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**ROUTES TO THE U.S. BEVERAGE ALCOHOL MARKET FOR
ENTREPRENEURIAL BRANDS**

BARRA MEXICO
MEXICO CITY, MEXICO – JUNE 2018



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Some Background for Today's Discussion

Today's discussion DOES NOT

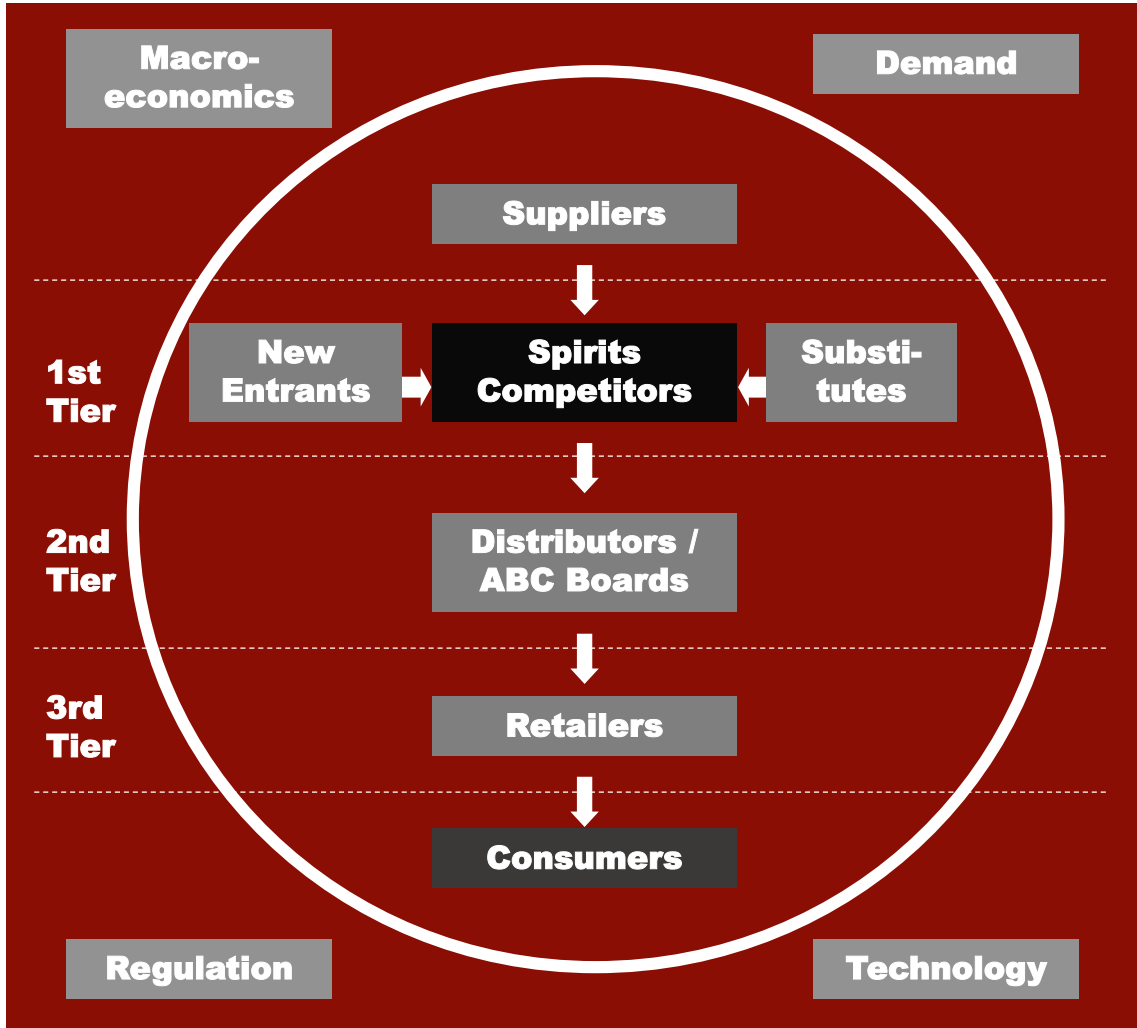
- Provide a full tutorial on all route-to-market opportunities for entrepreneurial spirits players
- Cover all nuances of each category: brown and white spirits
- Cover nuances of all types of states and accounts (control chain versus independent and on-versus off-premise)
- Provide a one-size-fits-all strategy
- Address global markets
- Offer advice on regulatory issues including e-commerce

Today's discussion DOES

- Offer a view on commercial and industry trends
- Focus on the U.S. distilled spirits market
- Offer a tutorial on select key concepts that support strategy development and execution
- Provide insights into the market forces influencing strategy development
- Focus on entrepreneurial brands with national growth ambitions



Discussion Topics



- **“The route-to-market in a highly regulated red tape environment that demands three tiers”**
- **“Vulnerable first tier Goliaths with David winning, not necessarily alone, but as a group”**
- **“The second tier on a fast track to a duopoly with some alternative options for starters”**
- **“The higher the relevant differentiation and badge value for the brand, the easier the route to market battle”**
- **“The start close to home and a focus on a success blueprint that can be replicated in other markets”**
- **“The concept of fair share of attention or there is no silver bullet for distribution”**
- **“Combining an above fair share of attention and economies of scale for an efficient and effective route to market”**



Route to Market: Definition and Requirements for an Effective Platform

General Definition:

“It is a 'path' or 'pipeline' through which goods flow in one direction (from supplier to the consumer), and the payments generated by them flow in the opposite direction (from consumer to the supplier).”

Market-driven

Coherent

Balanced

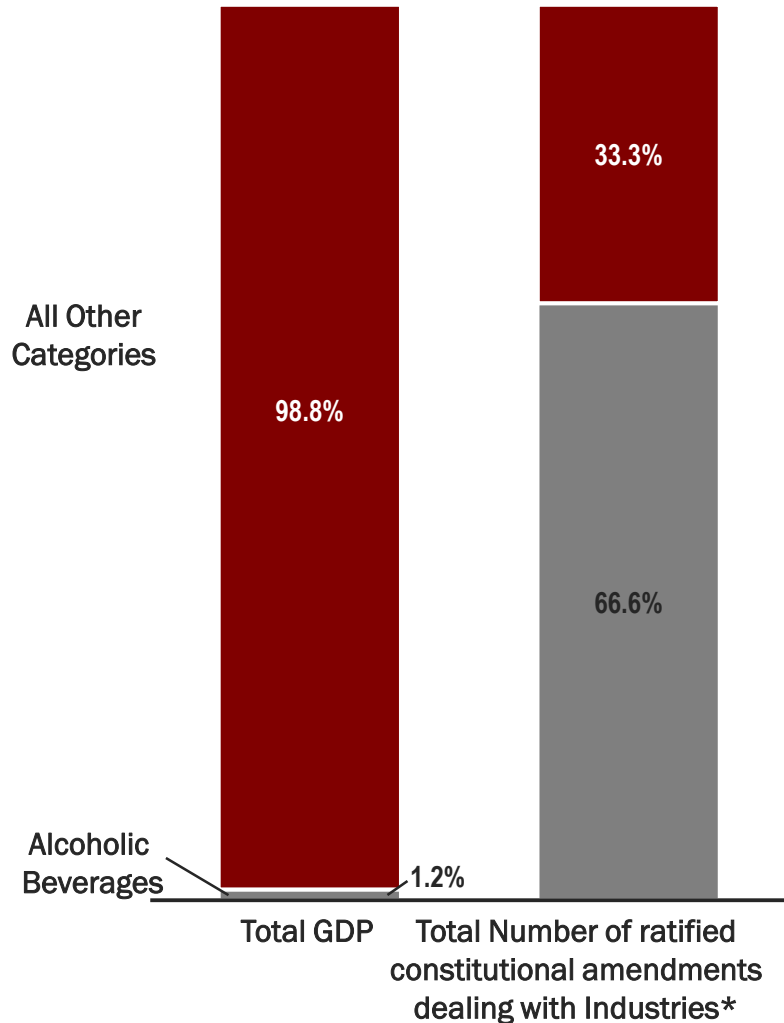
Flexible

- Route to market platform needs to be designed from the market back instead of inside-out and must effectively address customer and consumer needs
- Route to market platform needs to be aligned and integrated with the company’s overall customer service framework including order processing, fulfillment, logistics, billing etc.
- Route to market platform must enable identification and balancing of three competing priorities:
 - Customer needs and preferences (i.e., “what they want”)
 - Revenue growth (i.e., “what you want”)
 - Cost-to-serve (i.e., “what you want to keep low”)
- Route to market platform must include a certain degree of flexibility as the original model may require modification based on data captured via a short feedback loop; improvements and adjustments must be made to address any change in market conditions



An Industry That Required Two Constitutional Amendments

100% = \$18.57 Trillion 100% = 3 Amendments



Only industry in the U.S. that required two constitutional amendments to regulate it

27 amendments in total. 24 amendments dealing with the role, rights and the functioning of government and the democratic process. Only other industry affecting amendment is the right to keep and bear arms. Sources: U.S. Constitution, data.gov, Park Street Analyses



Historical Background of Prohibition: A Movement and Two Constitutional Amendments

Anti-Saloon League

- Formed by women in 1893
- Powerful political force of the temperance movement focusing on passing a national ban on alcoholic beverages.
- Believe that alcohol contributed to social problems related to abuse, prostitution, and criminal activity.

18th Amendment

- "The 18th Amendment to the U.S. Constitution prohibited the manufacture, sale, transport, import, or export of alcoholic beverages.
- National Prohibition Act became effective 1920

21st Amendment

- Ended Prohibition in 1933 by repealing the 18th Amendment
- Some states, however, continued prohibition within their jurisdictions. Almost two-thirds of all states adopted some form of local option which enabled residents in political subdivisions to vote for or against local Prohibition.
- For a time, 38% of Americans lived in areas with Prohibition.





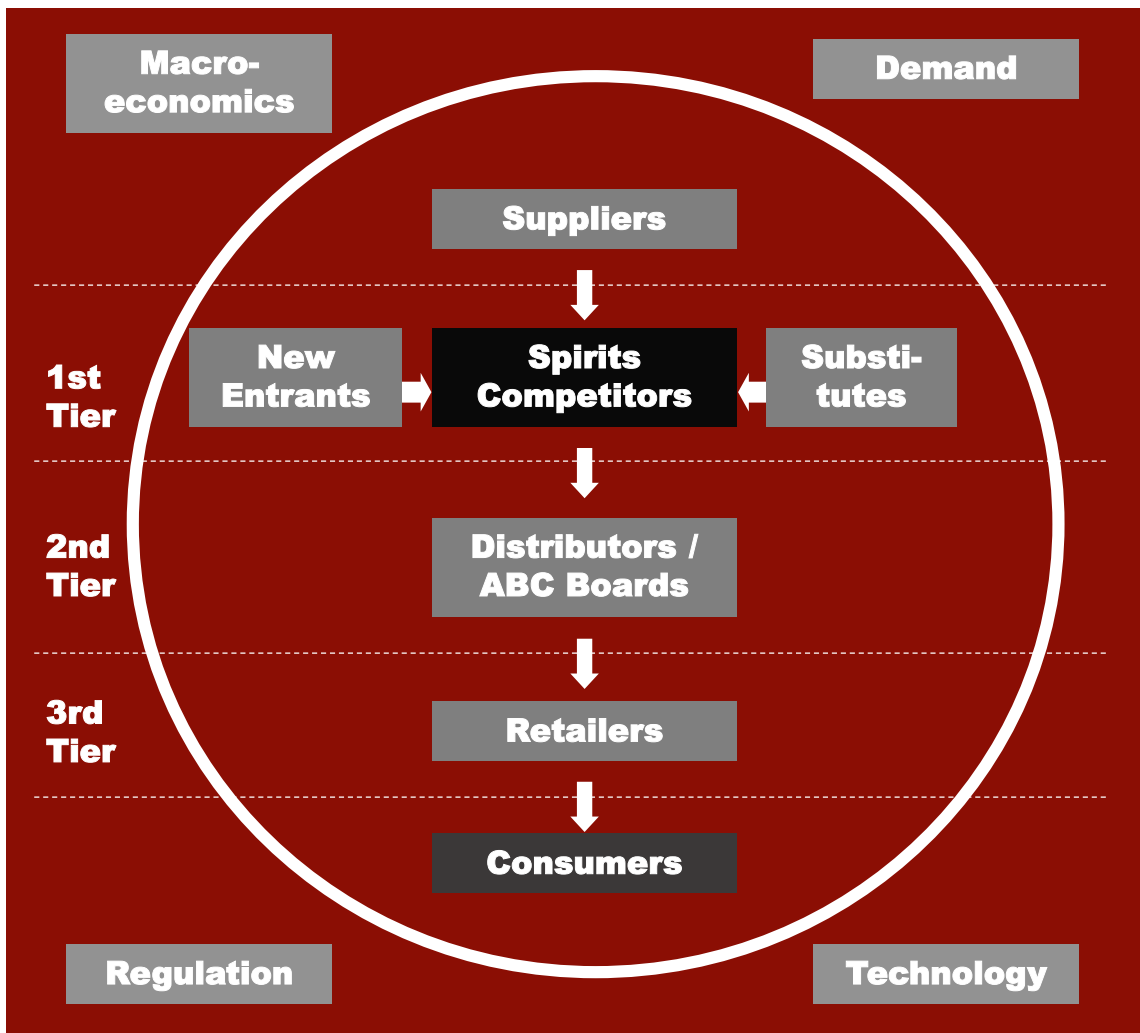
The Legal Ramifications Today

- Alcohol is still regulated by a complex and decentralized legal framework
- Results of the 21st Amendment & the FAA Act of 1935:
 - Adoption of today's three tier system
 - Elimination of “tied house” practices
 - Introduction of FET's
 - Federal government granted authority to license importers, manufacturers, wholesalers, and warehouses (not retailers).
 - Consumer deception laws and standards/ requirements for labels and formula approval
- Federal regulations are administered by four main bodies:
 - Alcohol and Tobacco Tax and Trade Bureau (TTB)
 - Food and Drug Administration (FDA)
 - Federal Trade Commission (FTC)
 - Bureau of Alcohol Tobacco and Firearms (ATF).
- States given power to regulate sale & distribution of alcohol within their state.
 - Liquor control boards
 - Some states push regulatory authority to the county level (e.g., Montgomery County)

- **Strong regulation through combination of federal and state authorities**
- **Three tier system & tied house rules**
- **Objective of tax collection and consumer protection (temperance)**



Discussion Topics

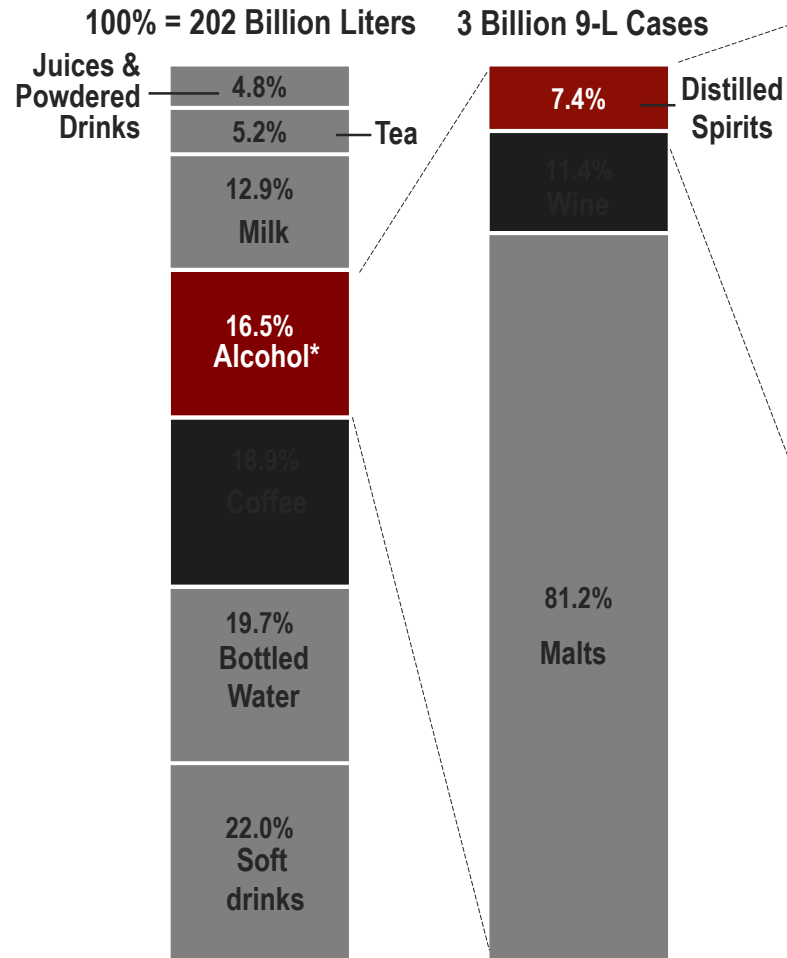


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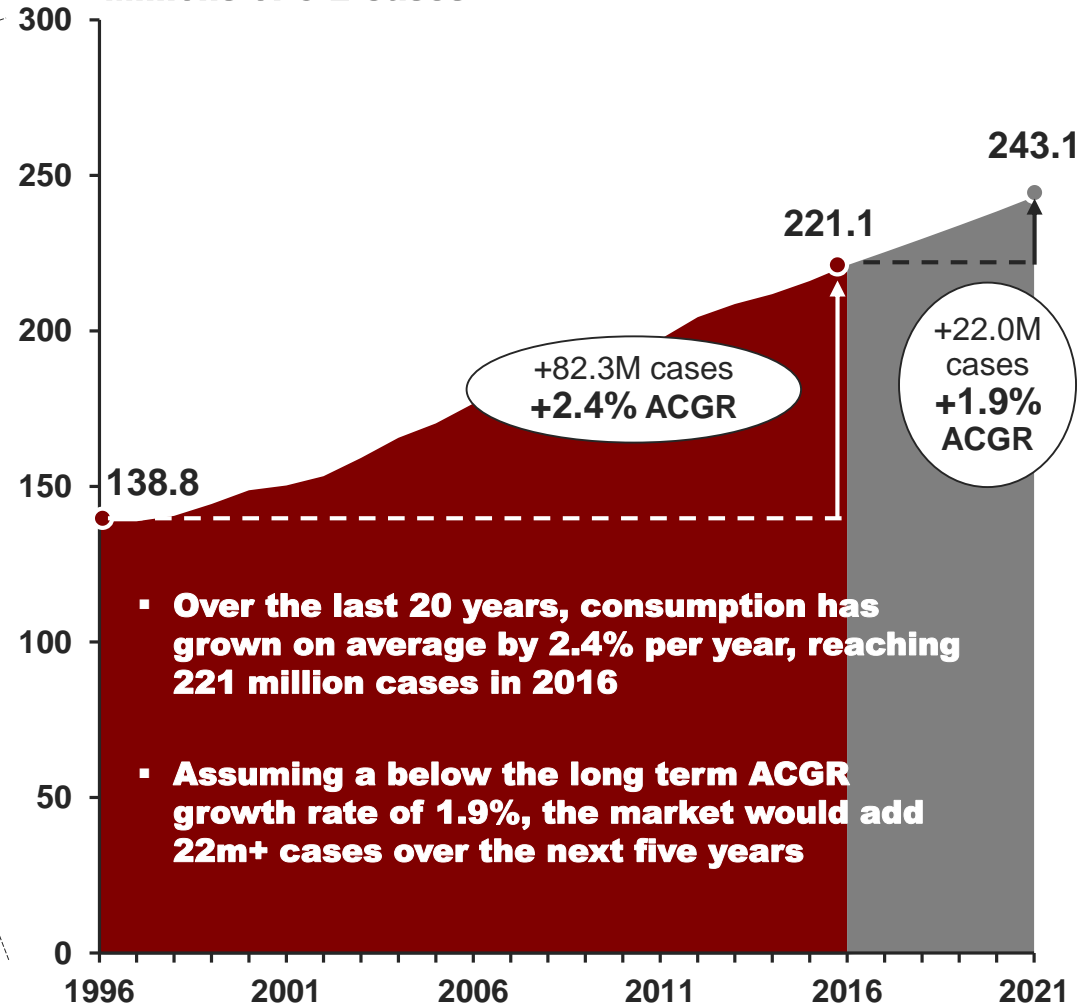


The Spirits Market Has Been Growing Steadily

U.S. Beverage 2016 Industry Size by Category



U.S. Distilled Spirits Consumption, 1996 – 2021 Millions of 9-L Cases



Sources: Beer Handbook, Liquor Handbook, IWSR, Park Street Analyses
 * Includes Malts, Spirits, Wine, and Cider



Most of the Growth is Expected at Premium Price Points

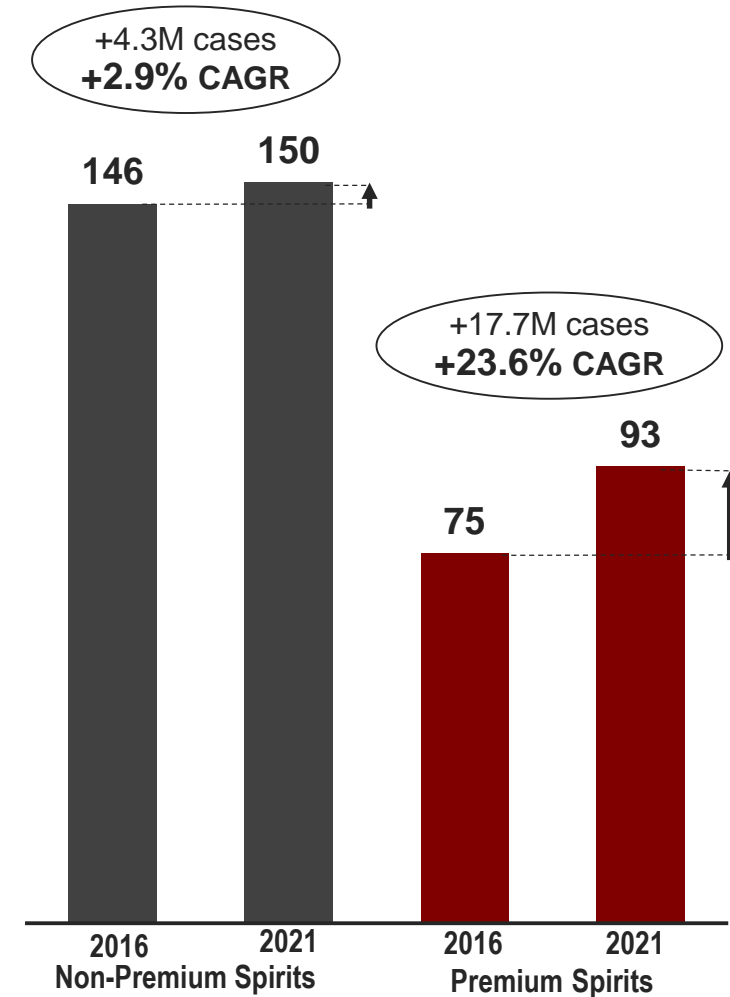
Breakdown of U.S. Spirits Market, 2016

100% = 221 Million Cases

		Non-Premium		Premium		2015 – 2016 Volume Growth	
		66% (146M cs)		34% (75M cs)			
12.7%	All other	3.5%		0.1%	↑		
		9.2%	0.0%				
4.6%	Gin	3.2%	-4.1%	8.7%	↑		
		1.4%					
5.7%	Brandy	4.2%	20.8%	13.4%	↑		
		1.4%					
7.2%	Tequila	3.6%	3.2%	18.6%	↑		
		3.6%					
11.1%	Rum	1.0%	-1.3%	3.9%	↑		
		10.1%					
25.0%	Whiskey	7.4%		7.9%	↑		
		17.6%	1.6%				
33.6%	Vodka	10.1%		10.3%	↑		
		23.5%	-1.4%				
Spirits		Weighted Growth: 2.7%		9.0%			

Growth of U.S. Spirits Market, 2016 – 2021

Million of 9-L Cases



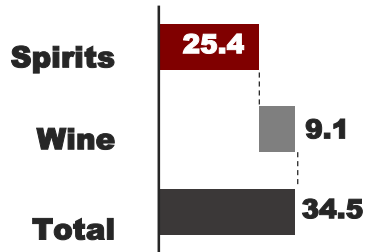
Sources: Beer Handbook, Liquor Handbook, IWSR, Park Street Analyses; Note: Non-Premium = "Standard" and "Value", Premium = "Premium," "Super Premium," and "Ultra Premium"



Industry Structure: Supplier and Wholesale Tier Concentrated

U.S. Wine and Spirits Sales by Tier (2016)

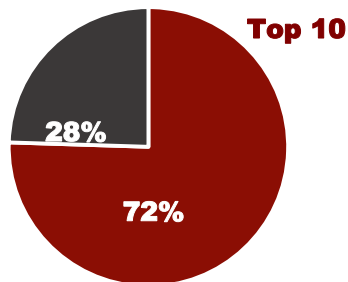
Dollars, Billions



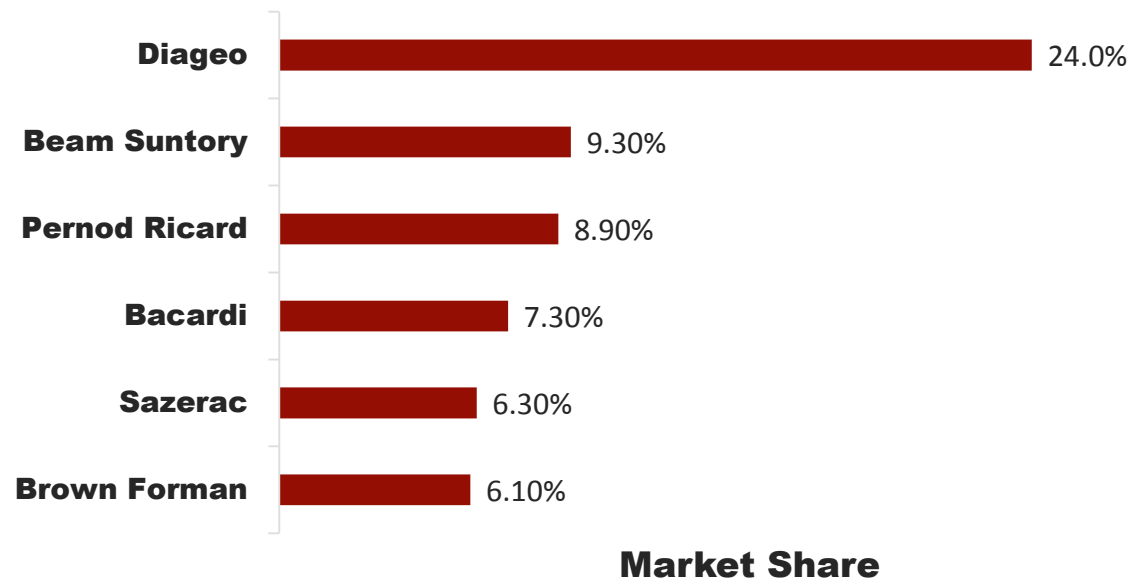
- Supplier tier is concentrated on national level
- Sales/product curves nationally mostly mirror regional and local sales/product curves
- Domestic craft spirits industry consists of over 1,600 distillers with a combined share of less than 4% (value)

Concentration

% of total



Top Suppliers (2016)

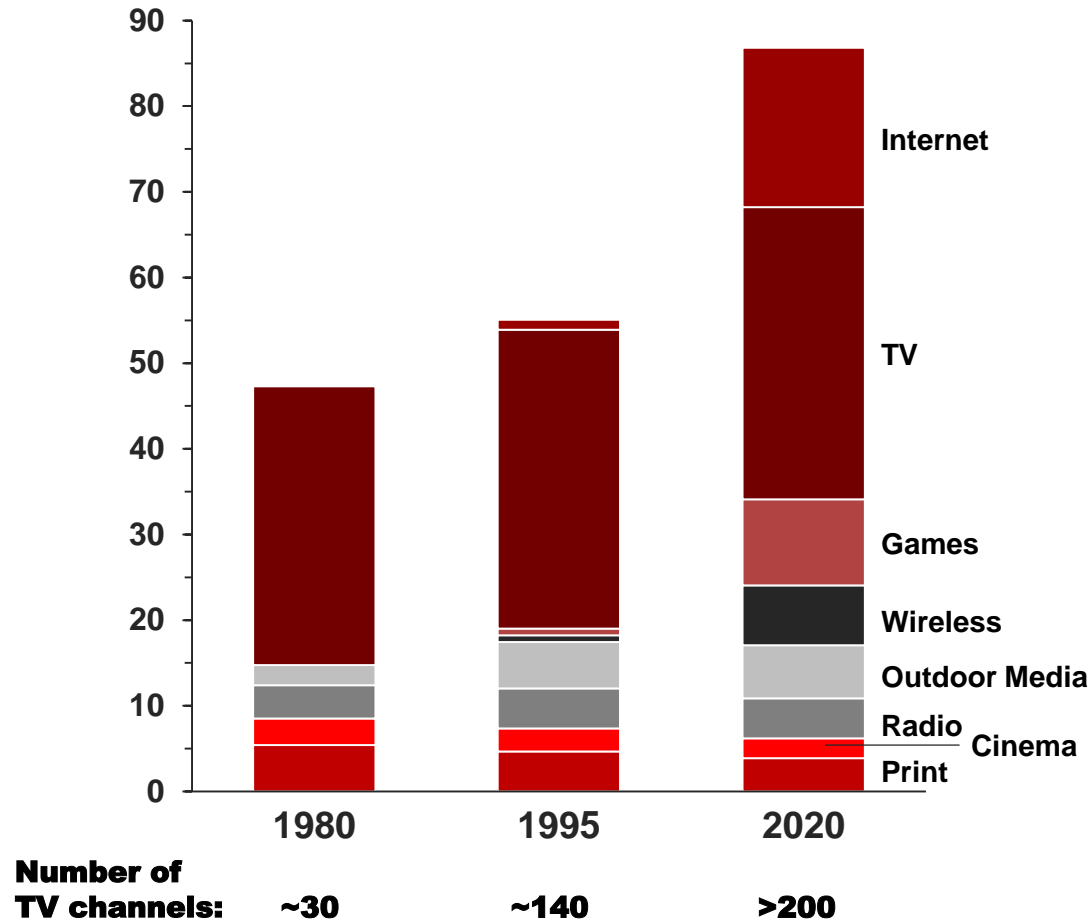




Authenticity: Democratization of Marketing and Validation

Media Consumption by Source

Hours per Week



- Many more messages reach an individual from many more different sources than in the past
- Due to the ability to cost-effectively target messages in new media to particular consumer groups, marketing channels have effectively opened up to subscale marketers
- Side effect of new media is that the individual is now empowered to validate messages instantaneously
- The democratization of validation increases the importance of discovery and therefore authenticity for new products
- The badge value of alcoholic beverage brands changes due to the increasing importance of discovery and authenticity and allows newer brands with the right credentials to compete more effectively



Trend Towards Fragmentation: Democratization of Production

Not as dramatic as in music, news, and film, but the barriers to entry are getting smaller

State laws easing for entrepreneurs

Multiple initiatives have improved success probability for entrepreneurial brands by simplifying access to the alcoholic beverage industry

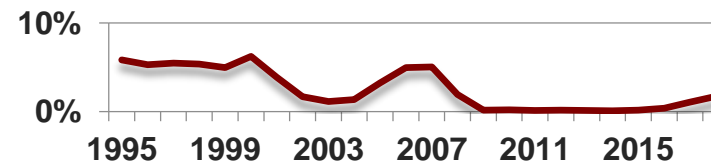
- Tax credits
- Simplified licenses (e.g., craft distiller licenses)
- Ease of three tier system regulations (e.g., on-premise consumption in tasting rooms)
- Production (e.g., 25%+ of craft distillers offer contract production)
- Back-office (e.g., Park Street)
- Distribution (e.g., self distribution options in markets like CA, NY, NJ and FL through Park Street)

Shared infrastructures and service providers

Low interest rates

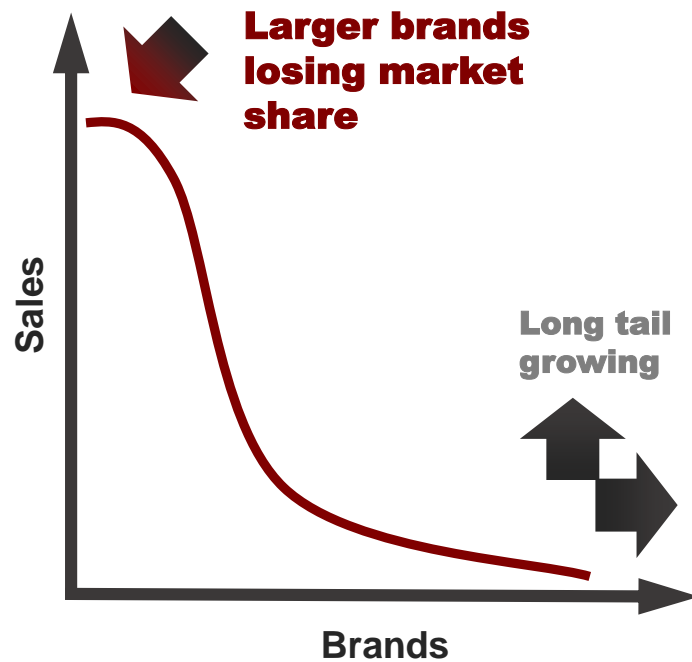
U.S. Federal Interest Rate, 1995 – 2018

Percent (Annual)

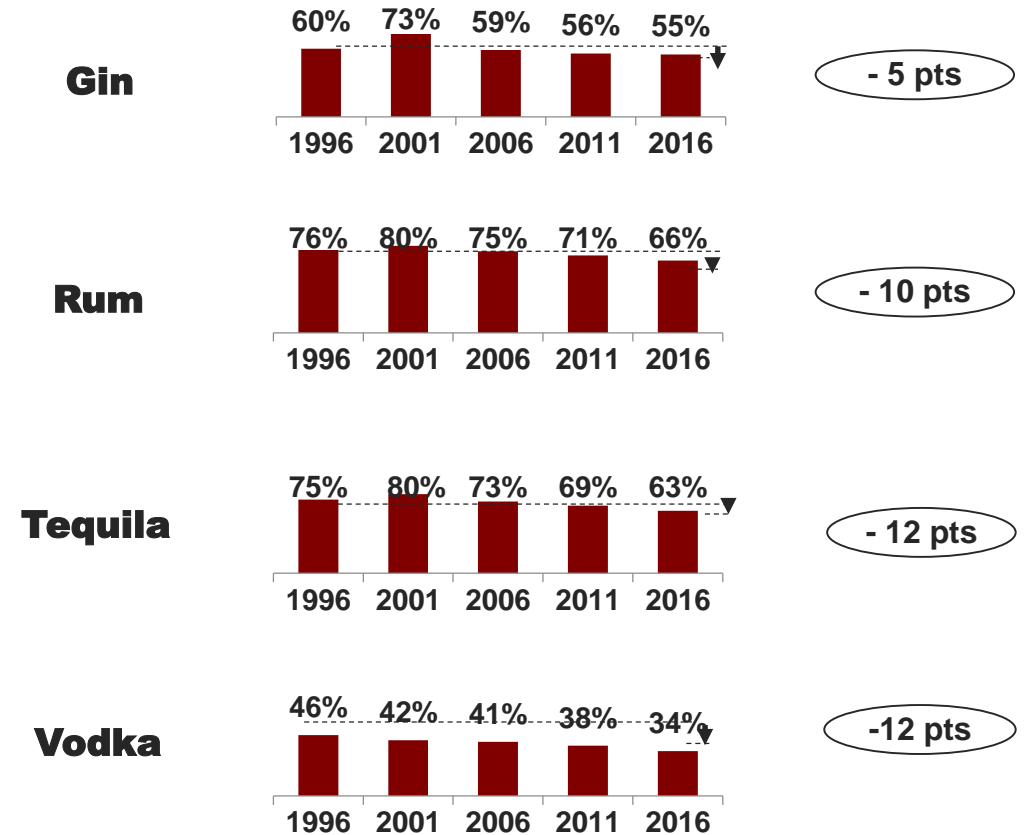




Fragmentation: Head of Sales/Brands Curve Getting Hit

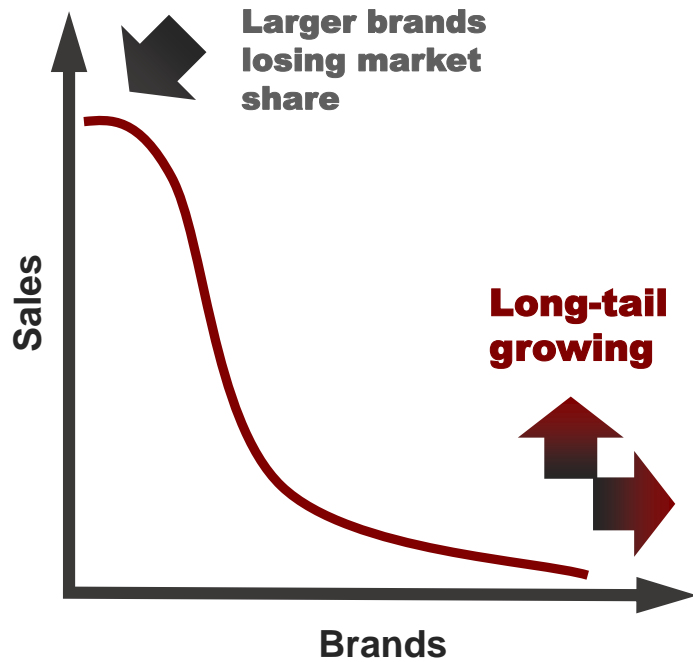


U.S. Spirits Market Share by Volume of Top 5 Brands over a 20-year Period

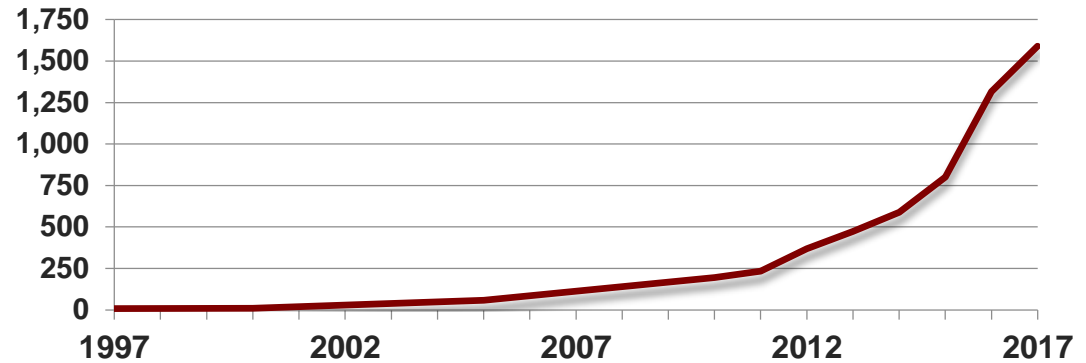




Proliferation of the Long Tail

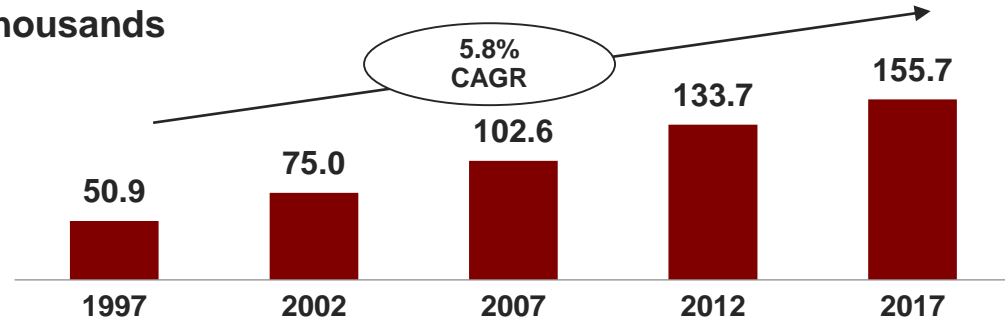


Number of Craft Distillers in U.S., 1997 – 2017



COLA (Certificate of Label Approval) Filings

Thousands



- Entrepreneurial activity both craft and non-craft has and will lead the way. Further explosive growth is possible once the barriers to entry and the operating costs are low enough for “keep your day job”-entrepreneurs to enter the industry on a larger scale
- Other drivers are new product development by existing suppliers both for existing brands and (to a smaller degree) new brands as well as private label activity by chain retailers



Trend Towards Fragmentation Does Not Mean A Fragmented Marketplace Without Large Brands

Resilient brands can still maintain large growth rates

- Brands in spaces with higher barriers to entry (e.g., regulatory or aging) have shown more resilience
- Brands at lower price points where scale and leverage matters more

New brands can still get big and continue to get bigger

- Independent brands without any major supplier affiliation – still relatively early in the brand lifecycle
- Large supplier innovation

EXAMPLES

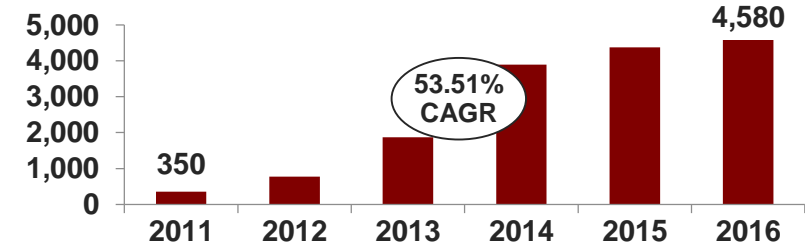
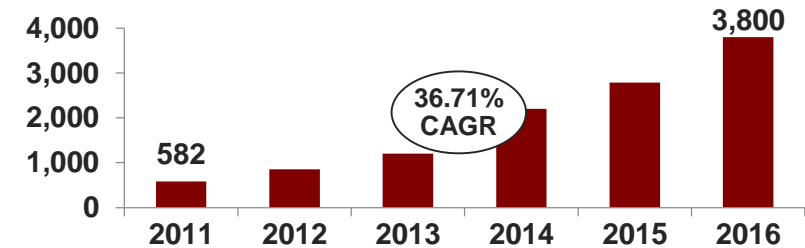
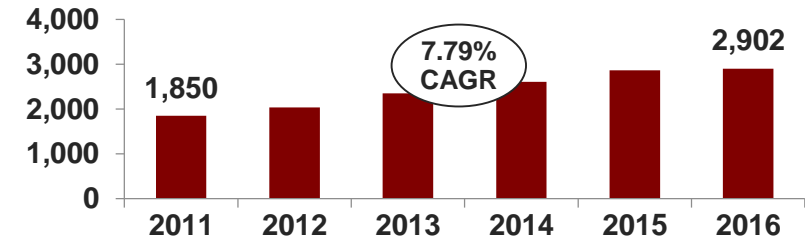
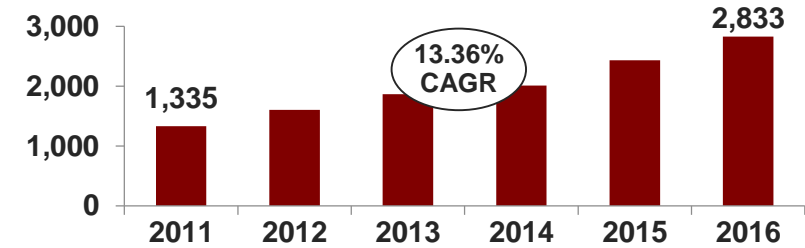
JAMESON
IRISH WHISKEY

BURNETT'S
VODKA

Tito's
Handmade
VODKA

FIREBALL
CINNAMON WHISKY

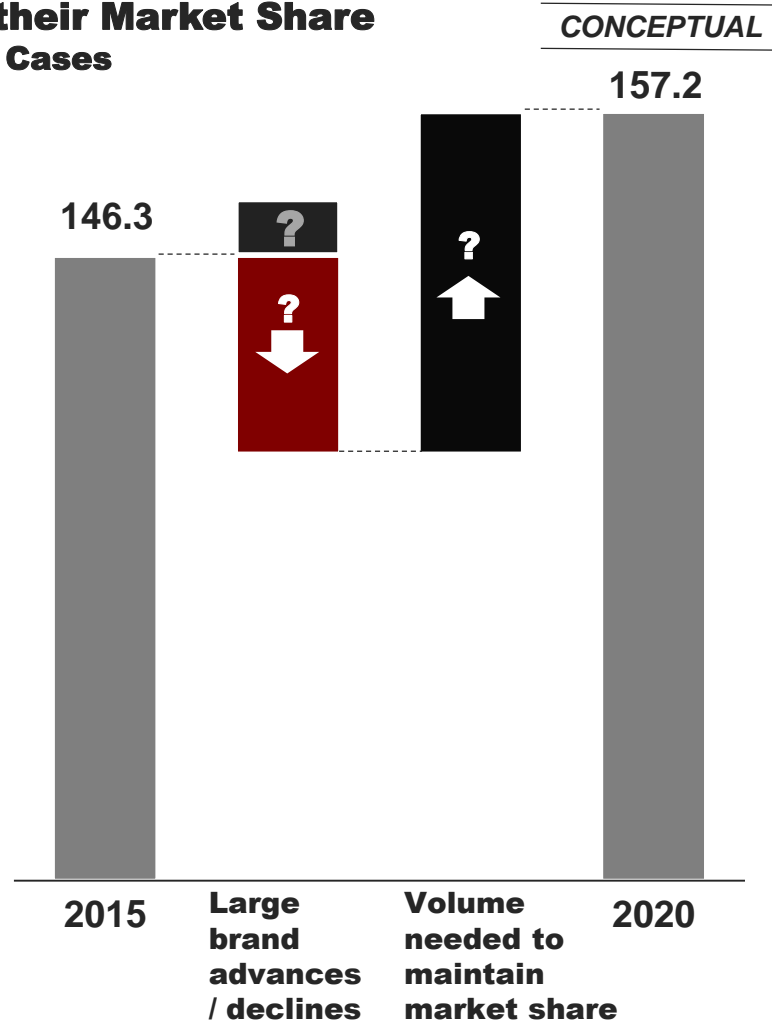
Thousands of 9-L Cases





Large Suppliers in Times of Fragmentation

Volume for the Top 10 Spirits Suppliers to Maintain their Market Share Millions of 9-L Cases



- Large brand growth acceleration and/or turnaround or just slowing the decline of the larger brands is and will be the highest priority for every larger supplier and the focus of their sales forces (pressure on distributors)
- Brand extensions and stretches will be used where feasible without decreasing the overall brand equity
- Might exit or decide to give management of sub-scale brands with declining sales and little hope (towards end of brand life cycle) to third party sales force operators
- New brand development within large suppliers has a poor track record and will not see much increased investment
- Acquisitions of new brands will be needed to bridge gap
 - Distilled spirits VCs (early stage)
 - Portfolio of local/regional brands
 - Larger mergers/acquisitions

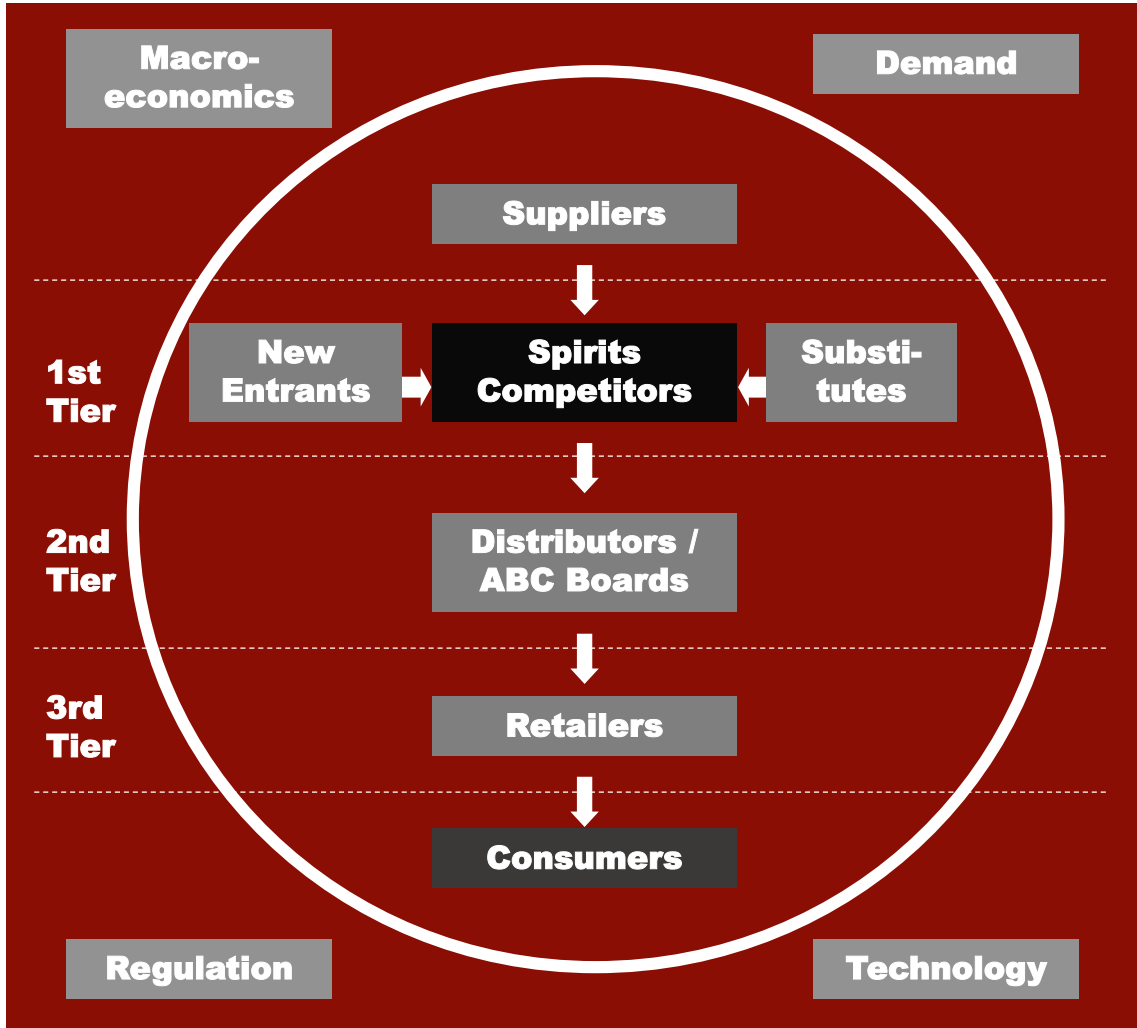


Pathway to Future Growth for Major Suppliers: Investments in Entrepreneurial Brands

Supplier	2015	2016	2017	2018
Diageo	<ul style="list-style-type: none"> • United Spirits • Peligroso Tequila 		<ul style="list-style-type: none"> • Casamigos 	<ul style="list-style-type: none"> • Belsazar
Constellation Brands	<ul style="list-style-type: none"> • Casa Noble Tequila 	<ul style="list-style-type: none"> • High West Distillery • Catoctin Creek Distillery • Nelson’s Green Briary 	<ul style="list-style-type: none"> • Schrader Cellars • The Prisoner Wine Company 	<ul style="list-style-type: none"> • The Real McCoy • Copper & Kings
Bacardi	<ul style="list-style-type: none"> • Angel’s Envy • Banks Rum • Leblon Cachaca 		<ul style="list-style-type: none"> • Illegal Mezcal • Teeling Irish Whiskey 	<ul style="list-style-type: none"> • Patron Spirits
Pernod Ricard	<ul style="list-style-type: none"> • Tequila Avion 	<ul style="list-style-type: none"> • Monkey 47 • Smooth Ambler • Paddy Irish Whiskey 	<ul style="list-style-type: none"> • Del Maguey Mezcal 	



Discussion Topics



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Major Supplier Consolidation has led to Major Distributor Consolidation

Large suppliers



Large distributors

DIAGEO



Beam



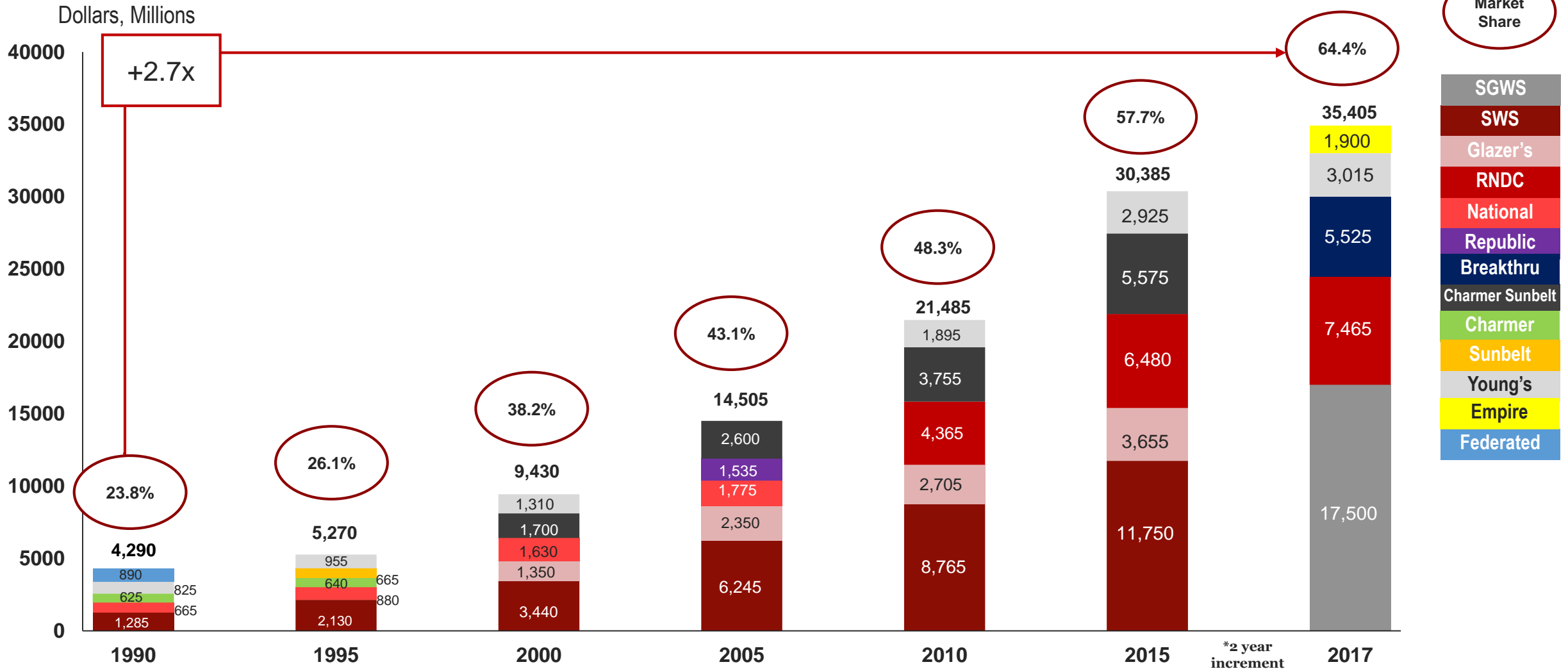
- Concentrated action (e.g., RFP)
- Increasing demands
 - Lower gross margins for distributors
 - Higher level of service and attention (e.g., dedication, specialists)
- Alignment
- Coordinated planning
- More sophisticated controls (with aim to eliminate any 'double coverage' through distributor and supplier sales personnel)





Concentration in Distribution Tier has Grown Exponentially Since 1990

Top 5 Distributor Sales Revenue and Market Share, 1990 – 2017





Southern Glazers Wine & Spirits is Leading the Distribution Tier with Revenues of Over \$17.5BN

US wine & spirit wholesalers, by revenue (2017 projected)*

Dollars, Billions

	Revenue (2017 projected)*	Market share (2017) %	Total states covered:	Accessible market** %
Southern Glazers Wine & Spirits	\$17.5	31.8%	44	85.2%
Republic National	\$7.5	13.6%	22	35.1%
Breakthru Beverage	\$5.5	10%	20	48.4%
Young's Market	\$3.0	5.5%	10	24.7%
Empire Merchants	\$1.9	3.5%	1	7.4%
Johnson Bros.	\$1.89	3.4%	22	52.3%
Martignetti Companies	\$1.25	2.3%	5	5.6%
Allied Beverage	\$0.8	1.5%	1	4.2%
Fedway Associates	\$0.8	1.4%	1	4.2%
Horizon Beverages	\$0.7	1.3%	5	5.2%
All other wholesalers (incl. control states)	\$14.2			

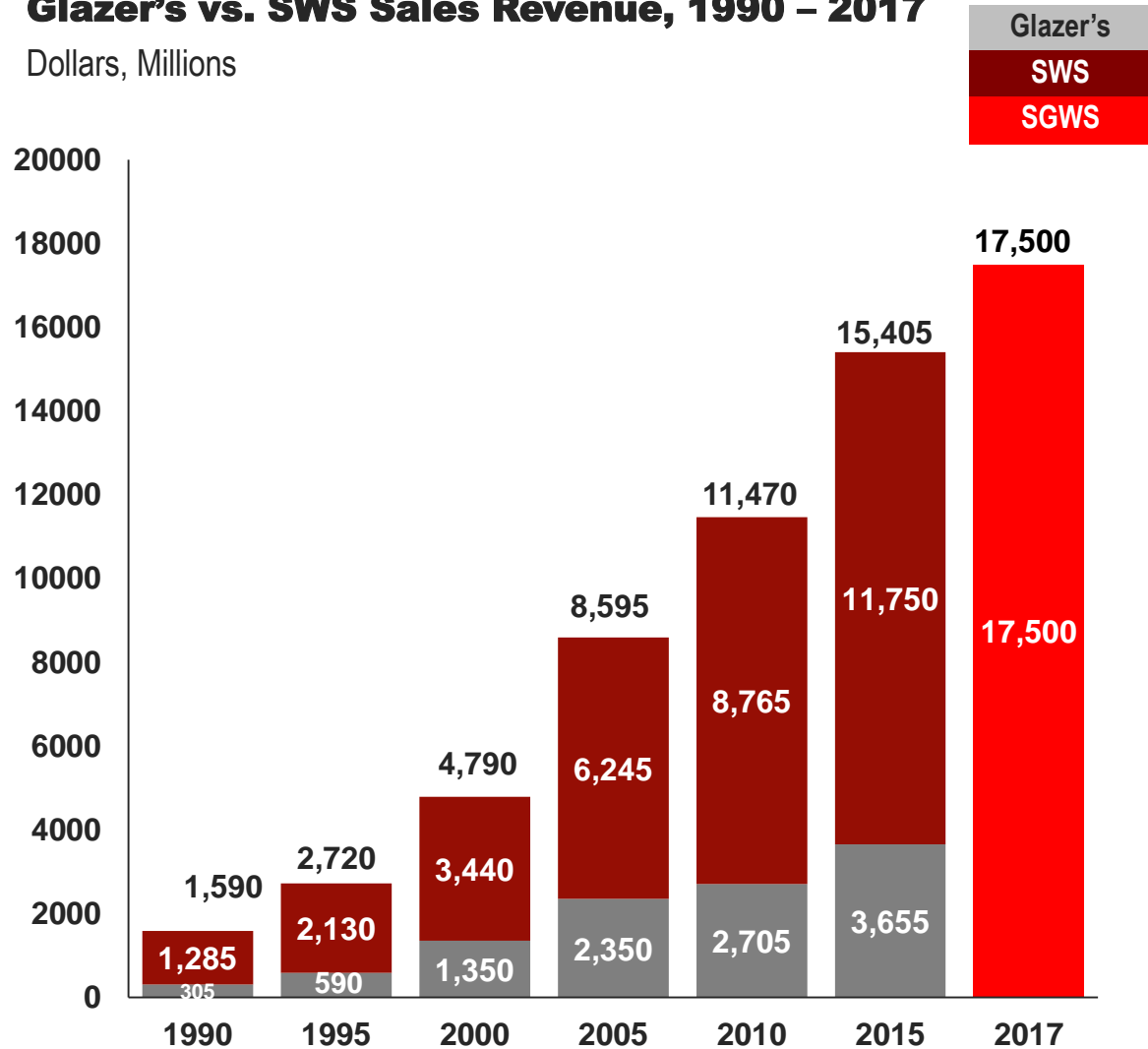
Source: Impact. * Some control state revenue not captured (e.g., broker commissions);
 ** as % of cases sold in the US



Southern Wine & Spirits and Glazer's – Growth

Glazer's vs. SWS Sales Revenue, 1990 – 2017

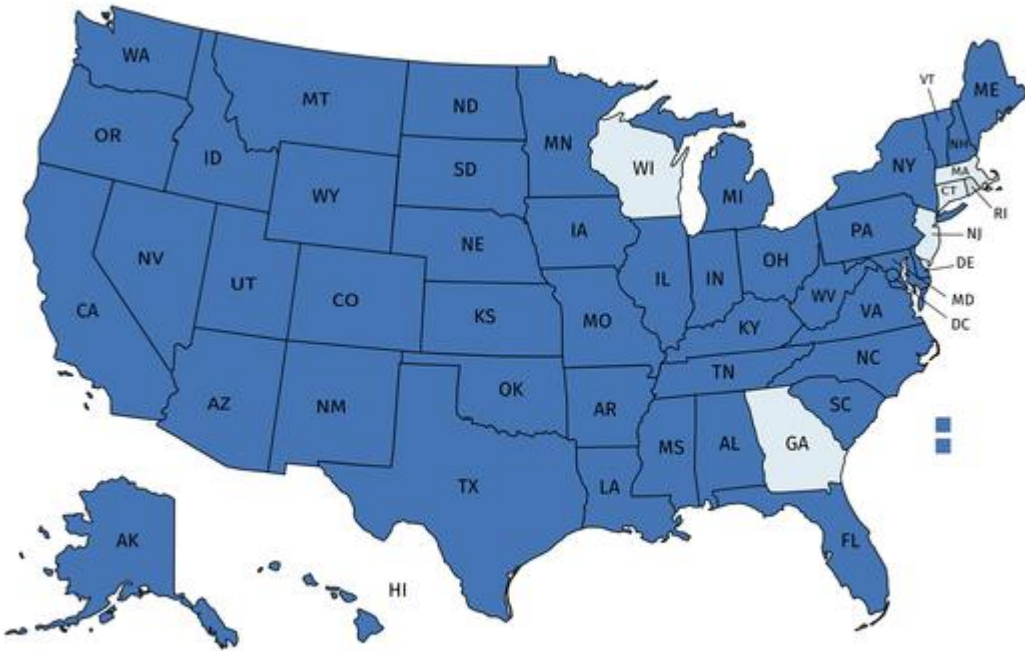
Dollars, Millions



- Southern Wine and Spirits has been the most aggressive consolidator in the wine and spirits distribution business in the US
- An important driver that accelerated the consolidation was Diageo's Next Generation Growth initiative in 2002, which awarded their business to Southern and Glazer's in several states. More importantly, Southern understood that this was a new era and was quick to position itself for similar processes by other suppliers
- The merger with Glazer's in 2016 paved the way to an almost complete national footprint, allowing suppliers to pursue simplified route to market strategies in the US with reduced requirements for dedicated supplier salesforces outside the distributor



Southern Glazer's Wine & Spirits – Current Landscape



Created with mapchart.net ©

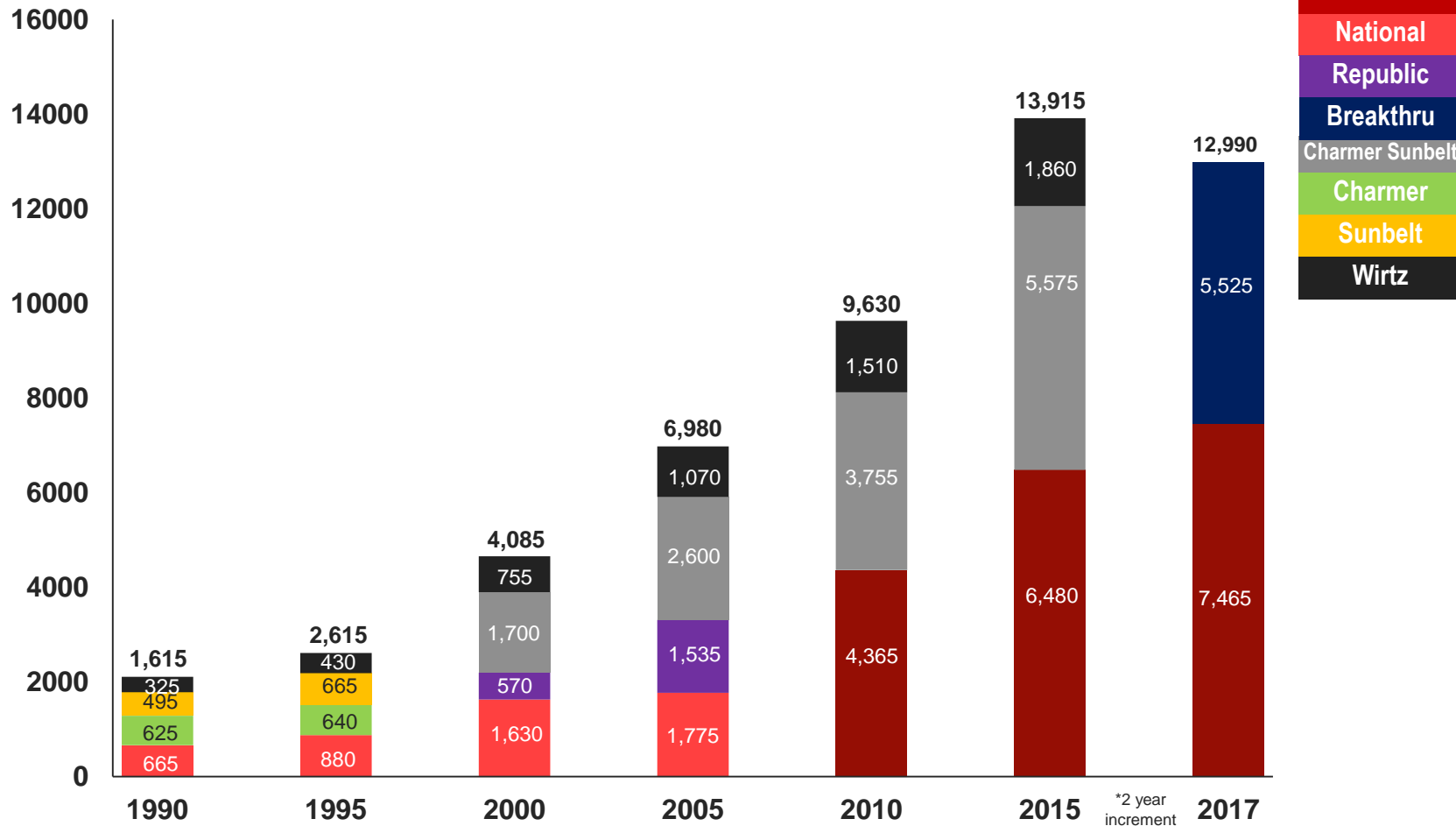
- **SGWS currently has operations in 44 states, the District of Columbia, Canada, and the Caribbean**
- **The states within the US without SGWS operations are WI, GA, NJ, CT, RI & MA**
- **SGWS' supplier portfolio contains all leading brands at least in some areas and they are aligned nationally with suppliers, such as Pernod Ricard, Beam Suntory, Campari, and Bacardi**
- **Additional deals to expand are feasible in the states without a current presence, but franchise laws complicate these deals as supplier leverage is typically absent**



RNDC Breakthru - Growth

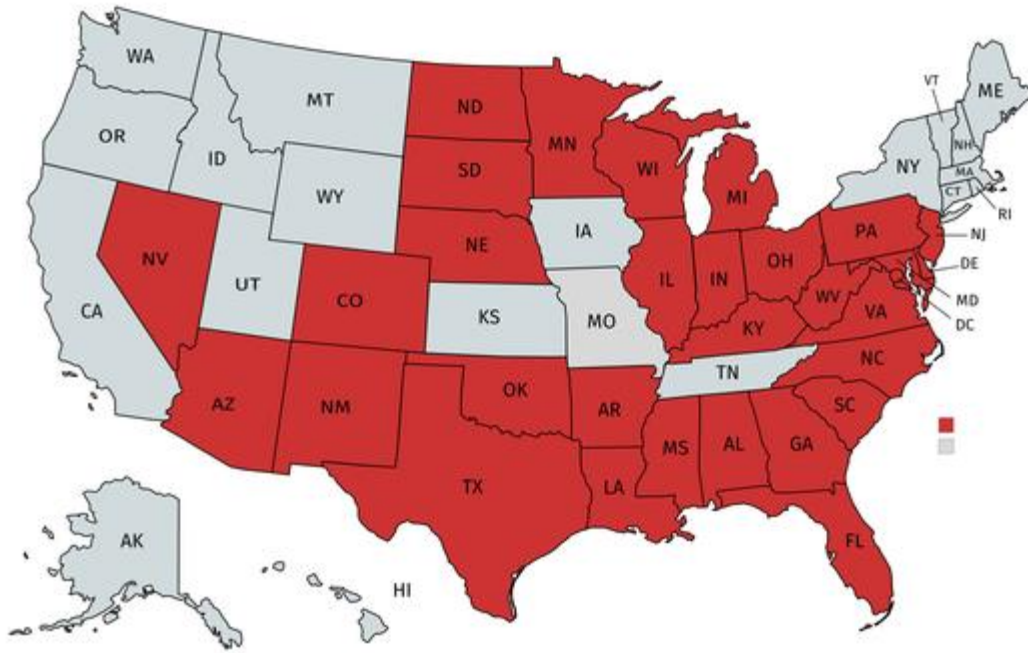
RNDC Breakthru Sales Revenue, 1990 – 2017

Dollars, Millions



- RNDC Breakthru is the result of several rounds of mergers and acquisitions.
- In 1994 Charmer Group and Sunbelt Beverages merged to create Charmer Sunbelt
- In 2007 Republic Beverage Company merged with National Distributing Company to create RNDC
- In 2015, Charmer Sunbelt and Wirtz merged to create Breakthru Beverage
- In 2017 RNDC and Breakthru announced their merger without providing guidance on a new name

RNDC Breakthru – Current Landscape



Created with mapchart.net ©

- RNDC Breakthru expect their merger to be completed by mid 2018
- Once completed RNDC Breakthru will operate in 27 US states and Canada
- California and New York are two large markets that are not covered by RNDC Breakthru



RNDC Breakthru – Missing Markets and Future Pathways



West Coast

- Young's Market Company covers states solely in the western part of the country and California is their home market.
- RNDC Breakthru is not currently selling in California, which is the largest spirits market in the US.
- In 2011, RNDC entered the Arizona market through a partnership with Young's Market. At the time, Young's was the fifth largest distributor in the US.



New York

- Charmer Industries merged with Peerless Imports in New York in 2007, which formed Empire Merchants.
- While Breakthru's Co-Chairman, Charlie Merinoff, co-owns Empire, Breakthru does not and as a result, neither Breakthru or RNDC are present in New York, the third largest spirits market in the US.

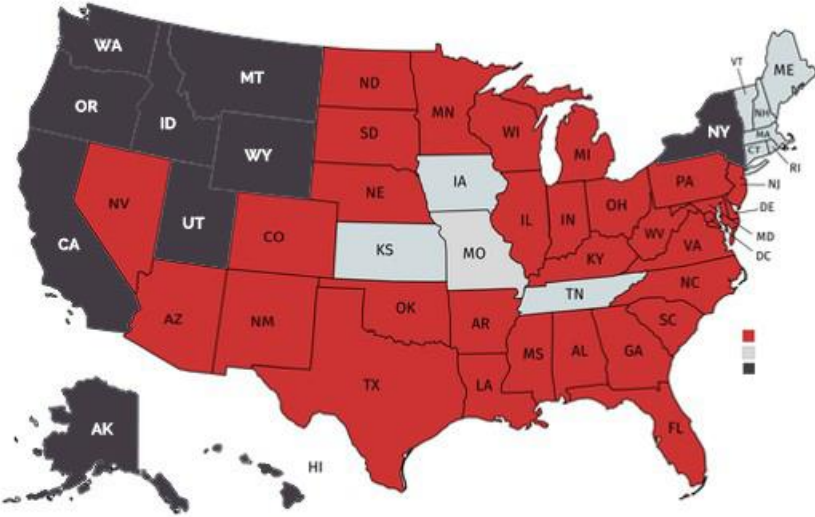
- Market rumors had suggested that the RNDC Breakthru partnership had tried to include Young's and Empire in the original deal
 - It is very difficult to imagine that top brand suppliers will not put their weight behind these deals and the industry expects deals once the RNDC/Breakthru merger is completed
 - If deals don't materialize, the Wine Warehouse in CA and a strategy of buying smaller distributors in NY as a start could be options and could force Young's and Empire to the table



A Merger between RNDC Breakthru, Young's, and Empire Would Create Another Distributor Powerhouse

RNDC Breakthru Young's Empire set-up

SGWS versus RNDC Breakthru Young's Empire set-up



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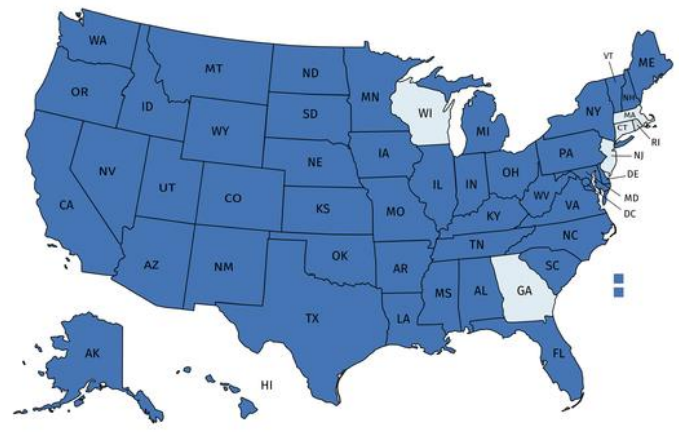
*Assumes Young's Market & Empire merge with RNDC/Breakthru

- \$17.9 billion combined revenue from 2017 (projected)
- 37 number of markets
- Market share 32.6%

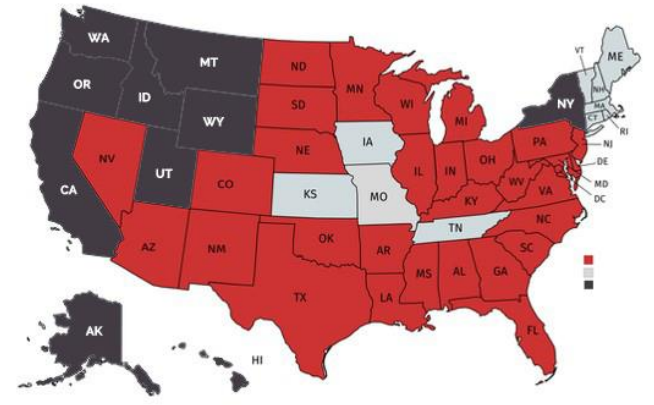
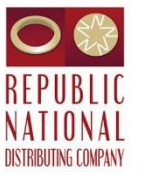
	SGWS	RNDC Breakthru, Young's & Empire
Markets	44	37
Accessible Market %	85.2%	82.7%
Revenue	\$17.5 billion	\$17.9 billion
Market Share	31.8%	32.6%

If RNDC Breakthru is able to complete deals with Young's & Empire, the result would be a formidable competitor to SGWS with regards to scope of activities in the US market

National Footprint Distribution Options



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Created with mapchart.net



*Assumes Young's Market & Empire merge with RNDC/Breakthru

- **Once RNDC Breakthru Young's Empire becomes reality, it will be a duopoly for top brand suppliers**
- **RNDC Breakthru Young's Empire will likely offer below cost deals to lure top brand suppliers nationally aligned with SGWS away, with the likely outcome of more demands for larger margins from small and medium suppliers**
- **Both distributor groups will be lower costs than other distributors in the areas they serve and they will have the highest service levels for accounts (customer service, frequency of visits, value added services)**
- **Both groups will have at least one division that will sell the balance of the portfolio**
- **Both groups will try to have a fair share of market specific craft products in their portfolio**
- **Both groups will likely ask for national distribution option agreements in case the brand wants to expand beyond their own home state**



Distribution in Open Non-Franchise States – Several Valid Options Beyond National Footprint Distributors

Other Top Supplier Distributors

- Other top supplier distributors also work with leading suppliers, but they are not fully aligned due to their more limited reach
- May operate in markets with franchise laws where it is difficult for national footprint distributors to expand to

Second Tier Distributors

- Small market share in particular state, typically focused on metro areas
- Represent none of the top 10 spirits and wine suppliers, just small and medium sized suppliers
- Lower customer service and balance sheet/credit risk

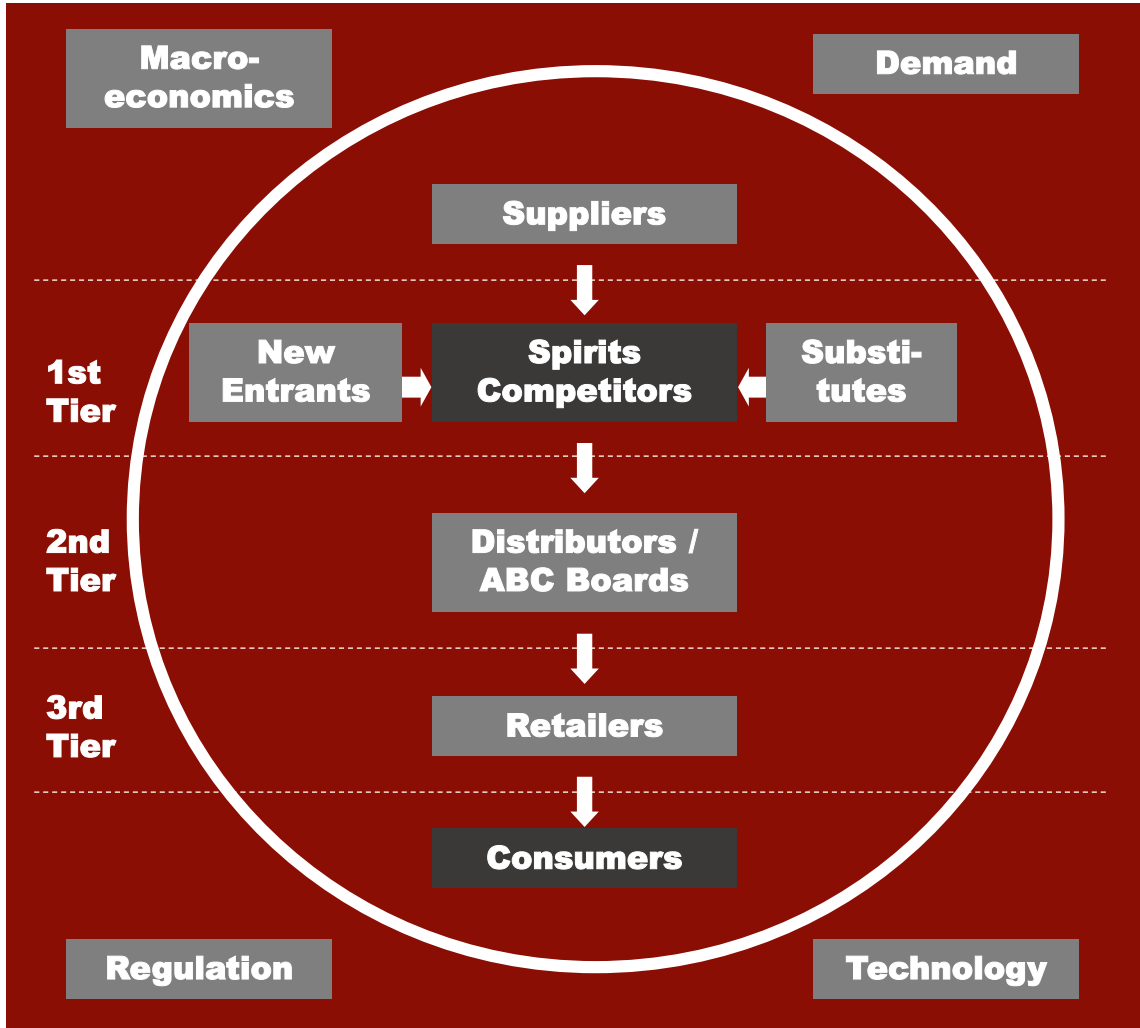
Alternative Distribution Options

- Unbundled logistics and sales: no salesforce in market, clearing and logistics only
- Represent small suppliers as well as top 10 spirits and wine suppliers on special projects and test markets
- Small per case fee instead of large gross profit

- From a strategy perspective, national footprint distributors and other top brand supplier distributors typically should be explored first, albeit with low expectations (they often pass knowing that with success they will likely get another shot)
- Second tier and clearing distributors are valid options as their reach is typically sufficient for the launch phase
- No matter what, the supplier has to supplement the sales resources in order to get traction – distributors at the start are often not more than order takers and delivery vehicles
- It typically helps to launch with a test market phase with a clearly defined target account universe and performance parameters
- Payment history should be taken into account when making route to market decisions



Discussion Topics



- “The route-to-market in a highly regulated red tape environment that demands three tiers”
- “Vulnerable first tier Goliaths with David winning, not necessarily alone, but as a group”
- “The second tier on a fast track to a duopoly with some alternative options for starters”
- “The higher the relevant differentiation and badge value for the brand, the easier the route to market battle”
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- “Combining an above fair share of attention and economies of scale for an efficient and effective route to market”



Starting Point for the Route to Market Strategy Should be the Target Consumer

- Who is the target consumer?
- Where do they live?
- What do they drink today?
- Where are they drinking it today?
- Where are they buying it?
- Who is selling it to them?

Examples of consumer groups that are currently driving distilled spirits growth

Millenials

Women

Multi-cultural



Examples of consumer groups segmented by behavior that might relate to new spirits brands

Drink local

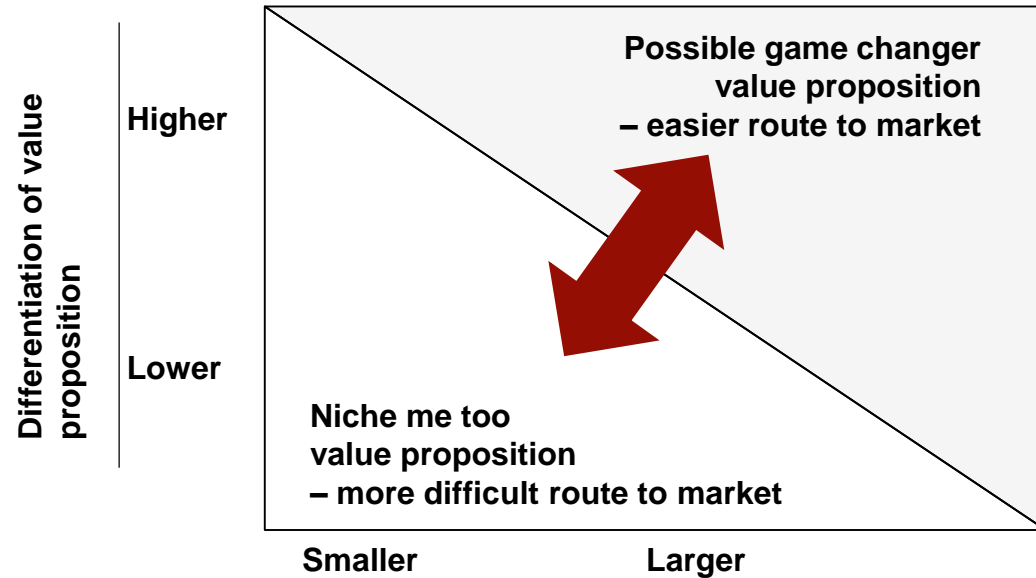
Drink healthy

Drink hip

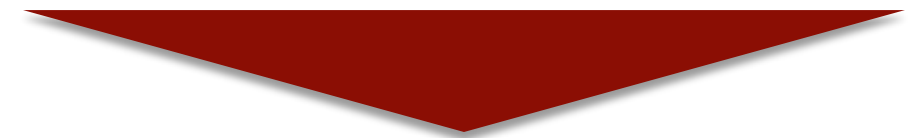
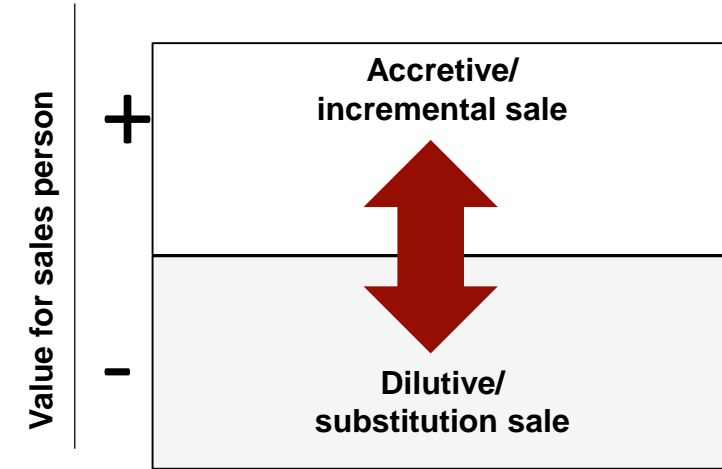




The Higher the Relevant Differentiation the Easier the Route to Market Battle



Number of target consumers who believe in the relevance of the differentiation (and are willing to pay for it)



- Products with a differentiation that is relevant for a target consumer are easier to sell
- If there is proof that there are many target consumers who are willing to pay for the differentiated value proposition the sale along the route to market is easier
- Once the salesperson perceives the sale as accretive for him/herself and not as a dilutive substitution sale, the route to market becomes the easiest

Relevant Differentiation: Badge Value

General Definition

- **Badge: a special or distinctive mark, token, or device worn as a sign of allegiance, membership, authority, achievement, etc.**
- **Brands can serve as a badge for people to communicate non-verbally to the world who they are (or who they want to be) and what they value (self-expressive benefits)**
- **Brands with highest badge value are the ones with simple messages and a strong and specific point of view**

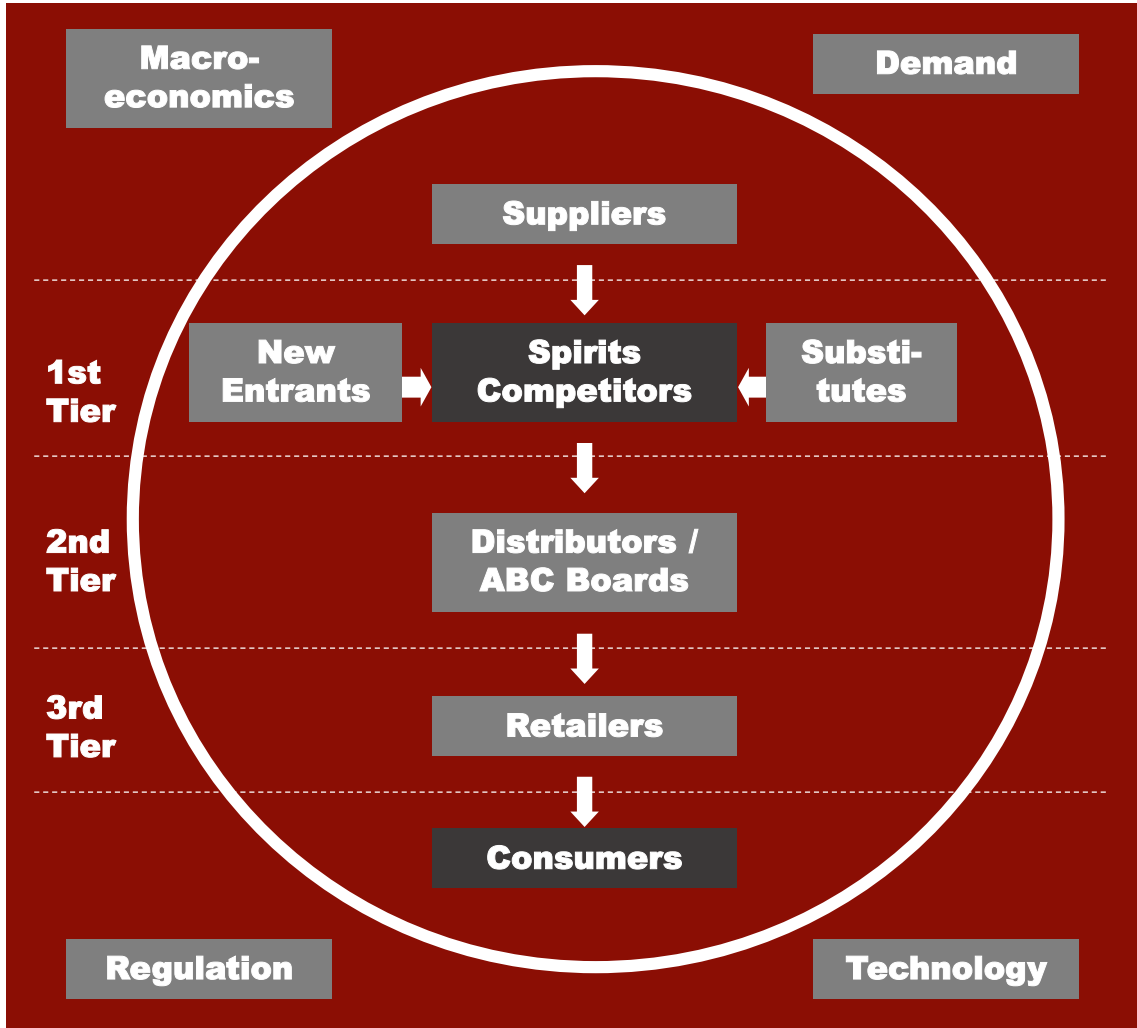
Case Study

- **Fizz agency conducted a case study on Grey Goose in ~2007**
- **They posed the question: “Do people use a louder voice when sitting at a bar and ordering Grey Goose vodka than when they order other vodkas?”**
- **The resounding answer was “Yes”. In fact on average the study found that a Grey Goose order was almost 20% louder than an order for any other vodka**
- **Following additional research, the study came to this conclusion: people associated Grey Goose with being “the best” or “excellence” and by ordering it they were communicating to others that they liked to and could afford to surround themselves with excellence**
- **These consumers wished that as many people as possible would associate them with “the best” or “excellence” , and thus they tended to unconsciously order Grey Goose using a louder voice than patrons who ordered other vodkas**

- **Creating badge value is essential for premium distilled spirits and premium tequilas and mezcals have been able to create badge value for the category**
- **Individual brands face the challenge of creating badge value on top of the category**
- **Badge value is not created overnight, requires relevant differentiation and thoughtful branding, and often includes strategies to activate influencers as early adopters**

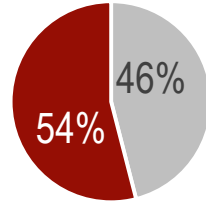


Discussion Topics



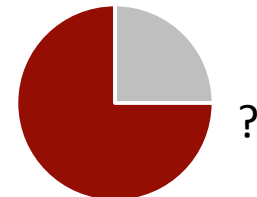
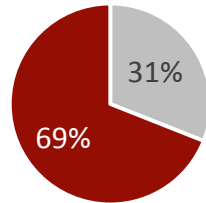
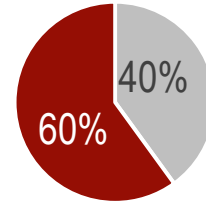
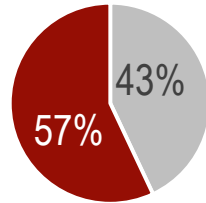
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Home Games vs. Away Games



Home Games Won

Away Games Won



- Home field advantage exists, and it is not because of theories such as “Sleeping in your own bed” and “Better familiarity with the home field”
- According to researchers the main reason for home field advantage is the slightly preferential treatment which home teams receive from referees (which is involuntary) in light of home crowd support



- Get your home crowd support in launch market
- Take advantage of slightly preferential treatment by the referees/gatekeepers
 - Define launch market as home market and gain home crowd support
 - Distributors
 - Retailers (on and off)



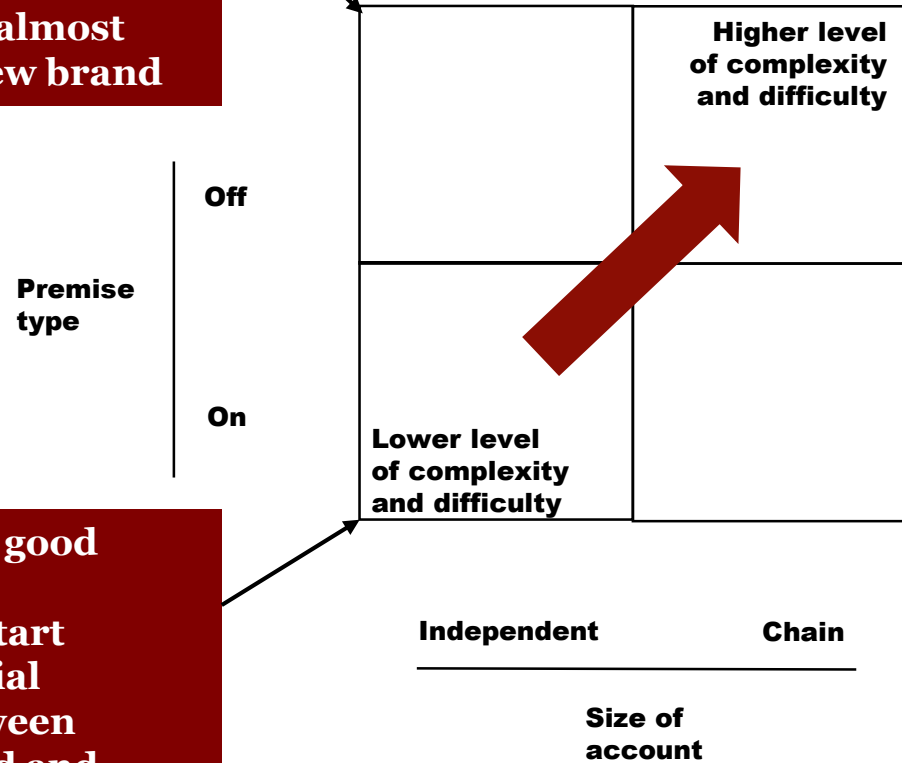
Retail Account Selection

- Good volume opportunity
- Interesting for proof of concept when used for tastings
- Floor placement almost mandatory for new brand

- Highest volume opportunity – typically part of roll-out after successful launch
- Business is typically being co-managed by large suppliers functioning as category managers
- Difficult to get listed and easy to get delisted (“one shot opportunity”)

- Low volumes but good visibility
- Easiest place to start
- Mutually beneficial relationship between bartender’s brand and supplier brand

- Good volume opportunity depending on size of chain
- Highly competitive to get on menu
- Good visibility for marketing purposes
- Elegant way to get distribution in new states





Important that Brand Works in Micro-market

Selling in and Re-orders

Selling in

- **First placement typically needs sales pitch to gatekeeper at retail (e.g., owner, bartender)**
- **Retailers are asked to invest working capital – they need to see ROI quickly**
- **Sales pitch needs to include a marketing element that provides confidence that product will sell; while the retailer can facilitate, the product needs to have pull**
- **Sell-in works at times easier with someone who has a relationship (importance of a well connected sales person) or who is an owner (accounts like brand owners)**
- **Selling in without getting on the floor (e.g., a bottle placement on the shelf) is not effective; in order to get on the floor, it may be required to offer volume discounts, floor displays, and/or tastings**

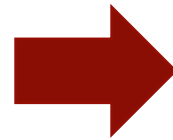
Re-orders

- **Re-orders are the single most important thing to evaluate the viability of a brand for distributors and gatekeepers**
- **A re-ordering retailer has experience with a brand and confidence that the brand will continue to sell**
- **Distributors and gatekeepers are wary of re-orders driven by large amounts of buy backs; off-premise re-orders at times seen as more reliable indicators than on-premise re-orders**
- **It is relatively better to have a smaller volume and strong re-orders than a big sell-in order and no re-orders**
- **If the retailer is unable to move the product with making a positive margin (i.e., retailer dumps) the brand might get severely damaged**

Comments



Example of Helping the Retailer Move Product: Get on the Floor and do Tastings





Blueprint for Home Market can be Replicated in Expansion Markets



***Blueprint defined: The blueprint includes items such as target consumers, target accounts, push and pull tactics, and more**

1. Before expanding into a new market, the blueprint for success in the home market should be clarified



2. After the blueprint is clarified, the market characteristics of the expansion market(s) should be researched in light of the home market blueprint



3. The sales and marketing strategy in the expansion market(s) might have to be tested and reworked as needed



When Selecting the Launch State(s) Beyond the Home Market There are Several Choices to Consider

High-end Image vs 2nd Tier Markets

- High-end image markets are cities with high density of influencers and high visibility (e.g., New York, Miami, Los Angeles, Las Vegas, San Francisco and Chicago are often included on that list)
- These markets are highly competitive and have many suppliers investing a majority of their marketing funds in these areas. It is therefore typically more expensive to conquer these markets than other markets

Franchise vs Non-Franchise Markets

- Franchise markets provide distributors a certain level of protection. In some markets (e.g., Georgia, Tennessee, New Jersey) the termination of a distributor is almost impossible. The entering of a franchise market is often considered a marriage without a divorce option
- Given the value of franchise protection distributors are often more willing to take a chance on a new product or a new supplier

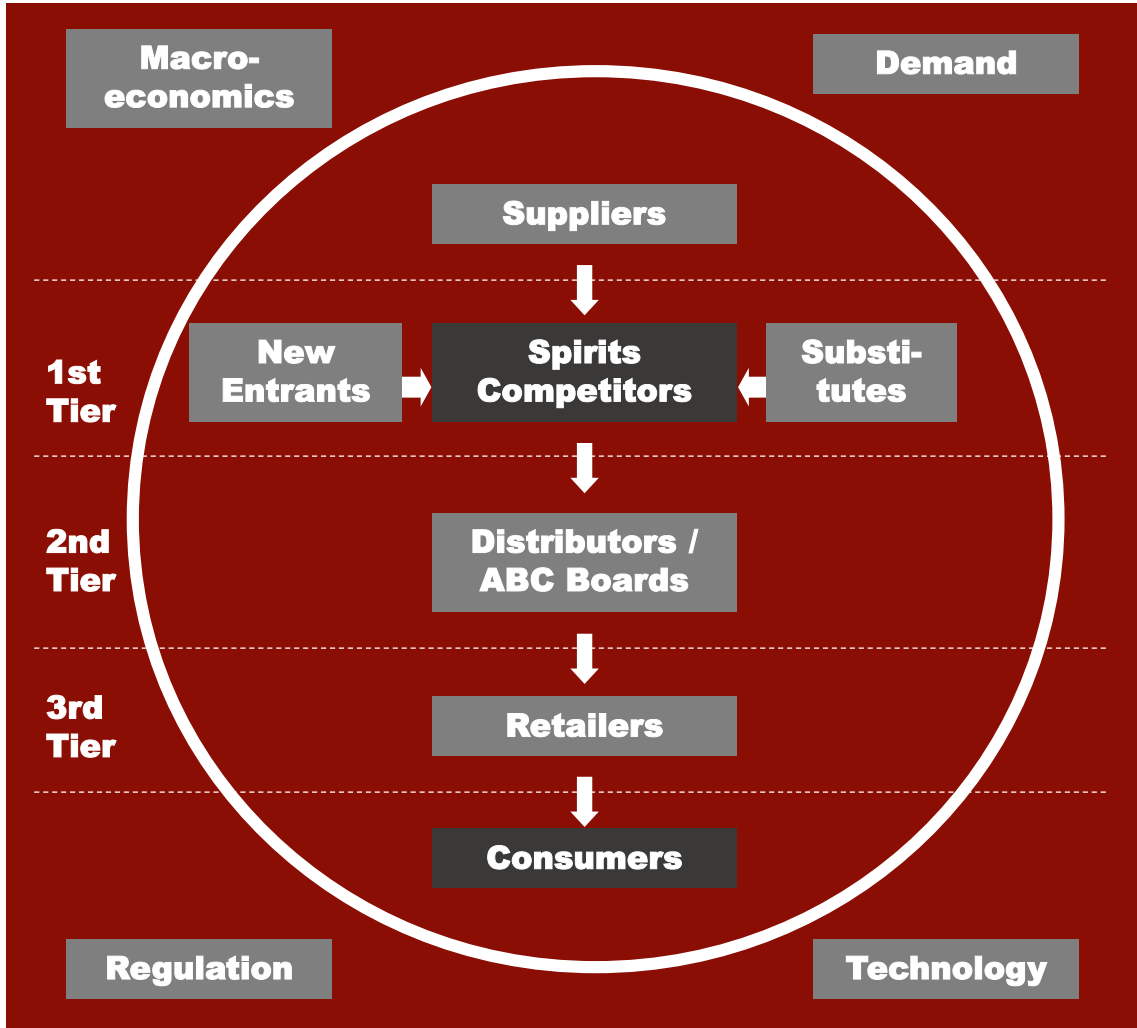
Open States vs Control States

- In many control states, a formal listing process is required before products can get into the bailment warehouses and into the stores. The alternative is to obtain special order item status which allows stores to order the product when it is requested by customers
- When attempting to get listed, the brand should have at least some consumer pull as slow moving SKUs are subject to delisting. A recovery from delisting is difficult

- The choice of expansion markets has to be carefully evaluated as each market has its own pros and cons
- The odds of being able to successfully replicate or successfully adjust the home market blueprint to expansion markets need to be considered
- There is no one-size-fits-all strategy as different brands in the past have shown that brands can be built in every state
- No matter which market(s) are prioritized, each market needs resources to support the launch



Discussion Topics



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Distribution Paradox

“I’m really upset with my distributor – they are not spending enough time on my portfolio. They are spending too much time and attention on the small brands!”

CEO of Top 10 supplier

“My distributor doesn’t pay any attention to my brand – they only do what the large suppliers want.”

Refrain of small brand entrepreneur

- **Distributors have a certain degree of freedom and power, but are limited by the desires and needs of their customers.**
- **Lack of consumer demand and the rejection of retailers often ends up as criticism of distributors.**



Not Getting Enough Attention? Distributors Typically Operate Based on the Concept of Fair Share of Attention

Allocation of priorities based on fair share of attention - conceptual

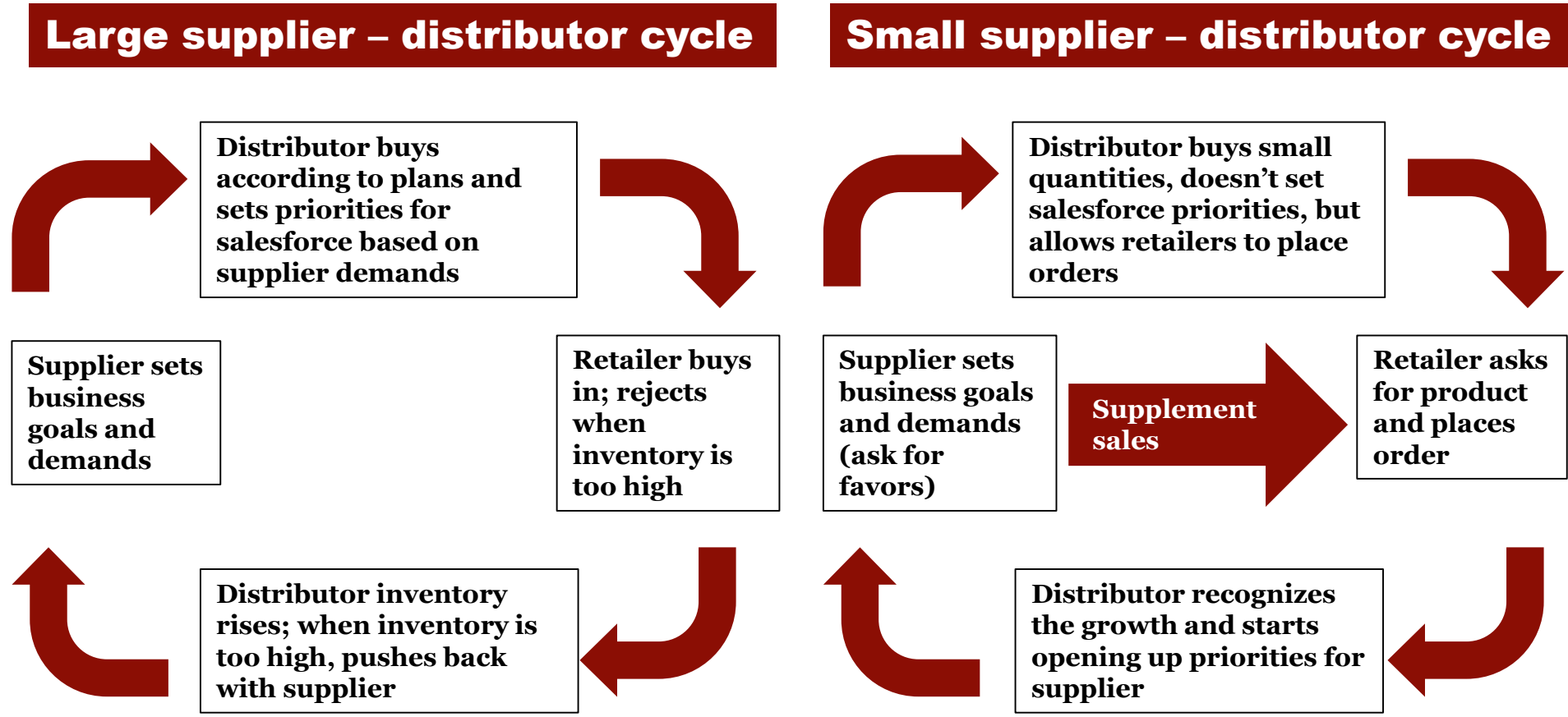
Supplier tier	Annual gross profit contribution range in \$m	# of suppliers in portfolio	# of top priorities	# of top priorities/ supplier	# of other priorities/ supplier	# of other priorities
Top suppliers	5<	2	2	1.00	2	1.00
Large suppliers	2-5	4	3	0.75	3	0.75
Medium suppliers	1-2	8	0	0.00	10	1.25
Small suppliers	0.1-1	30	0	0.00	5	0.17
Entry suppliers	<0.1	250	0	0.00	0	0.00
Total		294	5		20	

Fair share of attention	Large gross profit contribution	=	High level of attention
	Small gross profit contribution	=	Small level of attention

Conclusion

- Priorities for the sales force are the outcome of negotiations between suppliers and distributors
- Most often the concept of fair share of contribution is used to come up with the fair share of attention which guides the allocation of priorities
- Small brands and small suppliers often end up without any priority – the same typically applies to small brands of large suppliers
- Distributors are often unable to pay attention to a small brand as the risk of losing a large supplier is too big

Small Suppliers Often Need to Create Retail Demand in Order to Get Distributors to Increase Attention



Key for smaller suppliers is to get retailers to ask for the product to break the cycle of fair share of attention; this requires supplemental sales efforts



Examples of Strategies and Tactics to Increase Attention – Create Awareness Within the Distributor

Margins and Incentives

- Large suppliers pay significantly smaller gross profit percentages than small suppliers (15-22% vs 25-35%). Standing out with high gross margins among small suppliers can increase awareness
- Providing large placement and re-order incentives for the salespeople (if distributor approves) can increase awareness

Communication: Presentations, “Ride-Alongs” and Follow-ups

- Presentations and trainings at general sales meetings are important opportunities to increase awareness of the brand among distributor salespeople
- Opportunities to spend a day riding along a distributor salesperson are great opportunities to build a personal connection with the sales-person and accounts
- Sharing of success stories and achieving of milestones can be impactful follow-ups to create and sustain the “winner image”
- All communications and pitches have to be carefully planned and crafted. Avoid desperate over-communication, giving the impression that the distributor salesperson’s time is not valuable

In-market Sales, Brokers & Brand Ambassadors

- Supporting sales activities with frequent market visits and dedicated or shared sales personnel in the market is crucial, especially at the launch
- In case of shared resources, make sure to get a fair share of attention from the shared resources

- Awareness creating activities are crucial with distributor salespersons who have 100’s if not 1,000’s of products to sell
- Focusing limited resources on particular distributor sales-people and their account universe can help create mini success stories that are newsworthy within the distributor
- Attention will come through awareness and success



Examples of Typical Pitfalls to Avoid With Top Supplier Distributors

Focus on Order Size

- Distributors have a high level of sophistication in managing their inventory levels
- Extra working capital capacity is typically used to support large suppliers in making their numbers
- New brands have no track record and will therefore typically be only ordered in small quantities
- Demanding larger order sizes or even showing a strong interest in the order size, sends the distributor a message that the supplier is potentially under-capitalized and may lead to a decrease in supplier credibility and cancellation of the order

Launch a Portfolio of Brands and Demand Full Distribution

- Distributors typically segment their account universe in order to focus their activities
- Launching more than one brand and demanding to get into every account is unreasonable especially for new or small suppliers and will likely result in not getting anything
- The focus should be on a particular brand or a brand with logical extensions (e.g., different age profiles)
- Distribution goals need to be very focused and in line with the relevant differentiation of the brand

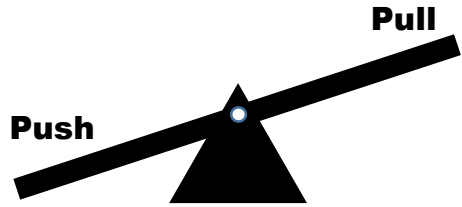
Working Without a Marketing Plan

- Distributors have only limited resources, and one of their largest assets is their relationships with accounts
- While distributors can place brands in outlets based on the trust the accounts have in them, distributors need to do their due diligence on the consumer pull activities first. Nobody wants to get calls from good accounts requesting that the distributor come back to pick up goods
- A comprehensive marketing plan that demonstrates how the target consumer is engaged and activated is crucial to get a distributor to buy in



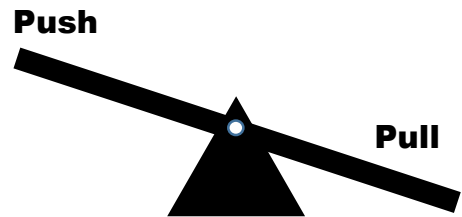
In Short: Mastering the Balance Between Push and Pull is One of the Keys to Success

Push > Pull



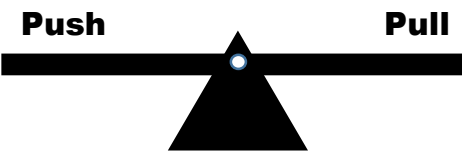
- When push activities lead the way without adequate consumer pull, product will get to retailers and will stay there until retailers determine to move the product, either by asking the distributor to take it back or by heavily discounting it for the consumer
- Relationships between retailers and distributors frequently get strained or damaged in this process, especially if large volumes are involved. Distributors try to avoid this situation as much as possible
- New brand developments of large suppliers often encounter this situation, ultimately leading to a high level of sensitivity and lower emphasis on new brand development among large suppliers

Push < Pull



- When pull activities lead the way without adequate distribution, consumers ask for the product and are unable to find it. This is good to a certain degree as it will drive retailers to ask their distributors for the product, but it is not sustainable over time as it impedes growth and may lead to frustration among consumers who are unable to purchase the product
- The costs of creating the pull have to be weighed against the benefits as an over-investment in pull without adequate push is a waste of resources. Such over-investment typically occurs in above the line spending
- Entrepreneurs who have significant capital, are impatient, and/or have unrealistic expectations are most likely to fall into this category

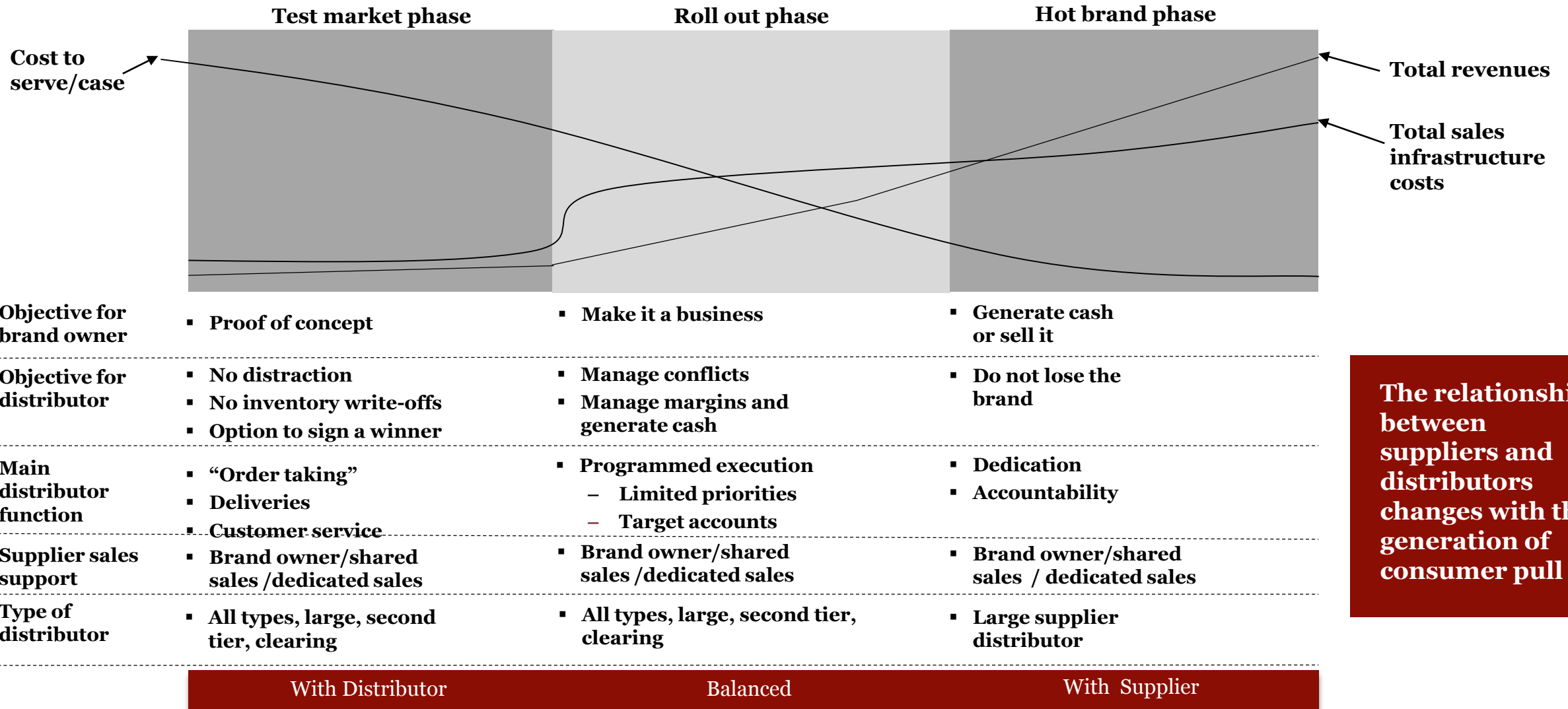
Push = Pull



- Balancing the right amount of push with the right amount of pull has often been the recipe behind successful brand launches. It combines below the line marketing spend and activities in target geographic areas and target accounts with the appropriate level of distribution
- A test market campaign is typically an effective method to create and optimize a pull/push playbook that can be replicated during the roll-out in other areas



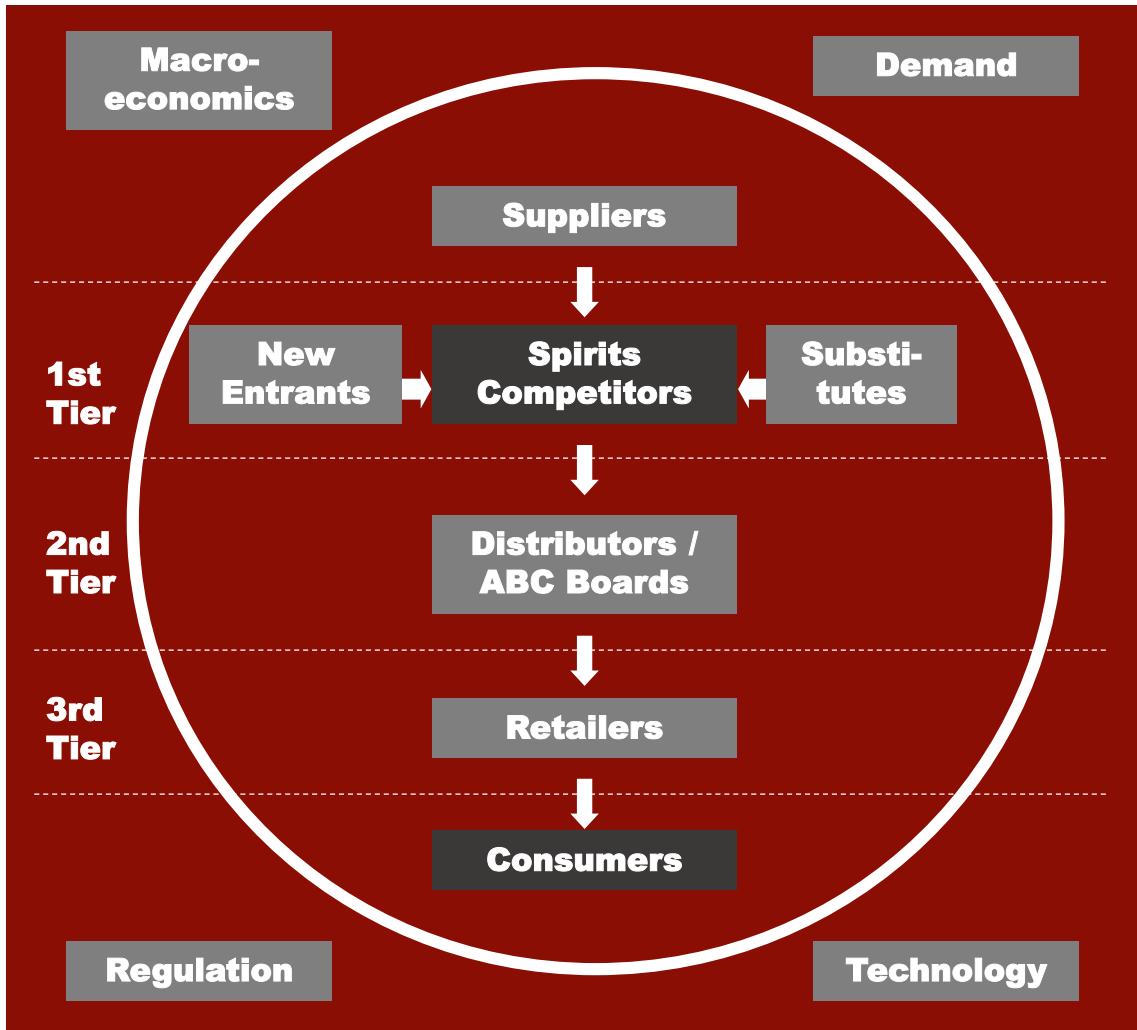
New Brand Launch – With Success the Power Balance and Route to Market Change



The relationship between suppliers and distributors changes with the generation of consumer pull



Discussion Topics



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Infrastructure to Conquer: Front-Office vs Back-Office Tasks

Front-Office

- Selling to an open state distributor
 - The principal/gatekeeper
 - The salesperson that ultimately sells to the retailer
- Selling to a control state broker / presenting to a control state board
- Soliciting retail demand
- Encouraging consumers to buy (sampling on- and off-premise)
- Consumer marketing

Back-Office

- Licensing and regulatory compliance management (federal and state levels)
- Logistics and supply chain management (warehousing and transportation)
- Order processing and fulfillment
- Distributor and control state customer service
- Financial, reporting and systems

Integrated

**In-house front-
and back-office
infrastructure**

Bundled / Agency

**Full service
national
distributor**

Unbundled

**Front
office**

**Back
office**



Assessment of Traditional Route to Market Options: Integrated and Bundled Approaches

Integrated

Front-Office **Back-Office**

Examples

Comments

In-House **In-House**



- Undivided attention of the sales force
- Full control of the marketing funds
- Need large volume to cover high fixed costs
- Long ramp-up time
- Scope and scale issues (e.g., specialist know how, relationships)

Bundled/Agency

Outsourced



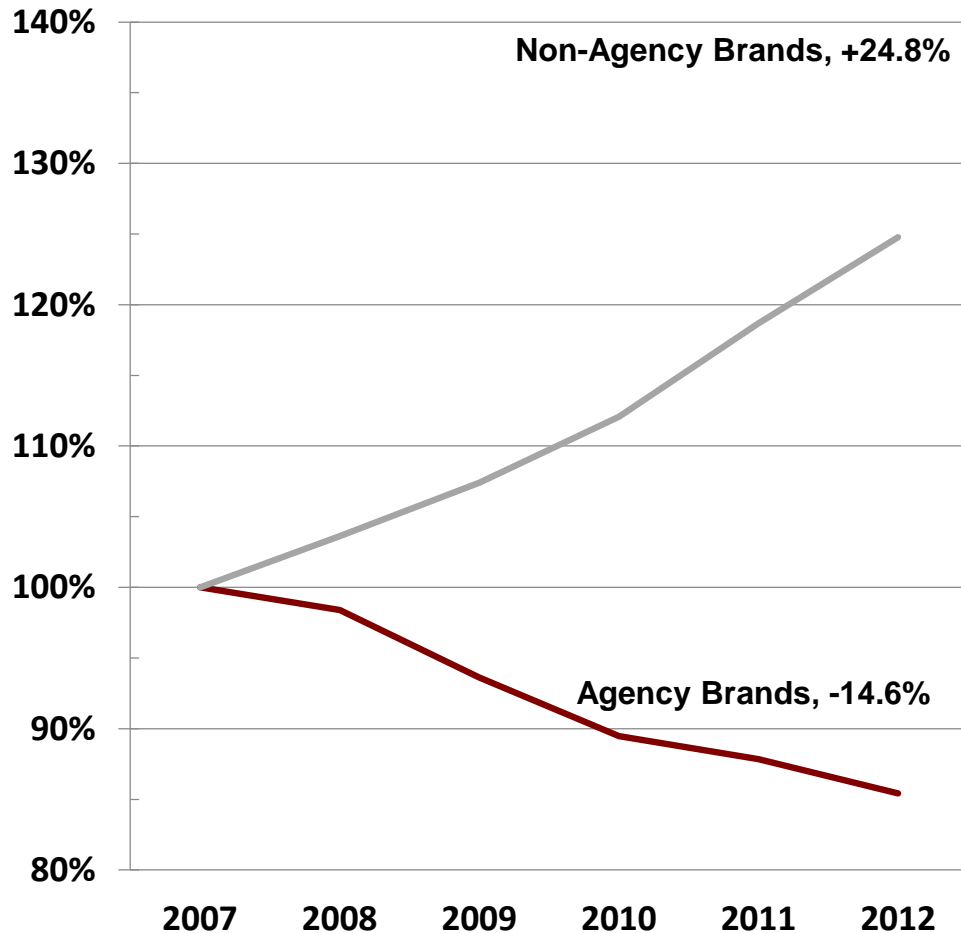
- Possibly lower fixed cost but high variable costs due to mark-up
- One stop shop
- Scope and scale advantages
- Possible additional layer of divided attention
- Possible conflict of interest due to lack of independence
- Risk of comingling of marketing funds
- Lack of control



Agency Brand Model Will Need to be Adjusted to Become a Credible Alternative

Sales of leading agency spirit brands vs. sales of leading non-agency spirit brands in same category, 2007 - 2012

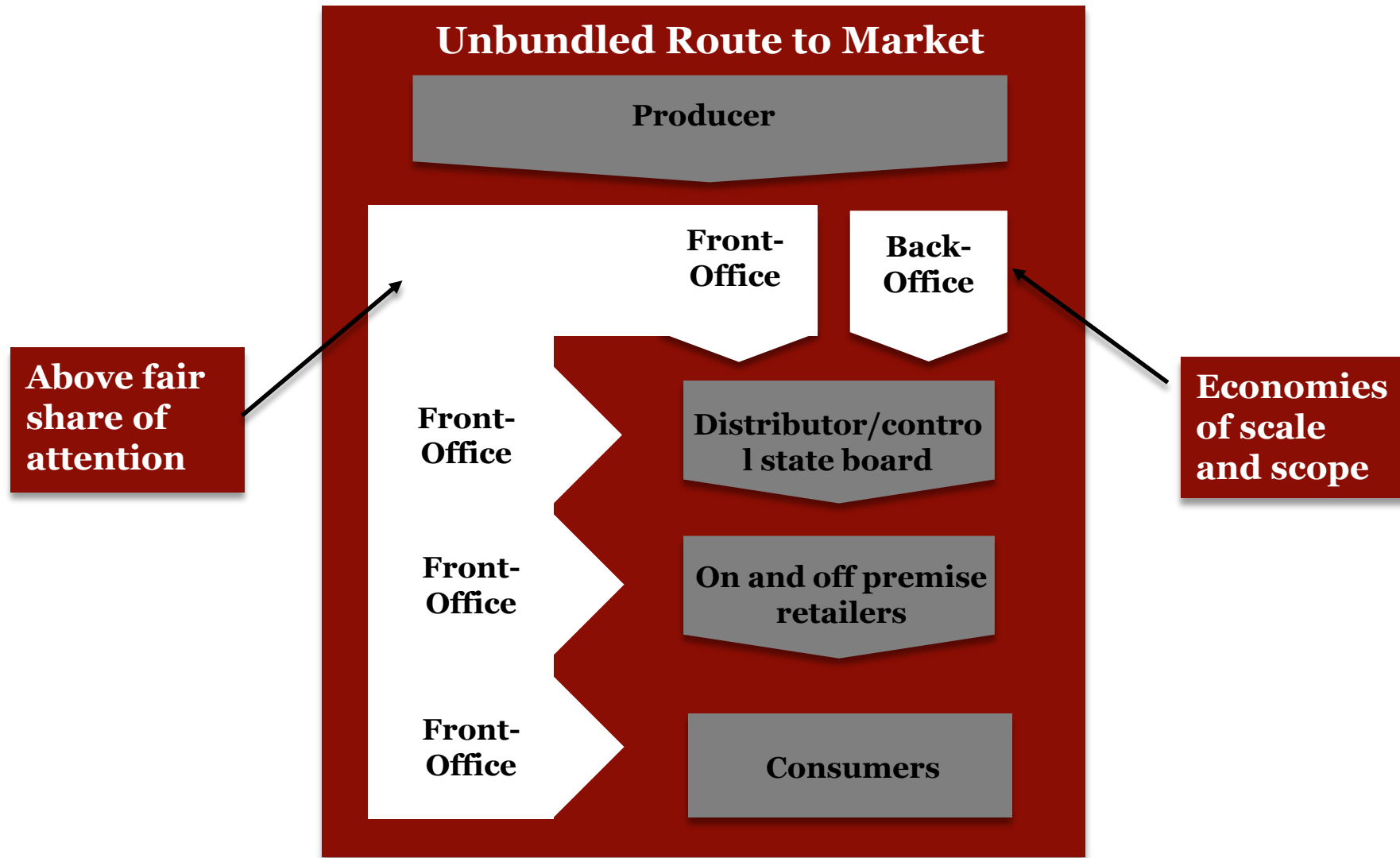
2007 Sales = 100%; All Spirit Categories



- Agency set-ups have traditionally not worked for both parties. In times of limited programming slots at distributors, agency brands have typically lost out
- Many of today's medium sized suppliers left agency set-ups due to disappointing results
- In order to make the model work, the participants have to apply a set of principles:
 - Independence or quasi-independence of the sales infrastructure with brand owners controlling the infrastructure in a JV type governance with full visibility and transparency for all participants
 - Should have a portfolio that has no direct conflicts and is not too large – the individual brand will get attention during every sales call, securing above fair share of attention



The Unbundled Approach Combines Above Fair of Attention and Economies of Scale





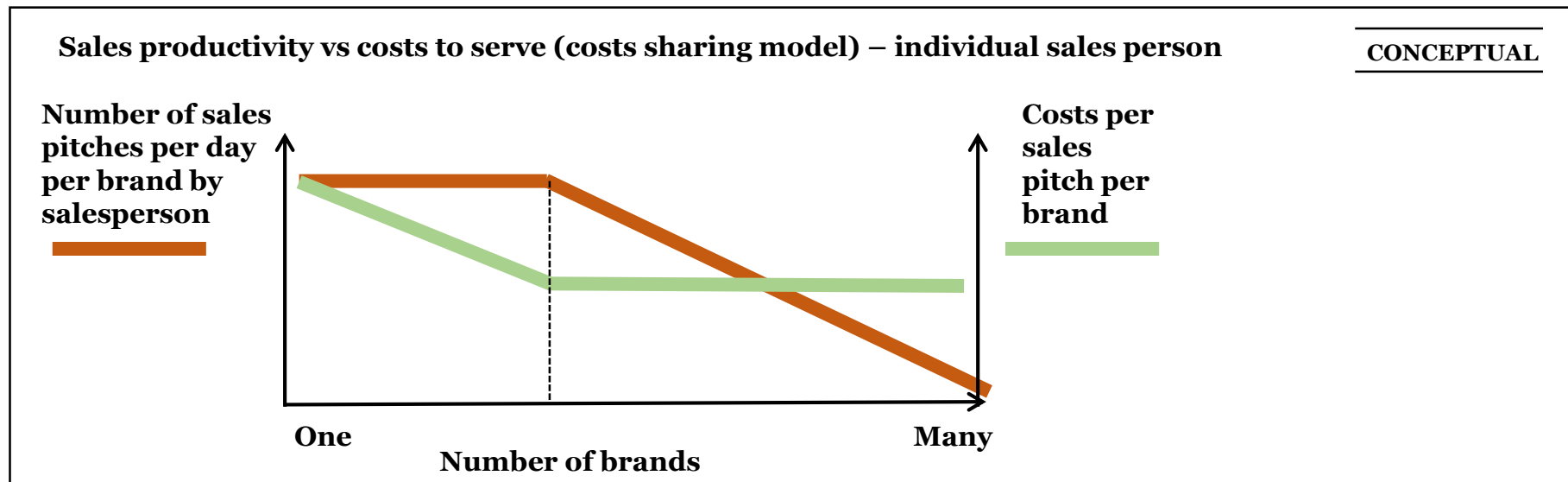
Sales Infrastructure Models – Getting an Above Fair Share of Attention

Dedicated Sales Infrastructure

- A dedicated sales infrastructure has salespeople with just one priority
- The salesperson manages the distributor and solicits retail demand, securing an above fair share of attention
- The disadvantages of this model are the high costs that are not shared with another supplier
- Dedicated national sales infrastructures for entrepreneurial brands can cost between \$1m and \$3m per year depending on the number of salespeople

Shared Sales Infrastructure

- A shared sales infrastructure needs to be independent (i.e., no ownership of brand) to ensure aligned incentives
- Should have a portfolio that has no direct conflicts and is not too large – the individual brand will get attention during every sales call, securing above fair share of attention
- Assuming the salesperson's productivity allows for 5 brands per sales call, the costs of the salesperson could be shared between 5 brands





Type of Shared Sales Infrastructure Models

National Shared Cost Infrastructure Providers

- There are few national shared cost infrastructure providers
- They typically operate by dividing their expected total costs among their brands and adding a small profit
- For maximum effectiveness, the portfolio needs to be aligned with the same distributor footprint, and the portfolio must not have any direct conflicts among brands
- Brands shouldn't be owned by the infrastructure provider to avoid a conflict of interest among the stakeholders

Joint Ventures Between Brands

- At one point or another, most operators of dedicated sales infrastructures examine transitioning into an agency provider in order to reduce costs
- The major (and often insurmountable) challenges of this exercise are the resolution of conflicts of interest and the alignment of the distributor footprint
- One viable approach is to spin-off of the existing sales forces and then merge the spun-off sales forces to create a new entity managed by its own CEO and governed by a board with joint representation
- The management and books are completely transparent for the partners

Regional Sales Brokers

- Regional sales brokers provide sales typically focused on a particular distributor in the market
- The costs are lower than a dedicated salesperson, but conflicts in the portfolio and the size of the portfolio are sometimes problematic
- The ease of set-up make this model the most prominent one, while the success is mixed

- Finding and/or creating an efficient and effective sales infrastructure that provides optimum sales productivity and low cost is one of the biggest challenges for small brands
- Getting into the right set-up can become a strong competitive advantage

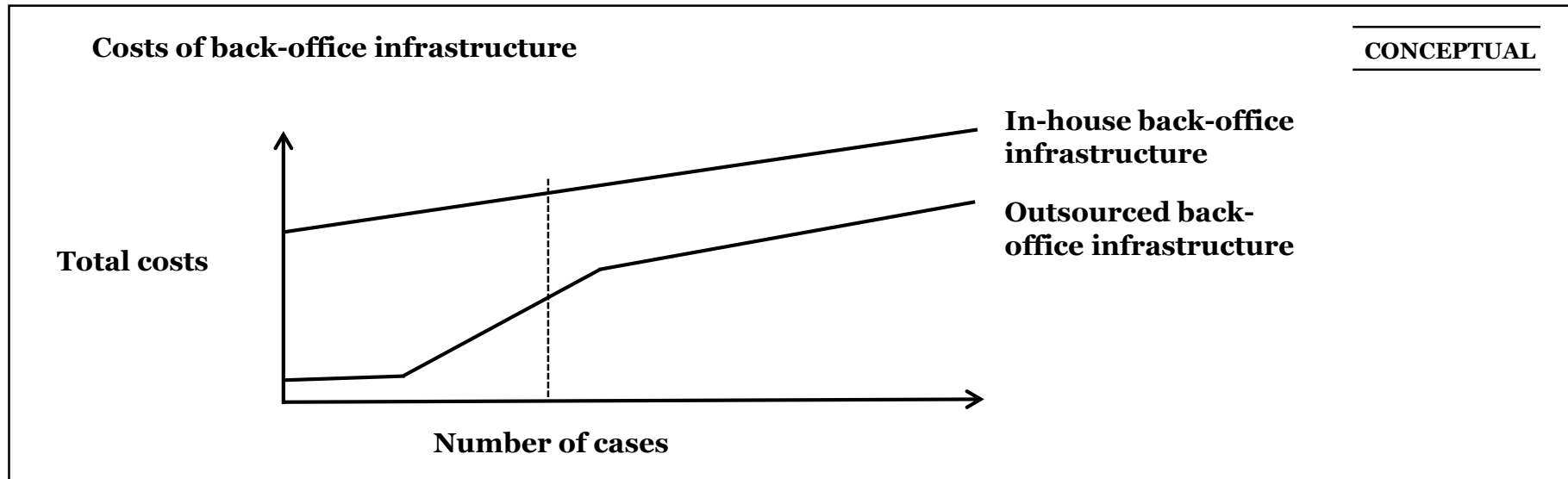
Back-Office Infrastructure Models

In-house Infrastructure

- An in-house back-office has full time employees who provide the service
- Lack of economies of scale make this model very expensive and vulnerable (e.g., dependency on particular employees, no redundancy)
- In order to make this model viable from a cost perspective, many brands under-invest and therefore put the business at risk
 - Regulatory Compliance
 - Management Systems
 - Business intelligence
 - Accounting, Data

Outsourced Infrastructure

- A back-office provider can serve an enormous portfolio, including competing brands, as it is not involved in front-office management
- In serving such a large number of brands, a back-office provider can utilize economies of scale to deliver cost savings vs the in-house model and provide a high degree of business stability and specialized expertise
- Small and medium sized brands benefit from sophisticated infrastructure and systems that are typically available only to large suppliers





Examples of the Unbundled Route to Market Approach

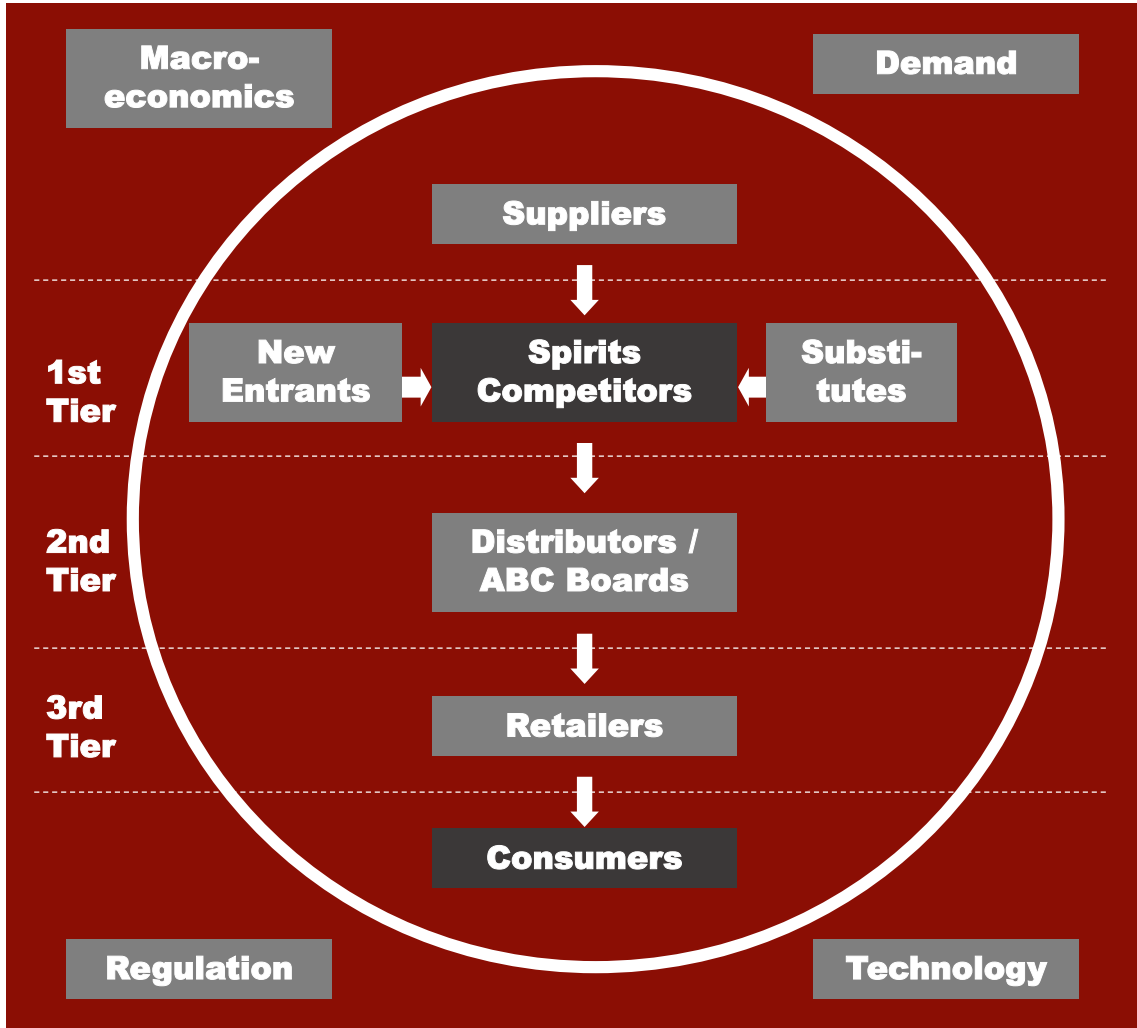
- Overview
- Split front- and back-office functions
- Outsourced or internal front-office
 - Salesforce
 - Marketing
- Outsourced back-office
 - Licensing and regulatory compliance
 - Logistics and supply chain management
 - Order processing and fulfillment
 - Distributor and control state customer service
 - Financial, reporting and systems

Examples

Company	Front-Office	Back-Office
		park  street
		park  street
		park  street
		park  street
		park  street
		park  street



Discussion Topics

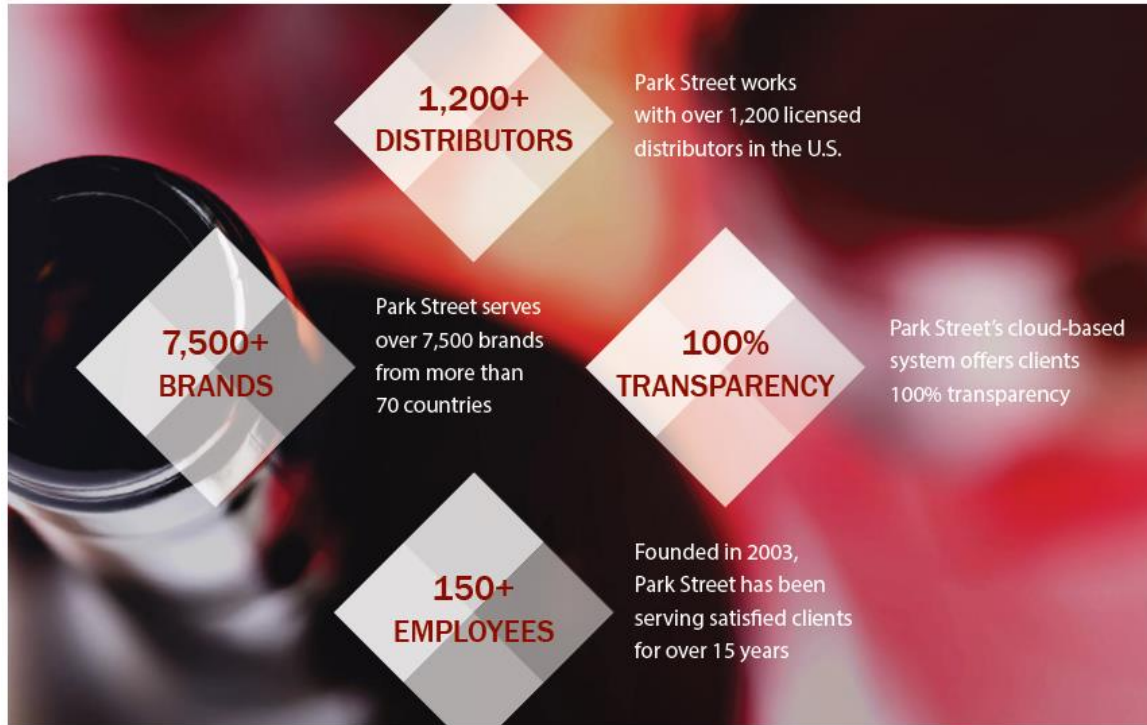


- **“The route-to-market in a highly regulated red tape environment that demands three tiers”**
- **“Vulnerable first tier Goliaths with David winning, not necessarily alone, but as a group”**
- **“The second tier on a fast track to a duopoly with some alternative options for starters”**
- **“The higher the relevant differentiation and badge value for the brand, the easier the route to market battle”**
- **“The start close to home and a focus on a success blueprint that can be replicated in other markets”**
- **“The concept of fair share of attention or there is no silver bullet for distribution”**
- **“Combining an above fair share of attention and economies of scale for an efficient and effective route to market”**



About Park Street

Park Street: The Platform for Innovators



Park Street's Mission Statement

Park Street's mission is to help emerging and established alcoholic beverage companies build and manage successful brands by providing innovative solutions and exceptional service.

The Park Street Advantage

Park Street invests heavily in technology-driven systems to streamline back office operations and provide clients performance-enhancing business management tools. Park Street was founded on the professional service standards of McKinsey & Company, and its talented people distinguish the firm through their responsiveness, accountability, and commitment to putting clients' interests first. Park Street offers a fully integrated solution across front- and back-office services, working capital investment, and advisory services. With more than seventy-five years of combined experience among its senior management team and expertise in operations, strategy, information technology, finance, and deal structuring and negotiation, Park Street is able to help clients overcome challenges, accelerate growth, and capitalize on opportunities.



Park Street Services (1 of 2)

Back-Office Services

- **Park Street provides a cost-effective, turn-key solution to manage the thousands of complex details required to import (if applicable), transport, insure, warehouse, sell, and receive payment for alcoholic beverage products in the United States (U.S.) and European Union (EU) — all while maintaining compliance with federal and state (U.S.) and European Commission and individual country (EU) alcoholic beverage control laws and tax requirements.**
- **The three core benefits to Park Street’s clients from the U.S. and around the globe are: (i) achieving cost effectiveness, (ii) enhancing operational performance, and (iii) focusing client resources on sales, marketing, and product innovation. With precision and transparency, Park Street manages the logistics, compliance, order fulfillment, data management, customer service, and accounting from the point the product is picked up at the producer until it is delivered to the customer and the customer invoice is paid. Park Street’s operational infrastructure integrates seamlessly with production facilities in the U.S., EU, or anywhere in the world resulting in streamlined operations.**

Distribution: Direct-to-retail

- **In select U.S. markets (FL, NY, NJ, CA), clients can leverage Park Street’s distribution network to sell imported and domestic product directly to retailers (restaurants, bars, liquor stores, etc.). This distribution model is attractive to both established and emerging brands. It allows established brands to lower cost by leveraging the wholesale clearing model and enables emerging brands to enter new markets quickly and inexpensively in order to demonstrate initial market traction (i.e., test market campaign) before moving on to a traditional distributor. Brand owners also utilize Park Street’s distribution capabilities to sell additional products not supported by their traditional distributor (i.e., supplementary distribution).**



Park Street Services (2 of 2)

Compliance Management

- Park Street offers a full suite of turn-key compliance set-up and management services in order to help U.S. and non-U.S. alcoholic beverage companies rapidly access U.S. and EU markets and operate in adherence with all applicable alcoholic beverage laws and regulations. The company's compliance set-up and management services provide an easy and cost-effective U.S. and EU solution which enables clients to avoid costly delays and penalties and remain focused on the core competencies which drive brand growth.

Working Capital & Trade Financing

- Park Street offers flexible working capital solutions which enable clients to capitalize on opportunities, meet seasonal liquidity demands, optimize production schedules, and more. Products include advance payments, credit facilities, overdraft privileges, and corporate guarantees. The underwriting process focuses on, among other factors, the quality and liquidity of the collateral/assets (e.g., creditworthiness of the distributor, payment history, inventory turnover rate), the financial and operational stability of the client, and the quality and track record of other relevant stakeholders (e.g., producers, suppliers).

Ancillary Services

- Park Street provides a range of ancillary services designed to help clients reduce costs, streamline operations, and/or accelerate growth and profitability. Some of these solutions are offered as value added services, while others are provided on a fee-for-service basis. Services include integrated accounting solutions (e.g., consolidated financial reporting, front-office accounts payable, expense management), advisory services (e.g., route-to-market, regulatory strategy, market insights, growth acceleration, dispute resolution, strategic partnerships, negotiation support, exit planning), trade show solutions (e.g., insights, managed set-ups, vendor qualification, site selection, POS materials), HR management solutions (e.g., employee benefit management, payroll, workers' compensation, employment documentation, HR dashboard), and more.

Export Solutions

- Park Street's export solutions enable suppliers to access markets beyond the U.S. and EU. For example, non-U.S. suppliers are able to utilize free trade zones at select U.S. ports to service regional and sub-regional markets (e.g., Mexico, Caribbean, Central America, South America). Services include, among others, warehousing, logistics management, regulatory compliance, order fulfillment, invoicing, and customer service.



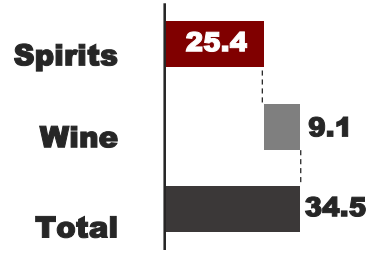
Industry Structure: Supplier and Wholesale Tier Concentrated

Tier

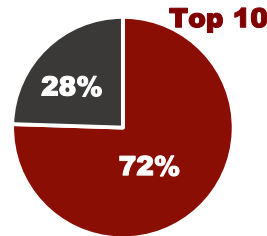
U.S. Wine and Spirits Sales by Tier (2016)

Dollars, Billions

Tier 1
Suppliers



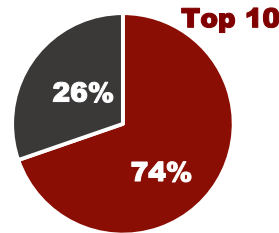
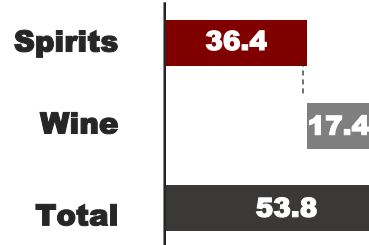
Concentration
% of total



Comments

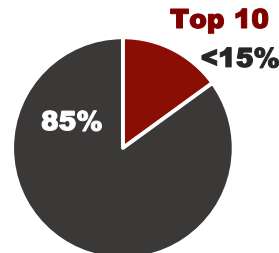
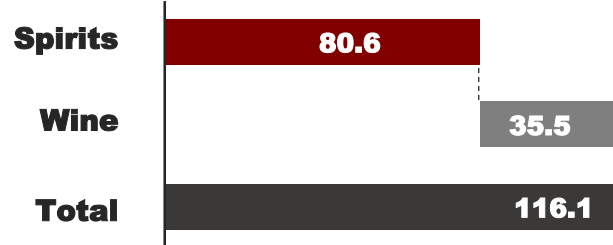
- Supplier tier is concentrated on national level
- Sales/product curves nationally mostly mirror regional and local sales/product curves
- Domestic craft spirits industry consists of over 1,600 distillers with a combined share of less than 4% (value)

Tier 2
Wholesalers



- Distribution tier has gotten much more concentrated over the last years in response to supplier consolidation
- Sales/distributor curves vary by state
- Many open states with 2 distributors having 80%+ share
- Some states in which national market share leader has zero presence

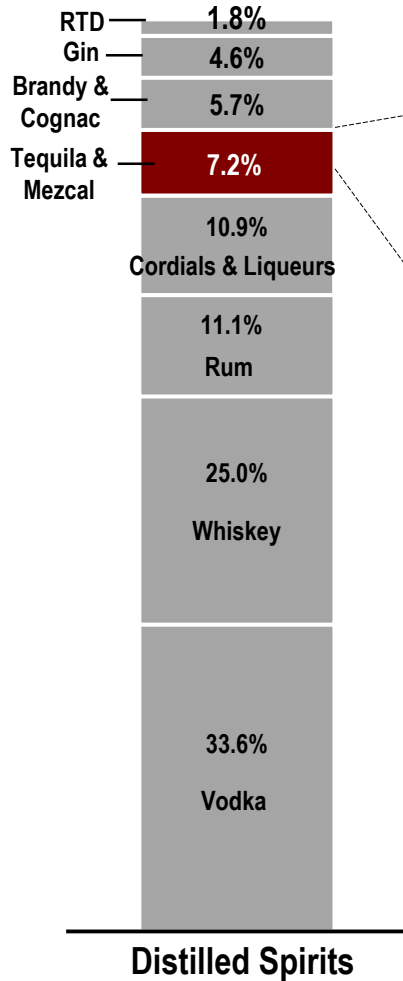
Tier 3
Retailers



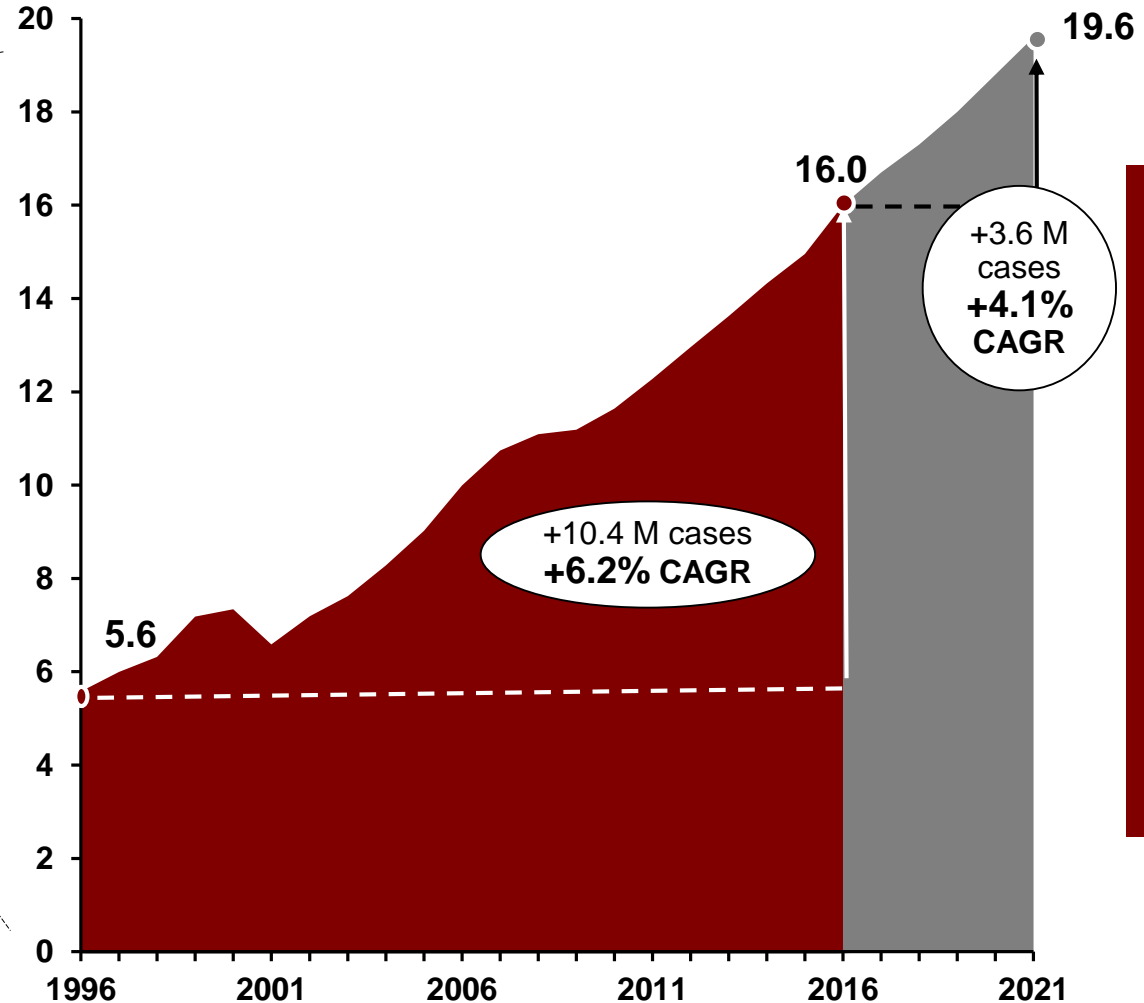
- Retail tier undergoing consolidation with growth of retail chains where permitted
- Sales/retailer curves vary by state –variation partly driven by regulation
- In some markets (e.g., NY) sector completely fragmented while in others (e.g., CA) sector very concentrated
- On-line retailers not yet with significant traction/share but expected to expand

Agave Based Spirits are Growing

Share of Distilled Spirits Consumption Market 2016 by Category



U.S. Tequila and Mezcal Consumption, 1996 – 2021
Millions of 9-L Cases



- Rapid growth in tequila and mezcal consumption in the US over the last 20 years
- Growth expected to be strong for the foreseeable future



The Method of Drinking Agave Based Spirits is Changing



- **Tequila has traditionally been a spirit consumed through shots and through cocktails, such as the margarita**
 - **44% of cocktails are tequila based**
 - **Margarita is the number one ordered cocktail**
- **With the rise of premiumization, the tequila consumer has “matured”**
- **This change and higher end tequila are primarily responsible for a shift towards drinkers choosing to sip tequila instead of taking shots or ordering a cocktail**
- **The category is undergoing a shift towards higher sophistication similar to the scotch industry with the proliferation of single malts**

Tequila: The Kombucha of Spirits?



- **Kombucha is riding a wave of popularity given the perceived health benefits of probiotics**
- **Probiotics line the digestive tract and support the immune system as they absorb nutrients and fight infection and illness**
- **The agave that tequila is derived from contains fructans, a short-chain polymer that supplies probiotics — beneficial bacteria found in the intestines**
- **Thus, many websites suggest that drinking a small amount of tequila may benefit digestive health like kombucha and other probiotic superfoods**



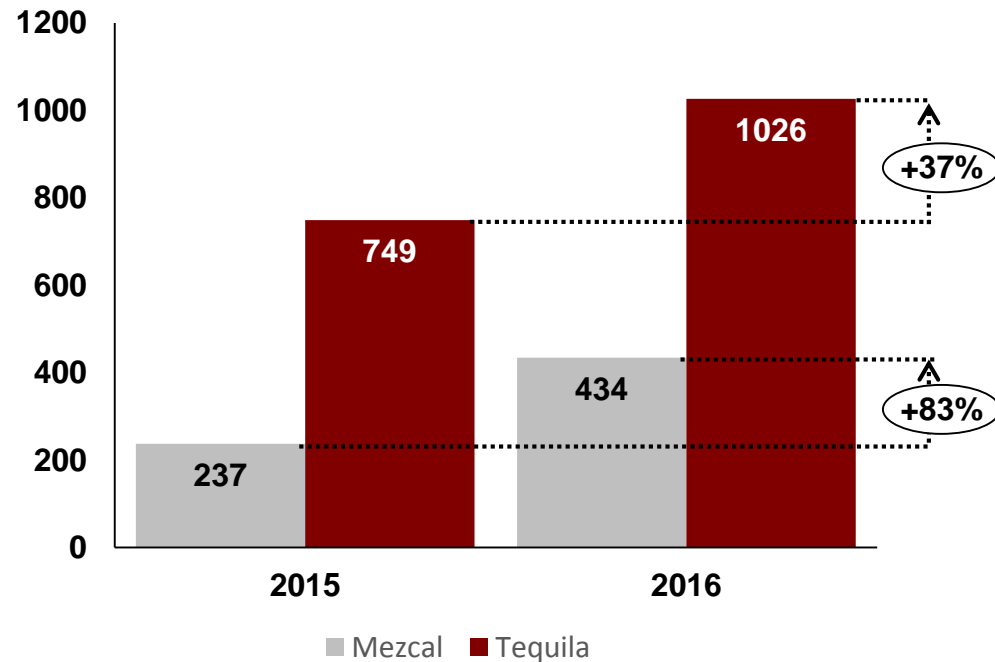
Celebrity Entries are Fueling the Higher Awareness of the Tequila Category





Rapid Growth in Product Launches of Tequila and Mezcal

**COLA (Certificate of Label Approval)
Filings For Tequila and Mezcal, 2015-2016**



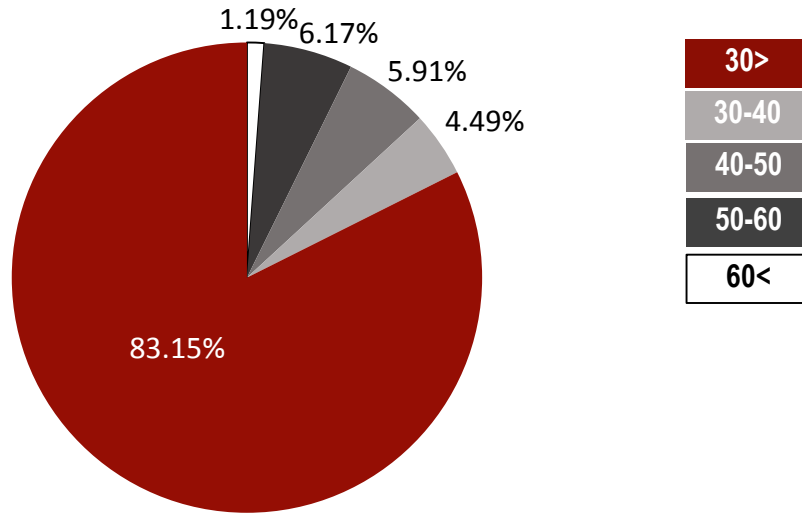
- Product launches and innovation in Tequilas and Mezcals is accelerating
- Level of competitive playing field is rising



Tequila Market by Price Segment – Strong Growth in \$60-70 Category

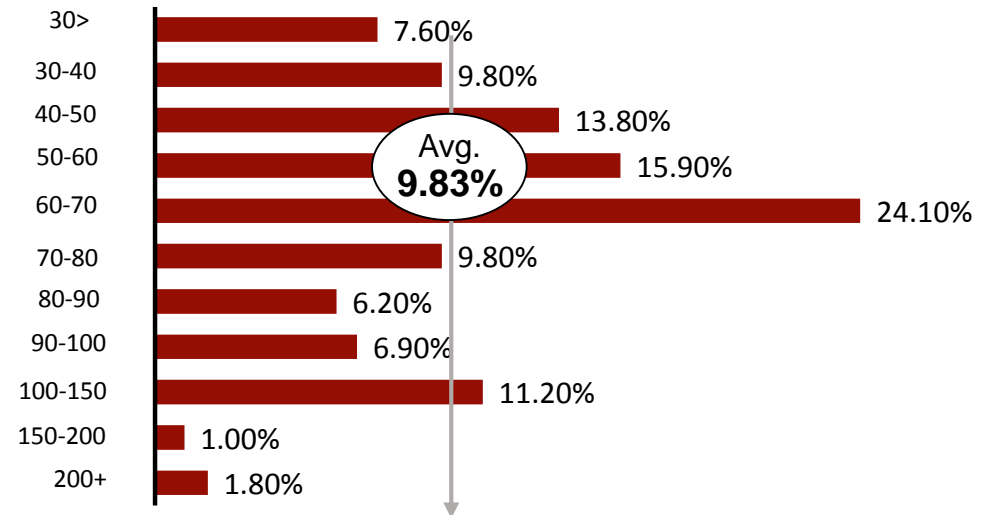
Share of Tequila Market by Price Segment, 2015

Percent



Growth Rate of Tequila Market by Price Segment, 2014 - 2015

Percent



- While lower priced tequilas are most common, higher priced tequilas are growing at a substantially higher rate
- The \$60 - \$70 price range has the strongest growth rate with an increase of 24.10% from the previous year