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***Special Edition***

**April 26, 2006**

*This year I serve as the President of the National Conference of State Liquor Administrators. The 2006 NCSLA 72nd Annual Conference, scheduled to be in Boston at the Omni Parker House from Sunday, June 4th through Thursday, June 8th, is less than six weeks away. One of the keynote speakers at the conference will be August Busch, IV of Anheuser-Busch Company of St. Louis, Missouri. Mr. Busch will be addressing the assembly on Tuesday, June 6th at 11 AM.*

*In anticipation of Mr. Busch’s presentation, I thought you might enjoy reading the cover story from today’s Wall Street Journal (WSJ) (“After Making Beer Ever Lighter, Anheuser Faces a New Palate,” WSJ, April 26, 2006). The Journal report offers a rare glimpse into the competitive U.S. beer market and provides a longitudinal perspective of the evolution of the American beer market.*

*Coincidentally, UBS released its 1Q 2006 financial report on Anheuser-Busch today as well. For your convenience, the report is attached and available either as a pdf file or as an MSWord document. And, for you readers with an insatiable appetite for the insider’s view, Anheuser-Busch website can be reached at* [*www.Anheuser-Busch.com*](http://www.Anheuser-Busch.com)*.*

*Read together, these sources offer a broad perspective and clearer understanding of the nation’s leading brewer. Mr. Busch, of course, will be able to offer his own personal insight on the publicly-traded company, as well as his viewpoint on the future of the beverage alcohol industry. A review of today’s WSJ article, the UBS financial report and the A-B website should provide the reader with more insight, knowledge and understanding when Mr. Busch addresses the National Conference of State Liquor Administrators in just a few short weeks.*

*Lynn Walding*

**After Making Beer Ever Lighter, Anheuser Faces a New Palate**

By Sarah Ellison – *The Wall Street Journal*

April 26, 2006; Page A1

**Seeking Mass Appeal, Brewer For Years Cut Bitterness; Now Drinkers Want More**

**Drink ability vs. Fat Squirrels**

ST. LOUIS -- Sitting in the wood-paneled "corporate tasting room" of [Anheuser-Busch](http://online.wsj.com/quotes/main.html?type=djn&symbol=BUD) Cos.' headquarters here, August Busch III surveyed five recently thawed cans of Budweiser beer, representing a quarter of a century of beer history. In the early 1980s, the Anheuser chairman ordered that freshly brewed cans of Budweiser and Bud Light be cryogenically frozen, using technology typically employed in preserving human tissue.

"We wanted to make damn sure we would have the same beer 20 years down the road," said Mr. Busch, 68 years old, tapping the table rhythmically with his index finger to accentuate his point.

For decades, Anheuser's aim was to develop a beer that would sell across America, one inoffensive enough to appeal to the nation's varied palate.

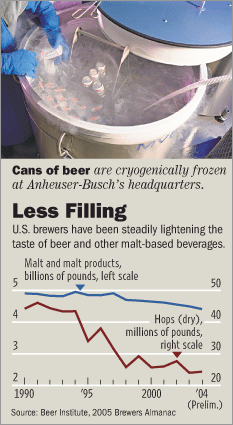
Now, that goal is out of step with a shift in consumers' tastes. From coffee to fashion to media, niche products are rising, especially ones that consumers can customize, and the great mass brands of the postwar period are under attack. Imported brews and smaller so-called "craft" beers with stronger flavors are more readily available and are selling fast, as are wines and spirits.

Moreover, for all its devotion to consistency, Anheuser concedes Budweiser has changed over the years. It quietly tinkered with its formula to make the beer less bitter and pungent, say several former brewmasters, a byproduct of the company's desire to create a beer for the Everyman.

The question of taste has created opportunities for Anheuser's rivals and has resulted in some ferocious marketing battles. Anheuser, an industry bellwether, used to shrug off such challenges. Now, among myriad other factors, it's begun to take a toll on Anheuser's financial performance and has led beer makers to a moment of self-reflection.

Anheuser's flagship brand, Budweiser, has been losing market share for more than 15 years. Two years ago, Anheuser as a whole lost market share as its Bud Light for the first time didn't pick up the slack. In 2005, after years of confidently raising prices, the brewer decided to discount cases of beer to retain customers. The brewer's profits last year slipped 18% and its stock fell 14%.

Anheuser says the earnings decline is unrelated to the taste of its beer. It also notes that Bud Light is on average more expensive than Miller Lite, which Anheuser says is a sign of the brand's continued strength. The company, however, has also acknowledged that the discounts were designed to combat SABMiller PLC's Miller Brewing Co., which has relentlessly poked fun at Bud Light's flavor in national TV ads. In part because of the discounts, Anheuser's shipments picked up late last year. The company is expected to report first-quarter earnings today.

In search of new drinkers, Anheuser last year threw more than 30 new products into the market. And, in a little-noticed move Anheuser is loath to discuss, the brewer recently added more hops to its beer to make it stronger.

After World War II, marketers strived to create products that would appeal to palates across the U.S. They succeeded, and partly with the help of the interstate highway system, built an unrivaled mass-market food industry. As refrigeration became widespread, it swiftly delivered products to every corner of the country at a reasonable price.

A diverse nation learned to like the same things. As regional varieties gave way to national brands, companies embraced soft-edged, broadly appealing formulas, which gradually lightened products from cigarettes to bread. It was a winning strategy that created success stories such as ranch dressing, Maxwell House coffee and Kraft cheese. A similar strategy in Hollywood produced the mass-market situation comedy and the Hollywood blockbuster. Market research fed the trend with its relentless tendency to find the common denominator.

For a long time, consumers were satisfied. Daniel Ennis, director of the Institute for Perception in Richmond, Va., a group that analyzes consumers' flavor preferences, says every person has an "ideal" taste for a beer or potato chip or cookie. But in the real world, companies create foods consumed by millions. "People live in suboptimal situations," says Mr. Ennis, who has consulted for Miller. "They don't send their kids to the best schools, they don't have the best jobs, they don't eat the best foods."

Or drink the strongest beer. From 1950 to 2004, the amount of malt used to brew a barrel of beer in the U.S. declined by nearly 27%, and the amount of hops in a barrel of beer declined by more than half, according to Brewers Almanac. Part of that decrease is due to improvements in how brewers extract flavor from hops. Nonetheless, beer's taste became steadily lighter. (Flowers of the common hop plant, *Humulus lupulus*, are used as a flavoring and stability agent in beer, helping create its characteristic bitter taste and aroma.)

The beer industry measures bitterness using a scale called International Bitterness Units. The higher number of IBU's, the greater the bitterness. Over the past twenty years the IBU's of most American-style lagers has dramatically declined, from roughly 15-20 IBU's to fewer than 10 today, according to the Siebel Institute, a Chicago laboratory and brewing school that tests beer.

"The North American palate has become lighter and lighter," agrees Graham Stewart, director of the International Centre for Brewing and Distilling at Heriot-Watt University in Edinburgh, Scotland. Mr. Stewart used to brew beer under license for Anheuser when he worked as technical director for Labatt Brewing Co., now part of [InBev](http://online.wsj.com/quotes/main.html?type=djn&symbol=inb.bt) SA.

Following this approach, Anheuser-Busch grew to control half the market for beer in the U.S. and its brands have dominated the beer industry for decades. It owns 50% of Corona brewer Grupo Modelo and 27% of Tsingtao, one of China's top brewers. As it put regional breweries like Rheingold and Schlitz out of business, Anheuser's flavors came to dominate beer drinkers' palates. Bud Light is now the best-selling beer in the world.

One key to Budweiser's popularity is that it produces no "palate fatigue" after several drinks. The bitterness in stronger beers tends to build up, causing a drinker to tire of the taste. Bud's appeal is what people in the industry call "drinkability." (In the U.K., it is called "sessionability," for how many beers one person will drink in a session.) Budweiser tests drinkability in "pub tests" in which the brewer rents a pub or a bar and invites people to drink free. Afterward, Anheuser drives the drinkers home.

For Mr. Busch, the definition of "drinkability" is simple: "I want the next beer!" he says. "You stop drinking because you know it's time to stop but you don't want to: That's drinkability."

Mr. Busch's obsession for protecting the integrity of his product is legendary. Head brewmaster Doug Muhleman says that in the 10 years he's been on the job, Mr. Busch has called virtually every evening at about 6:00 p.m. to discuss the day's batches.

"We've been tasting these beers for 50 years," says Mr. Busch. "If we can't sit down and drink three or four of them, then it's not right."

Mr. Muhleman, who is officially Anheuser's group vice president for brewing and technology, says the company didn't set out to make the beers less bitter. He calls the change "creep," the result of endlessly modifying the beer to allow for changes in ingredients, weather and consumer taste. "Through continuous feedback, listening to consumers, this is a change over 20, 30, 40 years," says Mr. Muhleman, gesturing toward the row of Budweiser cans. "Over time, there is a drift."

The five Budweiser cans in front of Mr. Busch, dating from 1982, 1988, 1993, 1998 and 2003, were pulled off the production line shortly after they were brewed. They were cooled to minus-321 degrees Fahrenheit over 16 hours and stored at that temperature in a secret laboratory in the company's headquarters.

The sample cans demonstrate how "creep" works. The difference in taste between two beers brewed five years apart is indistinguishable. Yet, the difference between the 1982 beer and the 2003 beer is distinct. "The bones are the same. It is the same structure," says Mr. Muhleman. Overall, however, "the beers have gotten a little less bitter."

The gradual move toward lighter tastes accelerated in the mid-1970s when Miller introduced Miller Lite. Anheuser followed with Bud Light several years later. Consumer tastes, influenced by the 1980's fitness and diet craze, gravitated toward products that promised fewer calories. Brewers followed and started tweaking the flavor of their full-calorie lagers as well, according to beer executives and industry analysts.

Bud's ever-increasing lightness worked for years. But lately, consumers have started cooling on mass brands in favor of smaller, often unknown rivals. The proliferation of new media gave consumers more information about niche products. Their tastes grew more sophisticated and aspirational, spurred by an increase in overseas travel.

At the same time, stores began using technology to improve their inventory systems. That made it easier to spot which products were selling well, letting retailers offer with precision an array of products more in tune with customers' new tastes.

As a result, rivals and some industry analysts blame Anheuser's recent lackluster financial performance on the very foundation of Budweiser dominance: its light, bubbly formula, which has been mocked for years by beer snobs and beer drinkers outside the U.S.

"I think you're seeing an increased consumer acceptance that bitter is a positive characteristic in beer," says Keith Lemke, vice president of the Siebel Institute.

Last year, craft beer shipments by volume grew 9% to 7.1 million barrels, according to the Brewers Association, the craft beer industry group. Beer drinkers reached for tiny brands such as Fat Squirrel Nut Brown Ale, Obsidian Stout and Dogfish Head Chicory Stout. Likewise, imported beer volume grew 7.1% to 25.6 million barrels, according to information compiled by the Beer Institute, the industry group for the big brewers.

At the same time, domestic beer volume dropped 1.2% to 178.8 million barrels. While the sales of regular American beer still dwarf those of the upstarts, the momentum is not running in its favor.

Anheuser's public response has been to introduce an array of niche products. This month, Anheuser said it would allow beer drinkers in Ohio and New England to pick a "hometown specialty brew" by voting on a selection of new Anheuser specialty beers with names such as Old Eyepopper. The beers that win will go on sale this summer. Anheuser recently signed deals to distribute imported beers such as Grolsch and Tiger Beer.

In October, the brewer also started selling Spykes, a flavored malt beverage designed to be added to beer, in flavors such as spicy mango and hot melon.

"People have been having fun with cocktails, mixing up different-colored and different-flavored cocktails," says Mr. Busch. "Well, we're going to have a little fun with beer."

Anheuser didn't talk publicly about it, but the brewer also recently made changes in its brewing process to correct for over-lightening. In August 2003, Mr. Busch met with hops growers in Oregon and Washington and told them that Anheuser was planning to increase the proportion of hops used in its beers, according to several people who were there.

Mr. Busch confirms the account, saying in a written statement: "I told the growers of our desire to use more hops in our brewing for the purpose of delivering more amplitude and hop flavor in Budweiser."

Mr. Muhleman adds that Anheuser makes changes all the time to maintain consistency. "When we've made changes, they haven't always been in the direction in removing hops," Mr. Muhleman says. "Sometimes we had more."

To Anheuser's chagrin, this sensitive issue has become a weapon in its battle against its smaller rival Miller. For years, Miller executives saw their slightly stronger-tasting beer as a weakness compared with Budweiser and Coors, according to current and former Miller executives.

In the late 1990s, Miller lowered the bitterness of Miller Lite to catch up. "Miller got caught for several years in the trap of trying to emulate all the things that were driving the success of the Bud brands," says Charles Frenette, a former Coca-Cola Co. marketer who now sits on Miller's U.S. board. "So there was no differentiation and everyone was looking more and more the same."

Then, in 2001, Miller increased the bitterness in Miller Lite to undo some of the prior lightening moves and the company started to embrace its slightly darker color and stronger flavor.

In a series of marketing campaigns in 2004 Miller attacked Bud Light's taste with TV spots such as "Epidemic," in which panicked Bud Light beer drinkers run through the streets, shouting, "I can't taste my beer." Another spot, called "Air beer," showed people in bars obliviously pouring and drinking invisible beer.

The spots highlighted the issue of taste at a time when consumers were ready to hear it. After years of declines, Miller Lite shipments by volume grew 13.5% in 2004 and another 2.1% the following year.

In the summer of 2004, Miller started testing Bud Light and Budweiser each month instead of twice a year, as had been its practice. Miller pulled Anheuser's beers off shelves in markets across the country, getting samples from each of Anheuser's 12 breweries. The beers were shipped to Miller's quality assurance labs in Milwaukee and tested for color, aroma, bitterness and "mouth feel," among other traits.

In early 2005, instead of the regular shift downward in bitterness it had come to expect, Miller says it found that Bud Light's bitterness had increased slightly. It had seen a similar shift in regular Bud two years earlier -- something that could be explained by the acknowledged increase in hop content.

Miller gathered a small group of top executives to work on a response. The project was named "Project Delta," referring to the letter in the Greek alphabet that denotes change in mathematics.

One Friday night in November, Miller started showing TV ads contending that the taste of Bud Light, the world's biggest beer brand, had "changed."

Anheuser realizes what damage a claim of a "change" in recipe could do to an iconic brand like Budweiser or Bud Light. Unlike many consumer and food products, "new and improved" is the kiss of death in the beer industry, which trades heavily on its heritage.

As a result, brewers tend to keep quiet about changes they make. "Almost every brewer is constantly changing their beer," says Henry von Eichel, president and CEO of John I. Haas Inc., a closely held hops producer, trader and importer based in Washington, D.C. "But no one likes to talk about it."

Mr. Muhleman says, "We don't chase our competition," and calls Miller's claims a "marketing ploy." He also says the company has made many fewer changes in Bud Light than in Budweiser over the years.

Many smaller brewers in the industry scoff at the idea there's any difference between the two beers. "I sit back and chuckle at them going after each other," says David Blossman, president of microbrewery Abita Brewing Co. in Abita Springs, La., which makes brands such as Purple Haze and Turbodog. "It's like comparing Bunny Bread to Wonder Bread." Last year, sales at Abita rose 22.4% to $9.3 million.

