750, Washington, DC 20001
(202) 737-2337
Web site: http://www.beerinstitute.org
Members include leading beer industry representatives.

Distilled Spirits Council of the United States (DISCUS)
1250 Eye St. NW, Ste. 400, Washington, DC 20005
(202) 628-3544
Web site: http://www.discus.org
Represents the distilled spirits industry.

Tobacco Merchants Association of the United States
P.O. Box 8019, Princeton, NJ 08543
(609) 275-4900
Web site: http://www.tma.org
Represents the interests of the U.S. tobacco industry.

The Wine Institute
425 Market St., Ste. 1000, San Francisco, CA 94105
(415) 512-0151
Web site: http://www.wineinstitute.org
Nonprofit public policy advocacy association of California wineries.

REGULATORY AGENCIES

Bureau of Alcohol, Tobacco & Firearms (ATF)
U.S. Department of the Treasury
650 Massachusetts Ave. NW, Washington, DC 20226
(202) 927-7777
Web site: http://www.atf.treas.gov
Government agency charged with regulating activities and collecting taxes within these industries.

U.S. Department of Agriculture (USDA)
14th St. and Independence Ave. SW
Washington, DC 20250
(202) 720-2791
Web site: http://www.usda.gov
Government agency charged with providing key statistics on the U.S. agricultural industry, including tobacco.

U.S. Department of Commerce
1401 Constitution Ave. NW, Washington, DC 20230
(202) 482-4883
Web site: http://www.doc.gov
This cabinet-level department's mission is to ensure and enhance economic opportunity for Americans by working with businesses and communities to promote economic growth. It provides key statistics on U.S. industry, including the manufacturing sector.

Food and Drug Administration (FDA)
5600 Fishers Lane, Rockville, MD 20857
(888) 463-6332
Web site: http://www.fda.gov
Government agency charged with supervising the U.S. food and pharmaceutical industries; a division of the U.S. Department of Health and Human Services.

MARKET RESEARCH FIRMS

ACNeilsen/Adams Business Research
50 Washington St., Norwalk, CT 06854
(203) 855-8499
Web site: http://www.albevresearch.com
Supplies market research information to the alcoholic beverage segment.

OTHER

Web sites with information on the alcoholic beverage and tobacco industries:
http://www.just-drinks.com
http://www.brownandwilliamson.com
http://www.beverageonline.com

Definitions for Comparative Company Analysis Tables

Operating revenues

Net sales and other operating revenues. Excludes interest income if such income is "nonoperating." Includes franchised/leased department income for retailers and royalties for publishers and oil and mining companies. Excludes excise taxes for tobacco, liquor, and oil companies.

Net income

Profits derived from all sources, after deductions of expenses, taxes, and fixed charges, but before any discontinued operations, extraordinary items, and dividend payments (preferred and common).

Return on revenues

Net income divided by operating revenues.

Return on assets

Net income divided by average total assets. Used in industry analysis and as a measure of asset-use efficiency.

Return on equity

Net income, less preferred dividend requirements, divided by average common shareholder's equity. Generally used to measure performance and to make industry comparisons.

Current ratio

Current assets divided by current liabilities. It is a measure of liquidity. Current assets are those assets expected to be realized in cash or used up in the production of revenue within one year. Current liabilities generally include all debts/obligations falling due within one year.

Debt/capital ratio

Long-term debt (excluding current portion) divided by total invested capital. It indicates how highly "leveraged" a company might be. Long-term debt are those debts/obligations due after one year, including bonds, notes payable, mortgages, lease obligations, and industrial revenue bonds. Other long-term debt, when reported as a separate account, is excluded; this account generally includes pension and retirement benefits. Total invested capital is the sum of stockholders' equity, long-term debt, capital lease obligations, deferred income taxes, investment credits, and minority interest.

Debt as a percent of net working capital

Long-term debt (excluding current portion) divided by the difference between current assets and current liabilities. It is an indicator of a company's liquidity.

Price/earnings ratio

The ratio of market price to earnings, obtained by dividing the stock's high and low market price for the year by earnings per share (before extraordinary items). It essentially indicates the value investors place on a company's earnings.

Dividend payout ratio

This is the percentage of earnings paid out in dividends. It is calculated by dividing the annual dividend by the earnings. Dividends are generally total cash payments per share over a 12-month period. Although payments are usually calculated from the ex-dividend dates, they may also be reported on a declared basis where this has been established to be a company's payout policy.

Dividend yield

The total cash dividend payments divided by the year's high and low market prices for the stock.

Earnings per share

The amount a company reports as having been earned for the year (based on generally accepted accounting standards), divided by the number of shares outstanding. Amounts reported in *Industry Surveys* exclude extraordinary items.

Tangible book value per share

This measure indicates the theoretical dollar amount per common share one might expect to receive should liquidation take place. Generally, book value is determined by adding the stated (or par) value of the common stock, paid-in capital, and retained earnings, then subtracting intangible assets, preferred stock at liquidating value, and unamortized debt discount. This amount is divided by the number of outstanding shares to get book value per common share.

Share price

This shows the calendar-year high and low of a stock's market price.

In addition to the footnotes that appear at the bottom of each page, you will notice some or all of the following:

NA—Not available.

NM—Not meaningful.

NR—Not reported.

AF—Annual figure. Data are presented on an annual basis.

CF—Combined figure. In this case, data are not available because one or more components are combined with other items.

Comparative Company Analysis — Alcoholic Beverages & Tobacco

Operating Revenues

		Million $							Compound Growth Rate (%)			Index Basis (1991 = 100)				
Company	Yr. End	2001	2000	1999	1998	1997	1996	1991	10-Yr.	5-Yr.	1-Yr.	2001	2000	1999	1998	1997
TOBACCO‡																
§ DIMON INC	JUN	1,401.0	1,473.6	1,815.2F	2,171.8D	2,513.2A	2,147.4	1,003.0	3.4	-8.2	-4.9	140	147	181	217	251
* PHILIP MORRIS COS INC	DEC	72,944.0C	63,276.0A	61,751.0	57,813.0	56,114.0	54,553.0	48,064.0	4.3	6.0	15.3	152	132	128	120	117
* RJ REYNOLDS TOBACCO HLDGS	DEC	8,585.0C	8,167.0	7,567.0	5,716.0	5,044.0	NA	NA	NA	NA	5.1	**	**	**	**	NA
§ SCHWEITZER-MAUDUIT INTL INC	DEC	499.5	496.8	504.4	546.7A	460.6	471.3	NA	NA	1.2	0.5	**	**	**	**	NA
† UNIVERSAL CORP/VA	JUN	3,017.6F	3,402.0F	4,004.9F	4,287.2F	4,112.7F	3,570.2F	2,896.5D,F	0.4	-3.3	-11.3	104	117	138	148	142
* UST INC	DEC	1,633.0	1,512.4	1,484.4	1,396.9	1,375.0	1,370.4	879.5C	6.4	3.6	8.0	186	172	169	159	156
BREWERS‡																
* ANHEUSER-BUSCH COS INC	DEC	12,911.5C	12,261.8	11,703.7	11,245.8	11,066.2C	10,883.7	10,996.3	1.6	3.5	5.3	117	112	106	102	101
* COORS (ADOLPH) -CL B	DEC	2,429.5	2,414.4	2,056.6	1,899.5	1,822.2	1,732.2	1,917.4	2.4	7.0	0.6	127	126	107	99	95
DISTILLERS & VINTNERS‡																
* BROWN-FORMAN -CL B	# APR	1,958.0	1,924.0	1,877.0	1,776.0	1,669.0	1,584.0	1,260.1A	4.5	4.3	1.8	155	153	149	141	132
† CONSTELLATION BRANDS -CL A	# FEB	2,820.5A	2,396.7	2,340.5A	1,497.3A	1,212.8	1,135.0	176.6	31.9	20.0	17.7	1,597	1,357	1,326	848	687
OTHER COMPANIES WITH SIGNIFICANT ALCOHOLIC BEVERAGE OPERATIONS																
BOSTON BEER INC -CL A	DEC	186.8	190.6	176.8	183.5	183.8	191.1	NA	NA	-0.5	-2.0	**	**	**	**	NA
DIAGEO PLC -ADR	JUN	18,048.1	17,959.3	18,594.8	20,082.4	20,346.5	6,099.2	NA	NA	24.2	0.5	**	**	**	**	NA
MONDAVI ROBERT CORP -CL A	JUN	505.8A	427.7	370.6	325.2	300.8	240.8	NA	NA	16.0	18.3	**	**	**	**	NA
OTHER COMPANIES WITH SIGNIFICANT TOBACCO OPERATIONS																
BRITISH AMERN TOB PLC -ADR	DEC	35,580.9E	35,260.9A,E	30,358.8E	30,924.8D,F	29,841.3F	27,706.7D,F	20,988.8F	5.4	5.1	0.9	170	168	145	147	142
GALLAHER GROUP PLC -ADR	DEC	1,996.9A	1,553.4A	1,552.3	1,560.8	1,608.0A	1,717.3D	NA	NA	3.1	28.6	**	**	**	**	NA
STANDARD COMMERCIAL CORP	# MAR	942.3D	1,116.9	1,105.7	1,102.8C	1,492.8	1,354.3	1,178.1C	-2.2	-7.0	-15.6	80	95	94	94	127
VECTOR GROUP LTD	DEC	593.0D	623.5D	500.3C,D	362.0D	301.9	348.1D	999.3	-5.1	11.2	-4.9	59	62	50	36	30

Note: Data as originally reported. ‡ S&P 1500 Index group. * Company included in the S&P 500. † Company included in the S&P MidCap. § Company included in the S&P SmallCap. # Of the following calendar year. ** Not calculated; data for base year or end year not available. A - This year's data reflect an acquisition or merger. B - This year's data reflect a major merger resulting in the formation of a new company. C - This year's data reflect an accounting change. D - Data exclude discontinued operations. E - Includes excise taxes. F - Includes other (nonoperating) income. G - Includes sale of leased depts. H - Some or all data are not available, due to a fiscal year change.

Net Income

		Million $							Compound Growth Rate (%)			Index Basis (1991 = 100)				
Company	Yr. End	2001	2000	1999	1998	1997	1996	1991	10-Yr.	5-Yr.	1-Yr.	2001	2000	1999	1998	1997
TOBACCO‡																
§ DIMON INC	JUN	25.0	18.0	-28.4	41.8	77.2	39.9	21.2	1.7	-8.9	39.0	118	85	-134	198	365
* PHILIP MORRIS COS INC	DEC	8,566.0	8,510.0	7,675.0	5,372.0	6,310.0	6,303.0	3,927.0	8.1	6.3	0.7	218	217	195	137	161
* RJ REYNOLDS TOBACCO HLDGS	DEC	444.0	352.0	195.0	-519.0	19.0	NA	NA	NA	NA	26.1	**	**	**	**	NA
§ SCHWEITZER-MAUDUIT INTL INC	DEC	24.5	27.8	31.4	31.0	45.3	38.7	NA	NA	-8.7	-11.9	**	**	**	**	NA
† UNIVERSAL CORP/VA	JUN	112.7	113.8	127.3	141.3	100.9	71.3	56.4	7.2	9.6	-1.0	200	202	226	251	179
* UST INC	DEC	491.6	441.9	469.3	455.3	439.1	464.0	265.9	6.3	1.2	11.3	185	166	176	171	165
BREWERS‡																
* ANHEUSER-BUSCH COS INC	DEC	1,704.5	1,551.6	1,402.2	1,233.3	1,179.2	1,156.1	939.8	6.1	8.1	9.9	181	165	149	131	125
* COORS (ADOLPH) -CL B	DEC	123.0	109.6	92.3	67.8	82.3	43.4	23.9	17.8	23.1	12.2	514	458	386	283	344
DISTILLERS & VINTNERS‡																
* BROWN-FORMAN -CL B	# APR	228.0	233.0	218.0	202.0	185.0	169.0	146.4	4.5	6.2	-2.1	156	159	149	138	126
† CONSTELLATION BRANDS -CL A	# FEB	138.0	97.3	77.4	61.9	50.1	27.7	7.7	33.4	37.9	41.7	1,790	1,263	1,004	803	649

Net Income (continued)

Company	Yr. End	Million $ 2001	2000	1999	1998	1997	1996	1991	Compound Growth Rate (%) 10-Yr.	5-Yr.	1-Yr.	Index Basis (1991 = 100) 2001	2000	1999	1998	1997
OTHER COMPANIES WITH SIGNIFICANT ALCOHOLIC BEVERAGE OPERATIONS																
BOSTON BEER INC -CL A	DEC	7.8	11.2	11.1	7.9	7.6	8.4	NA	NA	-1.4	-30.3	**	**	**	**	NA
DIAGEO PLC -ADR	JUN	1,725.8	1,476.7	1,485.1	1,467.5	1,332.2	1,172.9	NA	NA	8.0	16.9	**	**	**	**	NA
MONDAVI ROBERT CORP -CL A	JUN	43.3	41.6	30.8	29.0	28.2	24.4	NA	NA	12.1	4.1	**	**	**	**	NA
OTHER COMPANIES WITH SIGNIFICANT TOBACCO OPERATIONS																
BRITISH AMERN TOB PLC -ADR	DEC	1,468.8	1,002.0	897.9	1,059.2	1,634.5	2,575.3	768.8	6.7	-10.6	46.6	191	130	117	138	213
GALLAHER GROUP PLC -ADR	DEC	341.0	371.8	389.9	362.2	395.6	378.0	NA	NA	-2.0	-8.3	**	**	**	**	NA
STANDARD COMMERCIAL CORP	# MAR	36.2	19.5	10.3	8.4	26.9	16.9	21.6	5.3	16.4	85.8	167	90	48	39	124
VECTOR GROUP LTD	DEC	21.2	169.6	236.1	24.2	-51.8	-64.9	-149.6	NM	NM	-87.5	NM	NM	NM	NM	NM

Note: Data as originally reported. ‡ S&P 1500 Index group. * Company included in the S&P 500. † Company included in the S&P MidCap. § Company included in the S&P SmallCap. # Of the following calendar year. ** Not calculated; data for base year or end year not available.

Return on Revenues (%) / *Return on Assets (%)* / *Return on Equity (%)*

Company	Yr. End	Return on Revenues (%) 2001	2000	1999	1998	1997	Return on Assets (%) 2001	2000	1999	1998	1997	Return on Equity (%) 2001	2000	1999	1998	1997
TOBACCO‡																
§ DIMON INC	JUN	1.8	1.2	NM	1.9	3.1	2.0	1.3	NM	2.2	5.1	6.1	4.5	NM	10.1	21.3
* PHILIP MORRIS COS INC	DEC	11.7	13.4	12.4	9.3	11.2	10.4	12.1	12.7	9.3	11.4	49.5	56.2	48.7	34.5	43.3
* RJ REYNOLDS TOBACCO HLDGS	DEC	5.2	4.3	2.6	NM	0.4	2.9	2.4	1.2	NM	NA	5.4	4.5	2.3	NM	NA
§ SCHWEITZER-MAUDUIT INTL INC	DEC	4.9	5.6	6.2	5.7	9.8	5.2	6.3	6.9	7.2	11.7	13.6	15.3	16.5	16.5	27.0
† UNIVERSAL CORP/VA	JUN	3.7	3.3	3.2	3.3	2.5	6.4	6.4	6.6	7.0	5.2	21.5	22.0	23.4	27.8	22.7
* UST INC	DEC	30.1	29.2	31.6	32.6	31.9	26.9	33.2	48.7	52.3	53.7	115.4	187.5	140.3	100.5	122.0
BREWERS‡																
* ANHEUSER-BUSCH COS INC	DEC	13.2	12.7	12.0	11.0	10.7	12.7	12.1	11.2	10.2	10.6	41.6	38.5	34.5	29.9	29.2
* COORS (ADOLPH) -CL B	DEC	5.1	4.5	4.5	3.6	4.5	7.3	6.9	6.1	4.7	5.9	13.1	12.4	11.4	9.0	11.3
DISTILLERS & VINTNERS‡																
* BROWN-FORMAN -CL B	# APR	11.6	12.1	11.6	11.4	11.1	11.5	12.5	12.3	12.5	12.6	18.3	20.9	22.2	23.5	24.2
† CONSTELLATION BRANDS -CL A	# FEB	4.9	4.1	3.3	4.1	4.1	4.9	4.0	3.7	4.3	4.8	17.6	17.1	16.2	14.6	12.8
OTHER COMPANIES WITH SIGNIFICANT ALCOHOLIC BEVERAGE OPERATIONS																
BOSTON BEER INC -CL A	DEC	4.2	5.9	6.3	4.3	4.1	7.6	10.6	9.4	6.9	7.5	10.3	14.3	13.4	10.3	11.1
DIAGEO PLC -ADR	JUN	9.6	8.2	8.0	7.3	6.5	7.0	5.9	5.5	5.0	6.2	23.9	21.9	21.1	15.6	14.6
MONDAVI ROBERT CORP -CL A	JUN	8.6	9.7	8.3	8.9	9.4	5.4	6.1	5.2	5.8	7.0	11.5	12.7	11.0	12.2	13.8
OTHER COMPANIES WITH SIGNIFICANT TOBACCO OPERATIONS																
BRITISH AMERN TOB PLC -ADR	DEC	4.1	2.8	3.0	3.4	5.5	5.4	3.5	4.0	2.2	2.0	19.0	11.9	20.0	26.8	19.1
GALLAHER GROUP PLC -ADR	DEC	17.1	23.9	25.1	23.2	24.6	9.4	16.9	13.7	11.9	16.0	NM	NM	NM	NM	NM
STANDARD COMMERCIAL CORP	# MAR	3.8	1.7	0.9	0.8	1.8	5.4	2.6	1.2	1.0	3.4	20.1	12.2	6.9	5.6	22.5
VECTOR GROUP LTD	DEC	3.6	27.2	47.2	6.7	NM	3.7	35.1	64.4	13.6	NM	33.7	NM	NM	NM	11.0

Note: Data as originally reported. ‡ S&P 1500 Index group. * Company included in the S&P 500. † Company included in the S&P MidCap. § Company included in the S&P SmallCap. # Of the following calendar year.

		Current Ratio					*Debt / Capital Ratio (%)*					*Debt as a % of Net Working Capital*				
Company	**Yr. End**	**2001**	**2000**	**1999**	**1998**	**1997**	**2001**	**2000**	**1999**	**1998**	**1997**	**2001**	**2000**	**1999**	**1998**	**1997**
TOBACCO‡																
§ DIMON INC	JUN	1.3	2.4	1.9	2.4	2.0	32.5	53.1	55.8	63.4	64.9	116.8	109.3	119.8	112.8	118.0
* PHILIP MORRIS COS INC	DEC	NA	NA	NA	NA	NA	35.3	46.9	36.8	37.2	38.7	NA	NA	NA	NA	NA
* RJ REYNOLDS TOBACCO HLDGS	DEC	1.4	1.4	0.8	3.9	1.5	14.3	14.0	16.0	29.2	27.3	153.3	152.9	NM	92.3	728.1
§ SCHWEITZER-MAUDUIT INTL INC	DEC	1.3	1.6	1.5	1.3	1.7	21.9	32.7	33.0	33.2	29.0	117.0	150.8	194.8	340.9	120.4
† UNIVERSAL CORP/VA	JUN	1.9	1.2	1.3	1.3	1.3	46.8	29.0	26.5	30.3	36.0	93.5	109.0	81.5	80.0	83.9
* UST INC	DEC	4.0	4.1	2.2	2.6	2.7	53.0	65.5	67.2	17.6	18.6	128.8	166.6	129.0	32.3	36.3
BREWERS‡																
* ANHEUSER-BUSCH COS INC	DEC	0.9	0.9	0.8	0.9	1.1	52.8	49.4	48.1	46.1	45.0	NM	NM	NM	NM	NM
* COORS (ADOLPH) -CL B	DEC	1.2	1.3	1.6	1.4	1.4	1.9	9.3	10.2	11.1	15.1	22.5	88.7	47.7	63.6	91.7
DISTILLERS & VINTNERS‡																
* BROWN-FORMAN -CL B	# APR	2.1	1.8	2.0	1.9	2.3	2.8	3.1	3.5	4.8	4.9	7.5	8.8	8.2	11.0	10.3
† CONSTELLATION BRANDS -CL A	# FEB	2.1	2.8	2.3	2.1	2.0	53.6	63.6	66.0	61.4	39.5	203.3	171.2	221.8	188.8	110.0
OTHER COMPANIES WITH SIGNIFICANT ALCOHOLIC BEVERAGE OPERATIONS																
BOSTON BEER INC -CL A	DEC	3.3	3.3	3.5	2.4	3.2	0.0	0.0	0.0	0.0	12.2	0.0	0.0	0.0	0.0	19.8
DIAGEO PLC -ADR	JUN	1.0	1.0	0.9	1.0	1.2	40.7	41.1	42.3	35.8	29.1	NM	NM	NM	NM	185.4
MONDAVI ROBERT CORP -CL A	JUN	5.1	5.1	6.3	6.1	4.8	44.1	43.1	43.1	45.3	40.5	86.7	91.1	81.9	86.4	85.0
OTHER COMPANIES WITH SIGNIFICANT TOBACCO OPERATIONS																
BRITISH AMERN TOB PLC -ADR	DEC	1.2	1.3	1.5	NA	NA	46.5	46.7	46.0	83.1	24.7	334.7	323.5	172.3	NA	NA
GALLAHER GROUP PLC -ADR	DEC	1.1	1.2	1.1	1.3	1.5	112.2	156.3	212.9	168.0	193.4	NM	847.8	775.8	290.1	319.7
STANDARD COMMERCIAL CORP	# MAR	1.6	1.6	1.5	1.4	1.5	42.9	51.5	52.3	53.1	51.9	80.6	93.7	103.1	107.2	90.0
VECTOR GROUP LTD	DEC	3.6	1.9	0.8	0.4	0.5	41.5	15.7	83.4	-199.7	-451.5	57.3	30.4	NM	NM	NM

Note: Data as originally reported. ‡ S&P 1500 Index group. * Company included in the S&P 500. † Company included in the S&P MidCap. § Company included in the S&P SmallCap. # Of the following calendar year.

		Price / Earnings Ratio (High-Low)					*Dividend Payout Ratio (%)*					*Dividend Yield (High-Low, %)*				
Company	**Yr. End**	**2001**	**2000**	**1999**	**1998**	**1997**	**2001**	**2000**	**1999**	**1998**	**1997**	**2001**	**2000**	**1999**	**1998**	**1997**
TOBACCO‡																
§ DIMON INC	JUN	21-8	15-5	NM-NM	28-7	15-11	36	50	NM	70	33	4.2-1.7	10.3-3.4	14.2-5.0	10.1-2.5	3.0-2.2
* PHILIP MORRIS COS INC	DEC	14-10	12-5	17-7	27-16	18-14	56	54	57	76	61	5.7-4.1	10.8-4.4	8.7-3.3	4.8-2.8	4.4-3.3
* RJ REYNOLDS TOBACCO HLDGS	DEC	14-10	14-5	18-9	NA-NA	NA-NA	72	89	86	NA	NA	7.5-5.3	19.7-6.2	9.7-4.7	NA-NA	NA-NA
§ SCHWEITZER-MAUDUIT INTL INC	DEC	15-9	11-6	9-6	20-7	16-11	36	33	30	31	21	3.9-2.3	5.1-3.1	5.2-3.4	4.6-1.6	2.0-1.3
† UNIVERSAL CORP/VA	JUN	11-7	10-4	9-5	12-8	14-10	39	32	30	27	36	5.3-3.6	9.0-3.4	6.0-3.2	3.5-2.2	3.7-2.5
* UST INC	DEC	12-8	11-5	13-9	15-10	15-11	62	65	62	66	68	7.9-5.1	12.7-6.1	7.0-4.8	6.6-4.4	6.4-4.4
BREWERS‡																
* ANHEUSER-BUSCH COS INC	DEC	25-17	29-16	28-22	27-17	20-16	36	37	39	42	42	2.1-1.5	2.3-1.3	1.8-1.4	2.5-1.6	2.6-2.1
* COORS (ADOLPH) -CL B	DEC	24-13	28-13	26-18	30-16	19-8	24	24	26	32	25	1.9-1.0	1.9-0.9	1.4-1.0	2.1-1.1	3.1-1.3
DISTILLERS & VINTNERS‡																
* BROWN-FORMAN -CL B	# APR	22-17	20-12	24-17	26-18	21-16	41	38	38	39	41	2.4-1.9	3.1-1.8	2.2-1.6	2.2-1.5	2.6-2.0
† CONSTELLATION BRANDS -CL A	# FEB	14-8	11-8	14-10	18-10	22-8	0	0	0	0	0	0.0-0.0	0.0-0.0	0.0-0.0	0.0-0.0	0.0-0.0
OTHER COMPANIES WITH SIGNIFICANT ALCOHOLIC BEVERAGE OPERATIONS																
BOSTON BEER INC -CL A	DEC	38-18	16-11	21-13	33-17	30-21	0	0	0	0	0	0.0-0.0	0.0-0.0	0.0-0.0	0.0-0.0	0.0-0.0
DIAGEO PLC -ADR	JUN	23-18	26-14	30-19	34-21	29-28	67	82	75	75	96	3.7-2.9	5.9-3.2	4.0-2.6	3.5-2.2	3.4-3.3
MONDAVI ROBERT CORP -CL A	JUN	20-11	20-11	21-15	26-11	32-19	0	0	0	0	0	0.0-0.0	0.0-0.0	0.0-0.0	0.0-0.0	0.0-0.0
OTHER COMPANIES WITH SIGNIFICANT TOBACCO OPERATIONS																
BRITISH AMERN TOB PLC -ADR	DEC	15-10	19-9	27-12	35-11	19-15	74	106	107	19	102	7.1-5.0	11.6-5.4	8.6-3.9	1.8-0.6	6.9-5.3
GALLAHER GROUP PLC -ADR	DEC	13-10	11-5	13-6	15-9	10-7	70	63	64	64	35	7.3-5.4	11.6-5.7	10.5-5.1	6.9-4.3	5.0-3.4
STANDARD COMMERCIAL CORP	# MAR	8-2	5-2	12-3	27-10	10-7	7	14	25	23	0	3.3-0.9	7.3-2.9	7.3-2.2	2.4-0.9	0.0-0.0
VECTOR GROUP LTD	DEC	65-21	3-1	2-1	21-3	NM-NM	214	17	6	25	NM	10.4-3.3	12.4-6.4	4.9-2.5	7.9-1.2	15.0-2.5

Note: Data as originally reported. ‡ S&P 1500 Index group. * Company included in the S&P 500. † Company included in the S&P MidCap. § Company included in the S&P SmallCap. # Of the following calendar year.

		Earnings per Share ($)					Tangible Book Value per Share ($)					Share Price (High-Low, $)				
Company	**Yr. End**	**2001**	**2000**	**1999**	**1998**	**1997**	**2001**	**2000**	**1999**	**1998**	**1997**	**2001**	**2000**	**1999**	**1998**	**1997**
TOBACCO‡																
§ DIMON INC	JUN	0.56	0.40	-0.63	0.94	1.79	5.49	5.06	4.53	4.77	4.46	11.61-4.75	5.81-1.94	7.94-2.81	26.31-6.56	26.75-19.75
* PHILIP MORRIS COS INC	DEC	3.93	3.77	3.21	2.21	2.61	-8.33	-8.19	-0.67	-0.56	-1.18	53.88-38.75	45.94-18.69	55.56-21.25	59.50-34.75	48.13-36.00
* RJ REYNOLDS TOBACCO HLDGS	DEC	4.57	3.48	1.80	-4.78	NA	-17.35	-17.20	-33.39	NA	NA	62.70-44.19	50.25-15.75	32.94-16.00	NA-NA	NA-NA
§ SCHWEITZER-MAUDUIT INTL INC	DEC	1.66	1.82	1.99	1.94	2.82	12.10	12.16	11.78	12.37	11.17	25.53-15.19	19.64-11.81	17.50-11.50	38.63-13.00	44.50-29.88
† UNIVERSAL CORP/VA	JUN	4.09	3.77	3.81	4.01	2.88	15.77	13.04	12.47	11.71	9.37	43.37-29.75	36.38-13.50	35.75-19.44	49.50-31.50	41.69-27.88
* UST INC	DEC	2.99	2.71	2.69	2.45	2.39	3.47	1.66	1.19	2.55	2.35	36.00-23.38	28.88-13.88	34.94-24.06	36.88-24.56	36.94-25.50
BREWERS‡																
* ANHEUSER-BUSCH COS INC	DEC	1.91	1.71	1.50	1.28	1.20	4.15	4.11	3.79	3.96	3.69	46.95-32.60	49.88-27.31	42.00-32.22	34.13-21.47	24.13-19.25
* COORS (ADOLPH) -CL B	DEC	3.33	2.98	2.51	1.87	2.21	24.06	24.32	22.06	20.51	19.36	81.19-42.65	82.31-37.38	65.81-45.25	56.75-29.25	41.25-17.50
DISTILLERS & VINTNERS‡																
* BROWN-FORMAN -CL B	# APR	3.33	3.40	3.18	2.93	2.67	15.41	13.57	11.36	9.53	8.08	72.00-57.65	69.25-41.88	77.25-54.94	76.88-51.75	55.38-42.00
† CONSTELLATION BRANDS -CL A	# FEB	1.62	1.33	1.07	0.85	0.67	10.80J	8.26J	7.16J	6.06J	5.54J	23.25-13.25	14.75-10.09	15.38-10.72	14.94-8.81	14.41-5.47
OTHER COMPANIES WITH SIGNIFICANT ALCOHOLIC BEVERAGE OPERATIONS																
BOSTON BEER INC -CL A	DEC	0.48	0.62	0.54	0.39	0.37	4.71	4.33	4.34	4.00	3.49	18.16-8.56	9.69-7.00	11.13-6.94	12.75-6.50	11.00-7.81
DIAGEO PLC -ADR	JUN	2.04	1.74	1.68	1.54	1.33	-0.80	-1.02	-2.14	-0.18	NAJ	46.35-36.63	44.94-24.38	49.56-31.56	51.75-33.00	39.13-37.38
MONDAVI ROBERT CORP -CL A	JUN	2.73	2.68	2.00	1.90	1.80	25.10J	22.35J	19.69J	16.54J	14.57J	54.63-29.65	54.69-29.44	41.38-29.00	50.25-20.13	56.75-35.00
OTHER COMPANIES WITH SIGNIFICANT TOBACCO OPERATIONS																
BRITISH AMERN TOB PLC -ADR	DEC	1.29	0.85	0.82	1.36	2.10	-2.43	3.50	-0.86	0.14J	8.59	19.05-13.30	16.50-7.75	22.25-10.19	47.63-15.00	40.50-31.00
GALLAHER GROUP PLC -ADR	DEC	2.17	2.35	2.33	2.10	2.31	-15.13	-8.93	-6.36	-6.12	-6.28	28.54-20.88	26.00-12.75	29.50-14.19	31.25-19.50	24.00-16.00
STANDARD COMMERCIAL CORP	# MAR	2.72	1.48	0.80	0.66	2.18	13.76	12.28	10.98	11.14	11.31	21.15-6.00	6.81-2.75	9.25-2.75	17.50-6.38	21.08-14.25
VECTOR GROUP LTD	DEC	0.69	6.54	9.28	0.98	-2.34	3.25J	0.44J	-5.23J	-15.49	-22.32	44.25-14.12	17.71-9.18	21.90-11.31	20.36-3.14	9.77-1.65

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Computers: Networking
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Healthcare: Managed Care
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