

CBC Online Seminar Q&A

State of the Craft Brewing Industry

Q: I realize no one has a crystal ball. That said, what are some of your main expectations for post COVID-19 culture?

A: I think this question really needs to get separated into short term, medium term, and longer term. In the longer-run I think we've seen that humans have an incredible ability to forget these things. So, in five or ten years I think the changes may not be as drastic as we all think right now. We've seen similar huge shocks to systems in the past that those systems seem resilient to. That said, I do think this is going to accelerate some of the e-commerce trends that were already going on in the United States. Beverage alcohol has been a laggard here. If you follow e-commerce, it's steadily grown across almost all categories for the last few decades, and I think beverage alcohol is going to see that more. In the short term too, I think we're going to see some wariness about being in public spaces – especially crowded public spaces – until there is a vaccine. We're still starting to get data on this and consumers aren't that good at predicting their future behavior, but there's a lot of wariness on the part of everyone about going out in public – particularly going to large crowded events – until there is a vaccine. One of my expectations is that we're going to see a bit more social distancing built into every part of culture. People are going to be a little bit more wary about crowding into particular places. That's going to have an effect for on-premise and at-the-brewery sales in the short term.

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Q: What changes do you see after all of this is over in terms of shipping, home delivery etc.? Do you see these things as something that will now be more mainstream or should be more mainstream?

A: Yes, and yes. This isn't going to shift everyone's behavior. Some people right now are getting DTC or delivery and they're saying, 'I hate this and I want to go back to the way it was before.' But some percentage of people are saying, 'I don't know why I didn't buy things like this before – it really works for me.' They're going to want it and demand this. Obviously, there is a heavy legislative and regulatory piece to this. So, there is work to be done to preserve these rules that have been either temporarily put in place – or now some legislatures are talking about actively changing. I think we're going to see more interest in shipping, home delivery, DTC in various forms. We will see a step level here where some percentage of people stick with these things, and we also see that the sky isn't falling from a regulatory perspective. So, I think that regulators are a little bit more open to these models going forward. In terms of beer vs other beverage alcohol, I don't think its DTC ceiling is ever going to be as high as other things. It's just heavy relative to its value, but there are going to be breweries where this model makes a ton of

sense – particularly for specialty beers. And I think we're going to see this increase going forward.

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Q: What is your take on breweries in planning at this point and where do you see the industry going, especially for new and upcoming breweries?

A: Again, you have to separate this into timeframes. There's a set of breweries that have already cast their die. They have raised their money. They have bought their tanks. They have found a location. They are still going to try to open, because that is the only thing they can do at this point. I've talked to numerous breweries like this in the last few weeks. We've seen breweries open during this pandemic. They are doing soft openings, and they're immediately pivoting to curbside, to-go, and other things, because that's what they have to do to try to keep their fledgling business alive. I do think this could scare off some investors and make it much more difficult to raise money for small brewers in the medium term. In the long term I think we were going to see a slowing in this anyway. But I think we're still going to see a lot of interest, and I've talked to plenty of breweries in planning and entrepreneurs in planning who see opportunities in this. Clearly there is and has been fundamental demand in the last few years for the at-the-brewery model and for small and local beer. So, if we see a thousand breweries go out of business, that's a demand-void to be filled. I think we're going to see lower opening and plannings, but we will see that number climb back up. We will see people looking to buy cheap on used equipment and locations, and go into places where breweries closed. We were already seeing that before and I think we'll see that going forward.

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Q: Of the closings in 2019, what was the breakdown of size/type (regional, brewpub, micro, taproom, etc.)?

A: *I don't know those numbers off the top of my head.* It is roughly in line with the percentage of breweries. Though, I know brewpubs are a little bit higher than their percentage and taprooms are a little lower, just based on average age. So generally, the vast majority of openings are taprooms, followed by brewpubs. I don't know the exact number of closings off the top of my head, but most of them are taprooms and brewpubs. And most closings are still very small. We are seeing a few larger companies close, but there's only a few regional closings per year. This year I think there was only one regional closing, and generally we see much higher closing rates from taprooms and brewpubs than from micros or regionals.

- Update: 112 micro closings, 60 taproom closings, 119 brewpubs closings. Some percentage of the microbreweries closed before we went through the BIPS process may in fact have been taprooms.

Q: What do you anticipate regarding package mix vs. draft mix post-pandemic? Will social distancing drive package growth and reduce draft on-premise sales long-term in your opinion?

A: I think long term its hard to know, but I would guess no. Medium term – certainly yes. Draught is going to be something that takes a hit, simply because A) we’re going to see an incredible number of restaurants and bars close. The National Restaurant Association is conducting surveys just like the Brewers Association, and there are similar if not higher rates of expected restaurant closings. I would expect bar closing will be fairly similar. So, we’re just going to see the entire on-premise take a hit. Now, some of that volume is just going to go to the accounts that stick around, but some is not going to. Because, again, I don’t think every bar is going to be incredibly packed the day after these restrictions get lifted. So, I do think we will see a bit more package mix in the medium term. In the long run, though, I think humans are resilient. People are social animals. They like going out. The pint is a beautiful thing. So, we’ll see it bounce back closer to where it was.

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Q: How do you anticipate direct-to-consumer sales will impact the craft beer market through COVID-19 and beyond? Is there anything we can pull from small wineries in regards to market sales expectations for DtC? And final question: Is the BA working to get more states open for direct-to-consumer sales?

A: I think they’re going to grow, and it is something that a certain percentage of consumers like. Obviously, brewers have a way to go to have the same regulatory environment as wineries. Prior to this, it was 8 or 9 states that allowed DTC shipment of beer, and wineries is in the forties. So, wineries have much greater ability to do this. Breweries have decent ability within many states – direct shipping is available, say, within California. I think we’re going to see it grow and it will have an impact – particularly for brands that are well differentiated. The winery DTC is driven heavily by the very highest end. You know, people aren’t having a lot of bulk wine shipped to themselves across the country. I think there are going to be particular benefits for companies that make something unique and really have demand further away from home. So, somebody who visits that special barrel-aged brewery in California on a vacation and signs up for their beer club – in the same way somebody goes to Napa on vacation and signs up for their wine clubs. Is the BA working to get more states open for DTC sales? That’s a conversation we’re having with state guilds, and we would work in conjunction with those guilds in various states. It’s certainly something we’re keeping abreast of, and we’re having conversations about that.

- Update, see state rules here: <https://www.ncsl.org/research/financial-services-and-commerce/direct-shipment-of-alcohol-state-statutes.aspx>

Q: How would you define the importance of education and engagement in the taproom in correlation to the growth of craft beer?

A: I would probably change the question slightly and just say experience is why people go to breweries. We ask people every year on our survey, “why do you visit breweries?” *Experience is things that happen there that are a little different than just going and drinking.* We’ve seen this

societally. There's been a shift in the last few years, where people don't go to drink – they go to do something, and drink while they're doing something. I've shown a slide in other presentations I've been doing of this new concept – the flight bar. It's a fancy darts club. And I point out that there have been darts in bars as long as there have been bars, basically. So, this isn't new in one sense, but in another sense it is flipping this around. Darts used to be something you do to distract yourself in between your beers, and now it's something you go to do so you can drink beer. Breweries have benefitted incredibly from this – they have a different experience. You learn something. When we go through the list of reasons people visit breweries education, the ability to sample, and quality often show up at the top of the list. So, having educated staff is certainly an important part of that. Being able to tell people about the process and educate them about why your story is different is [also] part of that. I would wrap this all up into a bigger thing. You need to provide an experience for people, and that only gets more important as there are more places to go and there are more breweries out there. You need to differentiate more and more.

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Q: Any stats on how much guests are spending per brewery visit?

A: We have estimations of that – I don't know them off the top of my head. We have a total visitor number and a total retail number, but I don't know those numbers off the top of my head.

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Q: Once we return to "normal," will higher or lower end brands make up a larger percentage of sales than before?

A: That's a good question that I don't have a great answer to. I think we're about to enter a recession – it's increasingly likely that no level of fiscal stimulus and government action, at this point, is going to forestall what is going to be a recession. Whether it's short, long, deep, light, I don't really know. Predicting recessions is very hard. I think we will see some consumers who trade down during that. And so, some lower end brands gain some share. In general, we have still seen premiumization be a primary driver of growth within beer. This is true outside of craft as well. The segments of beer that are growing are very heavily the high-end ones. So premiumization has continued. And stats throughout the different buying that has gone during the last four weeks has shown that premium brands have continued to grow faster, even during this period. So, people are returning to their classic favorites, but they're still buying more of those in the premium segments of the beer market. What I'm setting up is that I think we see contradictory trends here. I think premiumization is still going to be a powerful force, but the economic realities of the next few years may stall that a little bit – and may drive people down market. I think in general we were moving to a place where craft was going to shift and was maybe going to bifurcate a little bit. And that we would see probably high end and more mass craft and that the middle space was going to be a bit tougher to go to. I'm a big believer that

demographics are destiny, and we're going to see an aging population over the next decade. So, the U.S. is going to have about the same number of 21-34 year-olds in a decade as it does now. But it's going to have a lot more 35-44-year-olds. Millennials aren't kids anymore – they're up to their late 30s. So, they're going to all be in their mid-30s to late-40s a decade from now. I think that's generally going to continue to drive premiumization within all parts of beverage alcohol.

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Q: Do you have any stats on 4-packs?

A: Yes. I don't know any of them off the top of my head, but 4-packs (primarily it's 4-packs of 16oz) have continued to grow. I'll say over the last four weeks they have not grown as much. Generally, the growth has been of larger pack sizes within craft. 12-packs have been the main beneficiary of shifts over the last four weeks, as people look to stock up a little bit more. That's mainly come out of 6-packs, which is the dominant pack within craft. If you're a BA member, send me an email and I can pull you some scan-data.

- <https://www.brewersassociation.org/insights/2019-craft-beer-packaging-trends-recap/>

Q: In general, what does the data look like if we include non-BA defined craft in this analysis?

A: I think you would see slightly higher shares. I haven't done the final numbers yet, but my guess is we're going to be at [updated] 8 million barrels of acquired craft at this point between all the various acquired craft. The growth rates of both acquired craft and fuller flavored brands built by the big brewers are similar to craft, if not slightly lower, because they tend to do better off-premise and off-premise has been slower. Generally, you would see a slightly bigger fuller-flavored category. You would see a little bit higher market-share for fuller flavored beer in general. Though, not drastically, depending on how you cut it and what you include. For instance, Beer Marketers Insight has a number that's a little bit higher than ours. It's not that much [higher], because they take out some things that we included in our small and independent brewer definition. And it would be a little bit lower price point, because those brands tend to be lower [priced]...and even more IPA-heavy. So, when you get to the styles, the acquired brands have leaned in very heavily on IPA. There's also, because of ShockTop and Blue Moon, a lot of Belgian Wit in there that doesn't end up in BA craft. But it would be even more IPA-heavy than you see in just the BA-defined craft.

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Q: What can small brewers do to survive through COVID-19? Some small breweries can't sustain long enough! Any suggestions or guidance will be appreciated.

A: This is a place I wish I could give better guidance. There are not a lot of easy business answers for a world in which your revenues have been slashed and your costs continue. We've provided a tremendous number of resources on this, and a lot of them boil down to:

- Protect your cash as much as you can
- Cut costs where you can.
- Anything you do not immediately need – try to save.
- And be creative in ways to generate revenue. Where your location allows, doing curbside pickup, drive-through, delivery in states where legal.
- Finding new sources of revenue – can you lean into your merch program.
- If you're a brewpub, can you do to-go food?

We're working on some things in government affairs – if there's a phase 4 – to try to directly help small brewers. These are both brewing-specific and as part of small-business coalitions. That hopefully will help, but unfortunately there are not easy answers in a world where on-site hospitality business are by and large shutdown – this is not unique to brewers – and yet your costs continue. We hear you. We're trying to work as hard as we can on this, and best of luck to every brewery out there.

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Q: Is there any regional data (geographic regions) that you found of note (openings, closings, visits, etc.)?

A: I've just started to dig into this. I certainly think you see some of the competitiveness of particular markets coming out. So, the Oregons, Colorados, and Michigans of the world are seeing slower growth than overall. They're seeing fewer openings and higher closings. I think we're starting to see some markets where that mature, maybe saturated, point has come. And that was prior to this [pandemic]. Other than that, we still see some parts of the country that are growing very strongly. Some of the places where at-the-brewery sales are growing more strongly as well. Places like Florida had pretty strong growth in that regard last year. I think we still see some of the variations we've seen in the last few years, where the leading markets are slowing down a bit and some of those laggard markets are catching up.

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Q: Do the numbers presented in your graphs and tables include contract breweries? How many contract breweries operate in the U.S. right now?

A: It would include any contract that was made for small and independent brewers, or any beer that was contracted at a small and independent brewer. Contract companies are at about 300,000 barrels in this data set. It's not huge. How many contract breweries operate in the U.S. right now? I do not know. Partly because its very hard to track. There are certain states where you can see it in the state reporting, but its very difficult to fully know. And, often those contracts are private and not shared. I anecdotally hear a lot more about companies offering these services. You know, regional companies who maybe have excess capacity, or companies who are specifically setup to do this. But I do not have a definitive number of how many companies offer those services right now.

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Q: How would you extrapolate these numbers and statistics to other countries or continents? Do you see the same trends across the world, or do you feel these are very specific to the U.S.?

A: It depends on what statistic and trend. Generally, we have seen an increase in the number of small breweries. The trends in Canada are very similar to the U.S. in terms of breweries per capita. In Europe, it varies by country. You see countries where these work very well as models, and others where they don't. So, there are sometimes trends that are going in different direction. One of my favorite facts right now is that France has more breweries than Germany does, which is kind of insane to say aloud. So, some of these are specific to the U.S. I think some of the general trends toward small, local production have pretty wide applicability. Some of the style trends, we've often seen the U.S. be a leader on, and then they get exported outside the U.S. a few years after. The mileage is really going to vary by country, continent, culture, and regulatory system. So, I would want to comment on a specific country more than looking at this broadly across the globe.

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Q: For the breweries that are able to make it through these uncertain times, what should they be doing right now to best position themselves to be able to capture the newly available market space?

A: Talk to your distributors and talk to your accounts. Have these conversations beforehand. If you're in draught distribution, what are you doing to prep to make sure that any account that needs a fresh keg the second this ends gets one, and you don't lose that tap handle? What are you doing to let those account (or other potential accounts) know that [if] they have a tap handle free, you've got a keg for them? What are you doing with your distributor to make sure that you have a plan to roll back out and get back out into the marketplace as soon as possible? For the on-site – which is going to be important for a lot of brewers – do you have a plan right now? If your governor comes back and says, "we're going to open restaurants and bars back up, but you have to be at a reduced capacity..." Have you written that plan out? Have you figured out what staffing you need? Have you figured out how you're going to still do to-go within this? To me, it would be a lot of scenario planning and being ready to hit the ground running the second these things re-open at various levels. And not being taken by surprise on this, because I think there's going to be a window of opportunity. It's not just those initial weeks, but then will continue after that. The breweries that are best prepared to capitalize the second the world starts to re-open (and I do think it will be gradual), will hopefully have some of the best opportunities.

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Q: Is there a place to access the "Craft Beer Insights Poll" that's noted on Slide 33?

A: It's available to BA members at www.brewersassociation.org. We have tons of data there. If you're not a BA member, I would consider it. We have a free trial going on right now for almost anyone. So, there's no reason not to join!

- <https://www.brewersassociation.org/power-hour/getting-inside-the-mind-of-the-craft-beer-consumer-2019/>

Q: What are your expectations re: COVID-19 "support local" impact on out of market craft?

A: There may be different impacts based on channel. For off-premise, we may see some out of market craft (depending on what you define as out of market) grow as people look for larger packs that they have had before and are confident they will like. At the same time, other consumers may try to pick up local brands, but there are only so many of those that are widely distributed. In general, the early sales numbers for on-premise and at-the-brewery sales suggest that smaller breweries, who are more likely to sell locally, are going to take the greatest hit. So even if there is strong consumer sentiment to support and buy local, the nature of where beer is selling may mean that this doesn't translate into local gaining share.

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Q: Are hard seltzer and non-beer products included in BA production numbers?

A: No.

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Q: Do you anticipate breweries and other operations being open and interested to try out new products and flavoring for said products since business has drastically slowed down?

A: It depends on how you define this. Increasingly, many of the new products that were coming out were going through taprooms and brewpubs. That innovation may slow since breweries don't have an outlet for those sales and consumers may be less willing to buy a growler or a six-pack of a product that haven't already tried. We're already hearing from breweries that the kegs they are sitting on are some of their newer, niche brands. At the same time, breweries are going to need to generate new revenue, so completely new types of products may increase in popularity.