Beer Quarterly Q4 2020

Can Beer Consumption Recover After Lockdowns?

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Introduction

Across the globe, the beer sector suffered from the Covid-19 pandemic in the early stages of 2020. In some countries, alcohol consumption was restricted (South Africa), while others classified brewing as a non-essential activity and ceased beer production (Mexico). In most countries, consumers faced a lockdown and the on-premise channel was closed, creating varying degrees of pain for nearly all brewers. As we approach November, we are still not out of the woods. In our first quarterly update on the beer industry, we take a look at how Covid-19 has impacted brewers in different regions, and what we expect to see moving forward.

North America – The overall market has held up relatively well, helped by its reliance on off-trade sales and stellar e-commerce growth. Brewers large and small have proved surprisingly nimble and adaptable – which may lead to notable changes to the on-premise moving forward. Craft brewers, who are more dependent on the on-trade, have so far avoided closures, though we are wary of the impact of winter on those dependent on outdoor seating.

Europe – On-trade markets have been hit hard, especially in tourist areas, and beer going stale in kegs has caused additional problems. As new Covid cases are on the rise and the risk of a second lockdown increases, chain integration might help to lower costs.

Asia – Despite a sharp recovery in China, the loss of summer sales will hang over 2020 Asian beer volumes. China comprises 70% of total Asian beer consumption, and thus, is critical to recovery. We have seen smart recoveries in Thailand and Japan in Q3 2020 but mixed fortunes in the rest of Asia, specifically, India, the Philippines, and Vietnam.

The North American Markets

Beer volumes in the US are only down 1% to 2% so far in 2020, but this slight decline in volumes conceals some massive changes related to style, brewery size, and channel. Of course, the grocery side of the business is doing well (in-line with the rest of the alcohol space). Volume growth has stabilized at high single-digits over the last three months, following the large initial spike in off-premise shopping (*see Table 1*).

E-commerce sales are far stronger – though growing off a very small base. We are regularly hearing about triple-digit growth for smaller platforms in industry discussions. Drizly is a great example, having announced in August that 2020 sales were up over 350%. While Covid-19 is driving consumer and corporate adoption of e-commerce, it's still too small to make a significant impact on total beer sales, despite being a crucial investment for the long term.

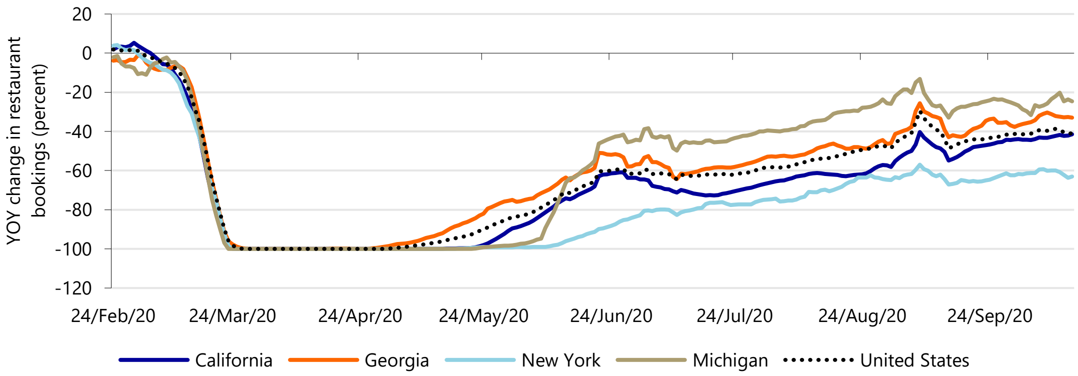
Table 1: US retail sales

Volume	4 wks - 2/9	4 wks - 3/8	4 wks - 4/5	4 wks - 5/3	4 wks - 5/31	4 wks - 6/28	4 wks - 7/26	4 wks - 8/23	4 wks - 9/20	Average 7 periods
Spirits	-2%	0%	41%	32%	26%	15%	11%	11%	10%	16%
Beer	3%	5%	34%	20%	20%	15%	8%	10%	7%	14%
Wine	-5%	-1%	38%	25%	21%	12%	9%	8%	9%	13%
Energy	8%	13%	17%	6%	12%	15%	17%	16%	12%	13%
RTD coffee	-3%	3%	7%	6%	17%	21%	17%	12%	12%	10%
Juice	-6%	-2%	28%	12%	11%	12%	12%	10%	9%	10%
Carbonated soft drinks	-3%	1%	23%	12%	13%	10%	11%	9%	9%	9%
Coffee	-3%	2%	36%	9%	8%	5%	9%	6%	4%	8%
Water	3%	19%	38%	-12%	-5%	5%	7%	8%	2%	7%
Milk	-4%	-2%	24%	13%	8%	2%	2%	1%	2%	5%

Source: IRI, Rabobank 2020

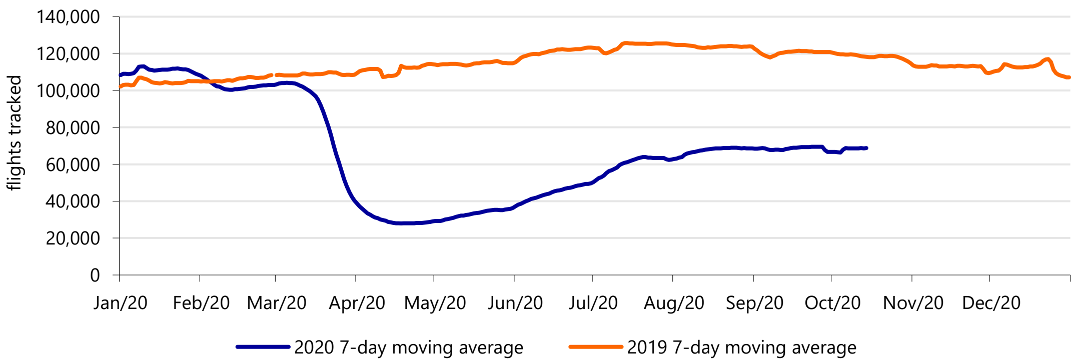
The biggest change has been the drop in on-premise sales. Sales to the on-premise briefly dipped near zero in March/April, and have been on a long, slow recovery since then. More recently, the recovery has mostly stagnated, driven by an uptick in new Covid cases and the end of several government assistance programs.

Figure 1: A varied recovery in US restaurant reservations



Source: Open Table 2020

Figure 2: Commercial flights tracked globally never fell as far as restaurant bookings

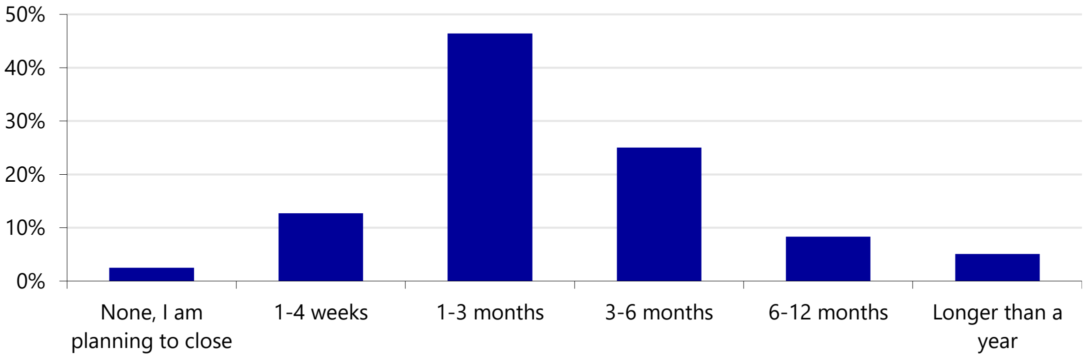


Source: Flight Tracker 2020

We estimate about 20% of US beer volumes go through the on-premise, and AB InBev showed that the US ranks fairly low among their markets, in terms of percentage of volume on-premise. Craft beer, which has ~40% of its volume in the on-premise, has faced a much bigger challenge, especially with many smaller operators heavily dependent on taproom sales.

In spite of all the challenges facing the on-premise, massive closures really haven't happened yet. A Brewers Association survey of craft brewers from April showed that over 50% of respondents said they might close within three months – but more than six months on, we haven't seen a large spike in closures. The on-premise has proven far more resilient than expected.

Figure 3: April 2020 survey of craft brewers: How long can you survive lockdown conditions?



Source: Brewers Association, Bloomberg, Rabobank 2020

It's worth noting that the coffee shop space, which has seen a craft beer-like boom of small independent specialty shops over the last decade-plus is in a similar situation. Following a few early closures, much of the on-premise has pivoted to digital ordering, pick-up and delivery, outdoor seating, and selling new products.

Biggest Takeaways:

Small, local independent drinks makers are more resilient than we thought – Success (which is often measured as perseverance in this case) is driven by a real consumer demand for local and the collective will of founders fighting for their livelihoods. The ability of the smallest entrepreneurs to be nimble – working on delivery and e-commerce solutions and adjusting both product portfolios and physical setups – has been a bright spot during Covid. Smaller companies that make it through could potentially come out stronger, having developed new routes to market, a closer connection with consumers, and more flexibility on how to serve them.

It's not just grocery stores cutting SKUs, some bars and restaurants are too – The reopening of the on-premise has a lot of establishments running at partial capacity. Matching reduced turnover with a more streamlined backbar is a common response that looks to gain efficiency on the cost and labor front. So far, this has proven to be an opportunity for bigger suppliers to leverage existing relationships through their distributors to design new offerings for the on-premise and attempt to grow market share (and put themselves in pole position for further capacity increases). This could be part of an increasing gap, as big brands gain share in grocery stores, bars, and restaurants, while smaller regional brands increasingly rely on 'own-premise' and e-commerce.

Branding menu opportunities – The long-maligned QR code has made a glorious comeback as a symbol of all that is different about the on-premise experience (and a way to be safer). Building new outdoor spaces, digital ordering systems, and even igloos and heaters for the winter are significant expenses. While branded patio umbrellas are common worldwide, explicit branding on the inside of bars/restaurants is often limited to coasters, drinkware, bar mats, and the like. Restauranteur David Chang referenced chefs in Spain wearing branded jackets, and welcomed any advertising help possible, especially as further government assistance for the hospitality industry has proven elusive. Tied-house laws obviously provide a serious obstacle in the US, but we expect to see creative solutions.

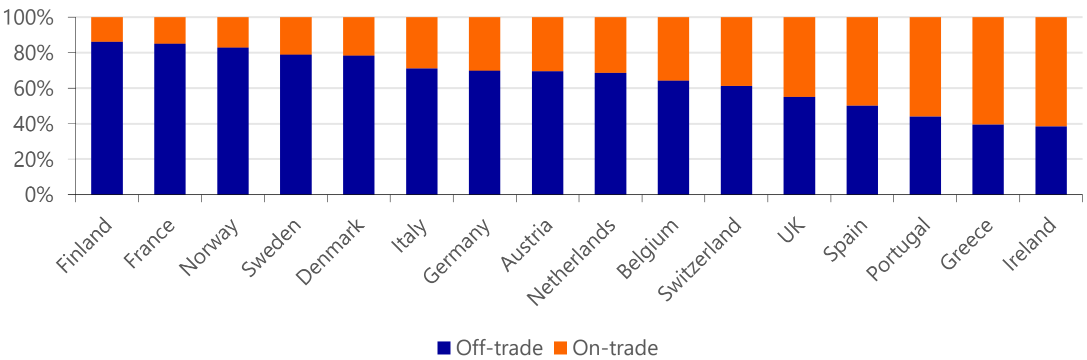
We are not simply recovering toward the 2019 on-premise market – Michel Doukeris, AB InBev's Zone President North America/CEO Anheuser-Busch, called this "one of the biggest resets of all time." He referenced the potential of to-go alcohol from bars/restaurants (now allowed in certain locations due to new regulations) and the opportunity for new behind-the-bar machines, like Drinkworks – a trend which might finally catch on in a reduced-SKU, more cost-conscious on-premise. Of course, the biggest change in the new on-premise might be hard seltzer. In the summer of 2019, hard seltzer was still a low single-digit percentage of overall beer – but by the summer of 2021, it could be 10% or more. Boston Beer founder Jim Koch said next summer will be "the point where you walk into a bar or a restaurant and you expect them to have some hard seltzer."

Winter is coming – We wrote of resilience, but much of the current dining and drinking capacity in the US remains outdoors. Enclosed tents are starting to take over sidewalks near my home in Manhattan, but these can only help so much. A recent Specialty Coffee Association survey showed almost one-third of coffee shop respondents' sales were down 50% or more, and we have seen similar if not worse numbers across the restaurant industry. Without a financial rescue plan in place, operating at sub-50% revenues is likely unsustainable. Rent will come due, and we may see on-premise closures pick up significantly over the winter. Talk of a K-shaped economic recovery in the US has increased recently, and small on-premise operators may be on the wrong side of such a scenario.

The European Markets

Brewers in Europe have been hit by the closure of the on-trade, but the impact has varied among different countries. In Scandinavia, out-of-home consumption is limited and most beer is sold through the retail channel, while in Mediterranean countries, on-trade is more prominent, especially during the tourist season.

Figure 4: Beer volumes by channel, 2019

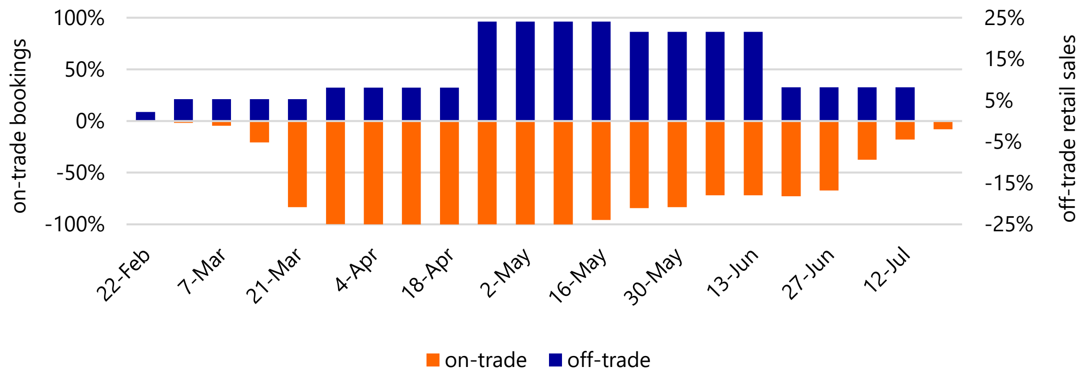


Source: Euromonitor 2020

Although during lockdown the decline in on-trade consumption was partly mitigated by higher retail sales, we estimate that overall beer consumption in western Europe was down 15% in Q2

2020. As the number of Covid cases declined in the summer months and the on-trade in Europe gradually reopened, sales recovered and the channel mix normalized.

Figure 5: European on-trade and off-trade consumption



Note: Data is the unweighted average of reported restaurant bookings and retail sales for major countries
Source: Open Table, Nielsen, Rabobank 2020

Looking Forward

As schools restart and people return to work, Europe is witnessing a second wave of infections, and the on-trade in the UK, Spain, the Netherlands, Italy, France, Portugal, Belgium, and Denmark have recently been ordered to adjust opening hours and close early. In Ireland, wet-led pubs have so far not been allowed to open at all. Although it's not the most likely scenario, there is a risk that a second full lockdown of the on-trade could be imposed if the number of cases increases further. This would be very disappointing news for landlords and brewers, but there are some lessons that can be learned from the previous experience.

A 'fresh' dilemma – After leaving the brewery in kegs, channel flexibility for beer is limited. Whereas bottles and cans can be redirected to the off-trade, keg beer will go stale when left unsold, resulting in missed revenues and high disposal costs. This is particularly problematic for beer exporters, who have a long transit time and a large number of kegs in the pipeline. In July, when restaurants started to reopen, US draft beer import volumes were down much more than beer in bottles or cans, and both Belgium (-97%) and the Netherlands (-93%) exported significantly less kegged beer than the year before. We think that export in bottles and cans currently reduces the risk profile, although bulk transport and local packaging is also an alternative.

The switch from kegs to single-serve packaging did lead to supply problems of cans, especially in the US, where hard seltzers also gained share. Molson Coors decided to focus on a limited number of core brands to address the can shortage issue, and Ball invested in more production capacity. In Europe, the can shortage has so far been less pressing, as glass bottles have kept its market share stable. Ball even exported some cans from Europe to North America to address the shortage. As hard seltzers are being introduced in the European market, brewers with a lot of keg sales (e.g. craft brewers who struggled with the first round of closures) might consider locking in cans and canning capacity to provide some peace of mind.

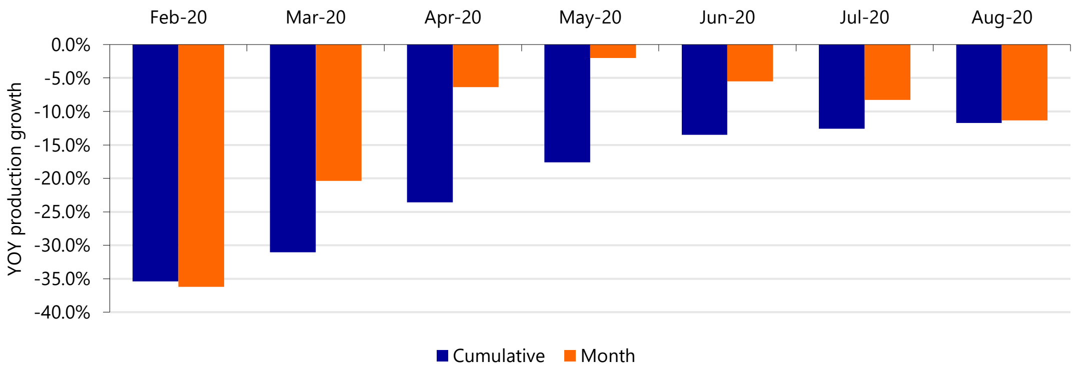
Pubs may require support to manage cash flow – Pubs have high operational gearing, due to their fixed cost structure. As furlough schemes come to an end and new restrictions on opening times in several European countries limit revenues, landlords will face liquidity problems. During lockdown, many countries ran a voucher scheme, providing income for the on-trade in exchange for future consumption. Heineken ran 'Back the Bars' in many countries, and in the Netherlands, Grolsch gave discount codes for vouchers to consumers who purchased a crate of beer in the off-trade. Many voucher schemes have now finished but could be restarted to help the on-trade again.

Cost control remains key – With revenues largely out of brewer's and landlord's control, focus on costs is key. Some costs can be diverted through government schemes. Helplines are available for smaller operators without detailed knowledge of all opportunities. AB InBev and C&C are among the many brewers helping landlords in this way. Brewers are also helping the on-trade through automatic ordering systems, flexible payment terms, waiver or postponement of rent, and replacement of old kegs for new ones. On a larger scale, the merger between Marston's and Carlsberg in the UK could also be seen as a way to control costs, leading to synergies in procurement, operations, logistics, and overhead costs.

The Asian Markets

A sharp correction in China severely dented Q1 2020 Asian beer volume. While brewers in the rest of Asia saw demand disruption toward the end of the first quarter, brewers in China faced Covid-19-induced production and distribution challenges at the end of January 2020. Consequently, overall Asian beer production declined by ~25% in Q1 2020. As China's demand recovered in the subsequent quarter, the rest of Asian volumes slid lower, as the impact of movement restrictions began to take a toll on consumer demand. Overall, Asian beer demand declined by ~12% in 1H 2020.

Figure 6: Beer production growth in China, Thailand, and Vietnam



Note: China, Thailand, and Vietnam comprise ~80% of Asian beer volumes
Source: national statistics offices, national excise data, Rabobank 2020

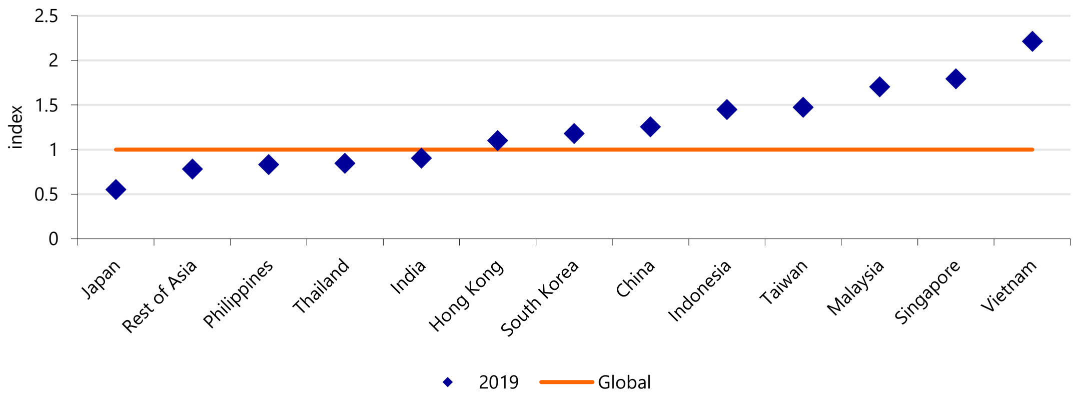
Despite continued supply chain disruption, beer production in Asia recovered sharply in Q2 2020 (*see Figure 6*). The robust recovery in China's beer production supported weak Q2 volumes in the rest of Asia. Since June, a sharp rally in the rest of Asia (Japan, Thailand, and a few other markets) supported weak growth in China's and Vietnam's beer production. It is worth noting that China comprises ~70% of Asian beer volumes, and therefore, recovery in China remains key to 2020 Asian beer output.

Three Visible Shifts in the Business Environment

Covid-19 created a definite shift in the Asian beer business environment. There are three visible sources of impact on beer volumes in Asia.

(G)on(e)-premise - Like elsewhere, the most visible of these impacts has been the decimation of on-premise consumption. On-premise comprises over 50% of China's volumes and even more in Vietnam – two of the biggest markets in Asia. On average, beer volumes in Asia are over-indexed on the on-premise channel, suggesting that the impact of mobility restrictions would be higher on Asian beer demand vs. the rest of the world. The seven-day moving average of Google's mobility data underscores the implications of mobility restrictions for retail and recreation services.

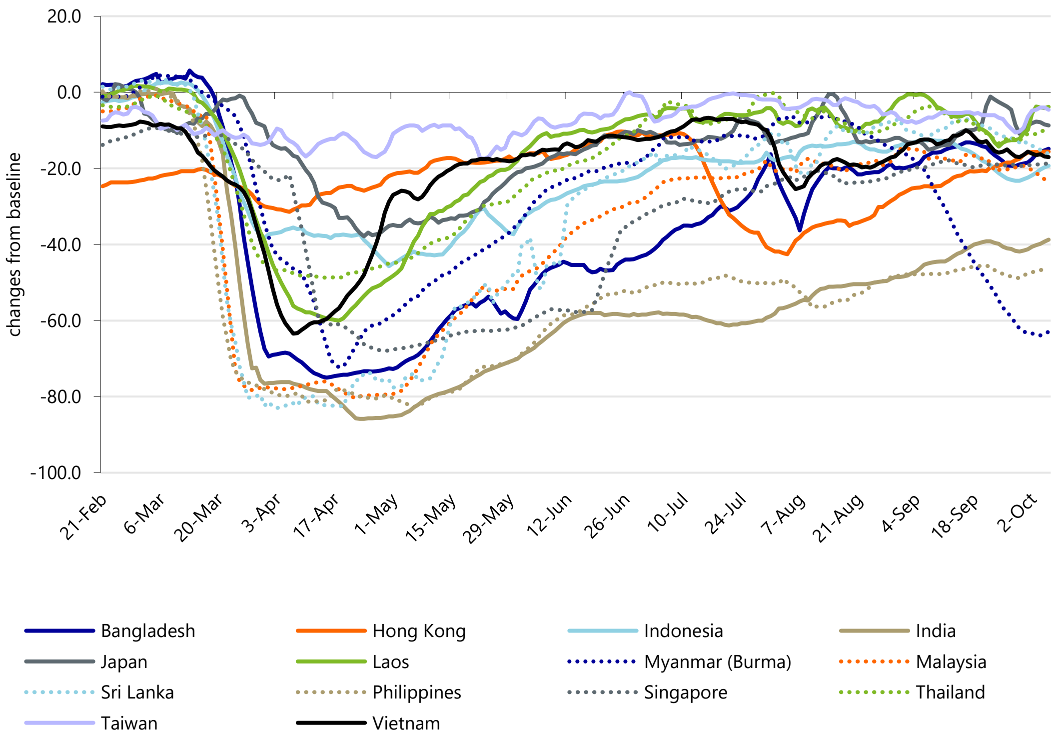
Figure 7: On-premise volume share indexed to the global average



Source: GlobalData, Rabobank 2020

The return of mobility restrictions in Europe and select Asian markets, including China and the Philippines, highlights the precarious balance between life and livelihood. Social distancing is likely to persist in some form throughout 2020, and to continue to reduce serving capacity at on-premise venues. This will impact beer demand beyond the initial lockdown period and likely well into 2021.

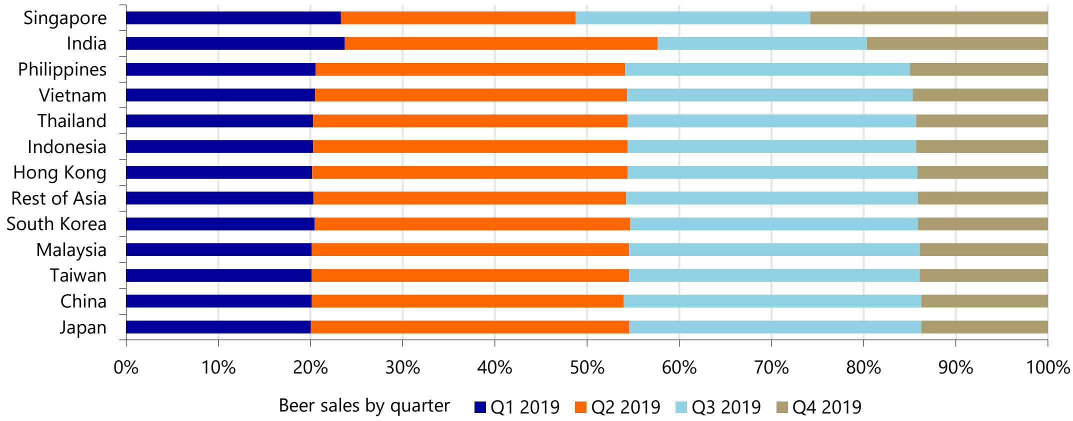
Figure 8: Seven-day moving average mobility data for retail and recreation



Source: Google, Rabobank 2020

Off t(r)opic – Mobility restrictions and supply chain disruption during the peak consumption season will severely impact 2020 annual beer demand in Asia. Typically, summer sales (Q2 and Q3 combined) comprise over two-thirds of annual beer volumes across all markets in the region, except Singapore.

Figure 9: Seasonality in beer demand

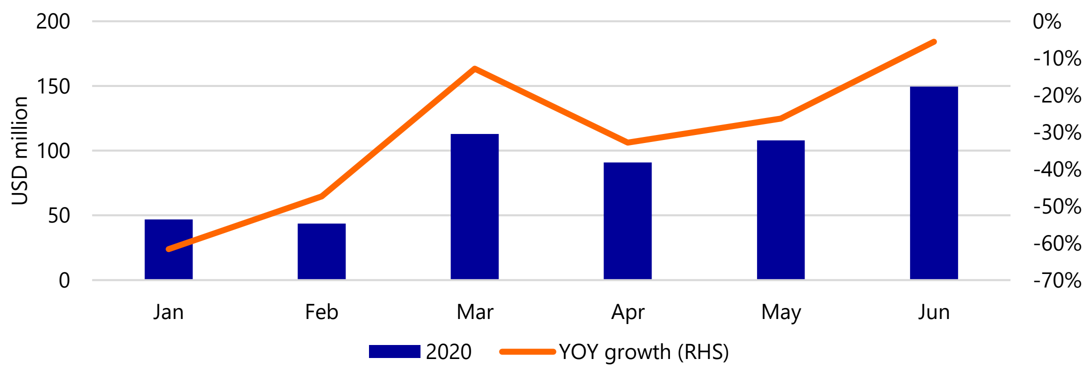


Source: GlobalData, Rabobank 2020

As brewers started preparing for summer sales, mandatory social distancing and other travel restrictions to control the Covid-19 outbreak decimated summer demand. With winter approaching, there is limited opportunity to recover lost ground in the final quarter of 2020.

Trade to rest – Exported beer is an integral part of revenue, especially for European brewers. Globally, one out of every 12 bottles is an imported brew. Although this proportion is significantly lower in Asia, it is growing ahead of overall demand and key to driving category premiumization. In 1H 2020, beer exports to Asia (including inter-Asia) declined by 28% due to disruptions in demand and supply chains. This was primarily driven by lower shipments to China, which fell by ~40% in 1H 2020.

Figure 10: Asia monthly beer imports, 2020



Note: includes inter-Asian beer imports
Source: International Trade Center, Rabobank 2020

Imported beer volumes will struggle, as supply chains (ports, etc.) are impacted, and container availability will be an issue for some time. But more importantly, even if brewers can put their brands on the ship, the critical consumer 'discovery & purchase' channel for imported beer – the on-premise – is likely to struggle for the foreseeable future across the region.

Transition to a 'With Covid' Era

Regulatory changes continue to create challenges for brewers reeling under the pressure of Covid-19 disruptions. The implementation of anti-drunk driving laws in January 2020 couldn't be more inopportune for brewers in Vietnam. Consumer demand plummeted immediately, declining by 25% in January, and remains under pressure amid Covid-19 restrictions. Similarly, the Philippines' excise tax hikes have created challenges for a market reeling under one of the most severe lockdowns. In India, state governments imposed an additional tax to mop up additional revenue to support state finances. However, plummeting consumer demand forced a rethink and rationalization of tax measures to avoid destroying the fragile demand recovery.

On a positive note, supply chain exigencies and market realities forced both regulators and companies to adopt a more realistic e-commerce sales stance. At the time of writing, six Indian states had allowed e-commerce sales for alcohol. E-commerce has become a visibly important sales channel across the region. Startups lead the adoption of e-commerce and online-to-offline integration in the region. Tsingtao innovated with their community commerce initiative, which can create an alternative direct-to-consumer model for brewers.

Uncertainties over second and third waves remain, creating the urgency to identify and build a contingency program to avoid or at least mitigate the impact of future supply chain disruptions. Further, the possibility of an economic recession in 2021 is driving companies toward cost control measures.

Imprint

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