



**Craft Alcohol Producers Industry Review
Executive Summary
Saskatchewan Liquor and Gaming Authority**

November 13, 2015

Prepared by:

**MNP LLP
900, 2010 – 11th Avenue
Regina SK S4P 0J3
Phone: (306) 790-7900**

MNP Contacts:

**Craig Gates, MPA, Practice Leader, Saskatchewan Consulting
Sean Fleming, CPA, CA, Craft Alcohol Specialist
David Cundall, MPA, Manager, Saskatchewan Consulting**

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REPORT LIMITATIONS

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The material in this report reflects MNP’s best judgement in light of the information available at the time of its preparation. MNP has relied upon the completeness and accuracy of all the information, data, advice, opinion or representations obtained from public sources, comparative jurisdictions, and SLGA management. The findings in the report are conditional upon such completeness and accuracy of the Information provided. MNP has not verified independently the completeness and accuracy of the information.

On November 18, 2015, SLGA Minister Don McMorris announced changes regarding the future of liquor retailing in Saskatchewan. The direction includes converting 40 government liquor stores to private stores and adding 12 new private liquor stores in underserved communities. Minister McMorris also announced mark-up and retail policy changes such as implementing a wholesale markup and creating a more level playing field for liquor retailers.

MNP’s review was conducted independent of Government’s review of liquor retailing in Saskatchewan. The scope of our review was to consider craft alcohol in Saskatchewan within the context of the retail, distribution, and mark-up policies that were in place as of May 31, 2015 when the review began. MNP did not have access to SLGA’s proposed changes prior to our report being developed, and as a result, we have not considered what impact the changes may have on our proposed options for the craft alcohol industry.

MNP reserves the right at its discretion to withdraw or make revisions to the report should MNP be made aware of facts existing at the date of the report which were not known to MNP when it prepared the report. The findings are given as of the date hereof and MNP is under no obligation to advise any person of any change or matter brought to its attention after such date which might affect the report’s findings and conclusions.

GLOSSARY

Term	Definition
Commercial Permittee	An individual, partnership or corporation in Saskatchewan that has been issued a commercial liquor permit authorizing them to sell and serve beverage alcohol at an establishment, manufacture beverage alcohol at an establishment or deliver beverage alcohol under the authority of one of the following classes of permits: <ul style="list-style-type: none"> • Restaurant Permit (sell and serve for onsite consumption) • Tavern Permit (sell and serve for onsite consumption) • Special Use Permit (sell and serve or deliver) • UBrew-UVin Permit (manufacture homemade wine, beer, cider and coolers) • Manufacturer Permit (manufacture beer, wine and spirits) • Direct to Consumer Delivery Permit (deliver)
Commercial Producer	A producer with a total production level greater than the craft or regional brewer levels.
Craft Producer	A producer in Saskatchewan with a manufacturer's permit to operate one of the following: micro-brewery, micro-distillery, cottage winery, brew pub.
Direct Impacts	Direct impacts are the economic impacts of an industry that are due to changes to front-end businesses that receive expenses or operating revenue as a direct consequence of an industry. Direct impacts are related to original purchases or "direct sales" from primary suppliers . <ul style="list-style-type: none"> • <i>Example: In the case of beer production, direct impacts are related to the spending that beer producers make when purchasing goods and services from their suppliers, for example, purchasing barley from Saskatchewan farmers. Beer producers' spending also supports a certain number of jobs and generates a share of the personal income of the employees of these primary suppliers.</i>
FTE	Full-time equivalent employee.
GDP	Gross domestic product; the "value added" to the economy (the unduplicated total value of goods and services).
Government Tax Revenue	Government tax revenue is the total amount of tax revenue generated for different levels of government, including municipal, provincial and federal taxes.
Hectolitre	A unit of volume equivalent to 100 litres.
Home Delivery Permittee	A commercial permittee in Saskatchewan who has been issued a special use commercial permit authorizing the permittee to deliver beverage alcohol purchased from an approved source within Saskatchewan to a private place for a fee. Commercial permittees who have been issued a manufacturing permit, also have the authority to deliver their manufactured beverage alcohol to a private place for a fee.

Term	Definition
Indirect Impacts	<p>Indirect impacts are due to changes in the activity of an industry's suppliers. Indirect impacts include the spending that beer producers' suppliers make when purchasing goods and services from their own suppliers (i.e. secondary suppliers) in order to meet the demand generated by beer producers.</p> <ul style="list-style-type: none"> • <i>Example: When beer producers purchase barley from farmers, the farmers in turn purchase inputs such as fertilizers and machinery to meet the beer producers' demand. This spending by farmers reflects the indirect impacts of beer producers' spending on barley. Beer producers' spending also supports a certain number of jobs and generates a share of the personal income of the employees of these secondary suppliers.</i>
Induced Impacts	<p>Induced impacts are due to shifts in spending on goods and services as a consequence of the payroll of the directly and indirectly affected businesses. In the case of beer production, induced impacts reflect the additional spending by the employees of the beer producers, beer producers' suppliers (primary suppliers) and their suppliers' suppliers (secondary suppliers).</p> <ul style="list-style-type: none"> • <i>Example: Additional wages received by the beer producers' employees, farmers' employees and fertilizer and machinery manufacturers' employees "induce" spending. These employees make consumer purchases that are considered "induced impacts".</i>
Output	<p>Output is the total gross value of all business revenue. This is the broadest measure of economic activity.</p>
Regional Brewer	<p>A brewer in Saskatchewan with a production level greater than 5,000 hectolitres, but less than or equal to 200,000 hectolitres.</p>
SLGA Retail Channel	<p>SLGA retail stores and franchises, commercial permittees, off-sales, and private retail stores.</p>
SLGA Retail System	<p>The entire suite of legal retail options for alcohol products in Saskatchewan which includes the SLGA retail channel outlined above as well as the direct to consumer retail options that exist for craft producers (such as farmers markets, sales at the producer's manufacturing facility, etc.).</p>
Special Occasion Permittee	<p>A business, organization or individual in Saskatchewan who has been issued a special occasion permit to sell and/or serve beverage alcohol at a private, invitation only event as well as public events not held in a commercially permitted establishment, an occupied private residence, or another private place.</p>

PROJECT SUMMARY

The craft alcohol market has grown significantly in Saskatchewan in recent years. Craft beer, wine and spirits products are available in stores throughout the province and craft alcohol producers are now operating in both urban and rural centres. SLGA showcases craft products in retail stores, manufacturing facilities are open for tours and producers are becoming visible members of their communities. As a result the general awareness of craft alcohol has increased among Saskatchewan consumers.

Craft producers have grown to become important contributors to their local, regional and provincial economies. They employ local community members, source many inputs locally and pay taxes to the municipal, provincial and federal governments. In many cases, Saskatchewan's craft producers are local entrepreneurs that have combined an appreciation for quality products with artisanal operations in order to grow the craft industry in the province. They provide consumers with additional choice and offer options for locally produced products. This entrepreneurial spirit and consumer focus is a cornerstone of the craft alcohol industry in the province.

It is important to note that government has played a significant role in promoting the growth of Saskatchewan's craft alcohol industry. SLGA has developed a regulatory and policy environment that has supported the growth of craft alcohol in the province. Craft producers have several advantages over national alcohol manufacturers (i.e. national breweries, distilleries and wineries) in terms of how they are able to develop, sell and distribute their products. SLGA charges a reduced mark-up on craft products compared to national products, and SLGA policy allows additional retail and distribution channels for craft producers that are not available to national manufacturers. This suite of advantages comes with a financial and non-financial investment from SLGA and, by extension, to the Government of Saskatchewan as a whole.

Purpose of the Review

The purpose of the review of the Saskatchewan craft alcohol industry was for MNP to provide SLGA with an assessment of the current state of the industry in the province, as well as key options for consideration in order to ensure the industry continues to be vibrant and sustainable in the future. The resulting report contains an economic assessment of the cost to SLGA of supporting the province's craft alcohol producers, and the impact that craft producers have had on Saskatchewan's GDP. As part of the review, a consultation process including one-on-one interviews, focus groups and an online survey was undertaken to solicit views and feedback from a wide variety of key stakeholders including craft and national alcohol manufacturers, industry associations, officials from the Government of Saskatchewan, and other interested groups and associations. Research was also conducted to understand the craft alcohol regulatory and policy environment in selected jurisdictions within Canada, the USA and internationally. The research and consultation process helped to inform the development of the 9 key options contained within the report.

REVIEW APPROACH AND METHODOLOGY

SLGA began the review by directing MNP to conduct a full analysis of SLGA's current policies and contracts that have a direct impact on the craft producer industry in Saskatchewan. Findings and viable options will be provided to SLGA and the Government of Saskatchewan that further contribute to the future success of the industry.

Although the review included both the craft alcohol and regional brewery industry in Saskatchewan, it quickly became apparent that the regional brewery industry had more in common with national producers due to their amount of production and associated economies of scale. The economic impact assessment presented an inaccurate picture of the size of craft brewing in Saskatchewan when the regional brewery industry was included. For that reason, information on the regional brewery industry has been provided separately to the SLGA.

In order to understand the current state of the craft alcohol producer industry in Saskatchewan, MNP conducted both comparative jurisdictional research and stakeholder consultations.

Jurisdictional research conducted by MNP involved a scan of all Canadian provinces in order to understand the state of the craft alcohol industry across the country. Research was then focused on the most established craft alcohol markets in Canada – British Columbia, Alberta, Ontario and Nova Scotia. However, relevant and significant reports and policy positions from all Canadian jurisdictions continued to be taken into consideration during the course of the review. In addition to the Canadian jurisdictions selected, the most mature craft alcohol markets in the United States of America were also chosen for close examination and included Oregon, California and Colorado. One final jurisdiction, Germany, was also chosen in order to provide an example of an established craft alcohol market outside of North America.

MNP supported the jurisdictional research with a consultation process. Through the consultation process, MNP heard from a wide variety of stakeholders including craft alcohol producers, national manufacturers, industry associations, macro-level producers, officials from the Government of Saskatchewan (e.g. Ministry of Agriculture, Ministry of Finance), as well as other interested groups and associations such as the Saskatchewan Hotel and Hospitality Association.

MNP's stakeholder consultation process consisted of the following three phases:

1. **Introductory discussions:** one-on-one discussions were held in Regina and Saskatoon with key stakeholders including producers, industry associations and government representatives.
2. **Focus groups:** MNP held focus groups in Regina and Saskatoon with craft producers. The purpose of these focus groups was to solicit producer feedback on existing policies, contracts and regulations relevant to the craft alcohol
3. **Surveys:** MNP requested that producers and key stakeholders provide written submissions outlining their views on the current state of the industry and potential changes that could be made for the future. Each producer was asked to share comments on policies, retail/warehousing, production levels/tax structures, product pricing and markup, refillable beverage containers, as well as any other relevant topics.

UNDERSTANDING CRAFT IN SASKATCHEWAN

Defining the Craft Industry

SLGA currently defines four types of craft alcohol producers: brew pubs, micro-breweries, micro-distilleries and cottage wineries. Craft producers are only able to produce a limited amount of beverage alcohol per year be considered “craft”. This production limit is measured in hectolitres (hl). One hectolitre is the equivalent to 100 litres.

The table below further defines each category of craft alcohol producer in Saskatchewan.

Craft Alcohol Producer Definitions – Current State		
Craft Producer Category	Definition	Annual Production Limit
Brew pub	A small brewery located in or adjacent to a tavern that produces up to 5,000 hl of beer and other malt-based alcohol beverages.	5,000 hl
Micro-brewery	A small brewery not associated with a tavern that maintains annual production levels between 100 and 5,000 hl of beer and other malt-based alcoholic beverages.	5,000 hl
Micro-distillery	A small distillery that achieves and maintains production levels between 2.5 and 500 hl of finished spirits product annually.	500 hl
Cottage winery	A small winery that achieves and maintains annual production levels between 50 and 450 hl of wine and other beverage alcohol products made from fermented sugar.	450 hl

Existing Unique Advantages for Craft Producers in Saskatchewan

Craft alcohol producers enjoy a number of advantages in Saskatchewan that are not available to national manufacturers. These advantages include reduced SLGA mark-up rates, additional retail and distribution channels, and marketing support within SLGA Stores. A list of supports for craft producers is provided below:

Mark-up Rates

SLGA mark-up rates on craft alcohol vary slightly among the four categories of craft alcohol producer. However, one key policy is the same for all craft alcohol producers: through obtaining a manufacturer’s off-sale endorsement, a craft alcohol producer may resell its manufactured product to commercial liquor permittees, special occasion permittees and the general public. Product sold in this way is subject the lowest mark-up rate; the mark-up rate increases when craft producers sell their products through the SLGA retail channel. By contrast, national alcohol producers are not permitted to sell their product other than through the SLGA retail channel.

To illustrate the mark-up rates applied to craft products in various scenarios, and how these mark-up rates compare with rates applied to national manufacturer products, the following example is provided. In the table below, a Saskatchewan micro-brewery is compared to a national brewery. In this example, both breweries wish to sell 1,000 hectolitres of beer (approximately 100,000 litres or 282,000 cans of beer) in Saskatchewan.

Example 1: SLGA Mark-up Rates for National and Micro-breweries.

National Brewery vs. Micro-brewery – SLGA Mark-up Rates			
Category of Producer	Mark-up Formula		Mark-up Applied
National brewery	If sold in bottles through SLGA	\$1.843/litre	\$184,300
	If sold in cans through SLGA	\$1.843/litre	\$184,300
	If sold in kegs through SLGA	\$1.313/litre	\$131,300
Micro-brewery	If sold directly by the manufacturer (all packaging)	\$17.15/hectolitre	\$17,150
	If sold through SLGA (bottles and cans)	\$0.987/litre	\$98,700
	If sold through SLGA (kegs)	\$0.660/litre	\$66,000

In this example, if the micro-brewery sells all 1,000 hectolitres of product directly to the consumer and the national brewery sells all 1,000 hectolitres of product in the form of cans or bottles through SLGA, the mark-up rate applied by SLGA is \$167,150 lower for the craft producer than for the national manufacturer.

As the table above shows, craft producers have the ability to sell directly to the consumer as well as through the SLGA retail channel (i.e. SLGA stores, private liquor stores, etc.). If the micro-brewery from example 1 chose to sell outside the SLGA retail channel, they have greater flexibility to choose the price their product retails to consumers. The main factor that affects the retail price outside of the SLGA retail channel is the social reference price. The social reference price is a policy that sets a minimum price that various types of alcohol can be sold for in Saskatchewan and is intended to protect vulnerable members of society from having access to low-cost, high-alcohol products. In the case of the micro-brewery above, the social reference price for a 330ml container of beer with less than 6.5 per cent alcohol at retail is \$1.60. In general terms, no product may be sold for less than the social reference price. However, there is one exception for craft alcohol producer as they are able to sell beneath the social reference price when selling products directly to commercial permittees (i.e. bars and restaurants in the province).

If the micro-brewery chose to sell bottles or cans of beer through the SLGA retail channel rather than directly to the consumer, the mark-up rate would be \$0.86 lower per liter than for the national brewery selling its cans or bottles through SLGA. When this is considered in terms of a six pack of beer, the mark-up rate for the micro-brewery's beer would be \$2.10 per six pack, while the mark-up rate for the national brewery's beer would be \$3.93 per six pack.

The previous example demonstrates the impact that mark-up rates have on producers, but it is also helpful to consider what impact mark-up rates have on consumers in SLGA retail stores. The pricing formula that SLGA uses is as follows:

SLGA Pricing Structure	
Step 1	Vendor quote
2.	x exchange rate (if applicable)
3.	= quote in Canadian dollars
4.	+ custom duty amount (if applicable)
5.	+ excise amount
6.	+ standard freight rate
7.	= landed cost per case
8.	/ by number of units per case
9.	= landed cost per unit
10.	+ appropriate SLGA markup
11.	+ high alcohol beer surcharge (if applicable)
12.	+ cost of service (if applicable)
13.	= list price (round up to the nearest cent)
14.	+ environmental surcharge
15.	= base price
16.	+ GST (base price x 5%) (round to the nearest cent)
17.	+ Liquor Consumption Tax (base price x 10%) (round to the nearest cent)
18.	+ refundable deposit
19.	= retail price

Assume that a local micro-brewery in Saskatchewan wanted to sell its 750ml bottle vodka (with an alcohol content of 40% alcohol by volume) within the SLGA retail channel, and sells the vodka to SLGA at a price of \$12.00 per bottle. A consumer who purchases that bottle of vodka within the SLGA retail store would pay \$32.59. The table on the following page provides an overview of how the final price to the consumer of \$32.59 is calculated:

Example 2: SLGA Retail Mark-up for Consumers

Craft Vodka (40%) 750 ML Bottle	Price
Micro-distillery price	\$12.00
+ Freight	\$1.28
= Landed Cost	\$13.28
+ SLGA mark-up amount (113%)	\$15.00
+Environmental surcharge	\$0.07
= Base price	\$28.35
+ GST (5%)	\$1.35
+ Liquor Consumption Tax (10%)	\$2.69
+Refundable Deposit	\$0.20
= Retail Price	\$32.59

Sale of Manufactured Product

Beverage alcohol produced by a permitted manufacturer for sale in Saskatchewan is deemed to be sold to SLGA in accordance with *The Alcohol and Gaming Regulation Act, 1997*, which designates SLGA as the sole legal supplier of beverage alcohol in Saskatchewan. SLGA applies a mark-up to the product and then sells the identical manufactured product to customers, including the original manufacturer. To effect the mandatory sale to SLGA, physical delivery of the product is not required.¹

In terms of product resale after the product has passed through SLGA, craft producers have several advantages over national manufacturers. In Saskatchewan, all alcohol manufacturers are able to resell their products through SLGA's special order process; at SLGA retail stores and franchises; and by export to another province or country, subject to compliance with export licensing and requirements in the destination province or country. However, craft producers may also obtain a manufacturer's off-sale endorsement, allowing them to resell their manufactured products to commercial liquor permittees, special occasion permittees and the general public.

The manufacturer's off-sale endorsement allows sales from the craft manufacturer's retail store (located at or adjacent to the manufacturing site), as well as online sales for shipping within Saskatchewan. For micro-breweries, micro-distilleries and cottage wineries, the off-sale endorsement also allows for sales at farmers' markets.

These advantages are intended to reflect the fact that smaller craft producers do not have the economies of scale that result from regional or national-level production. The following table further outlines SLGA sales policy for craft producers and national manufacturers.

¹ *Commercial Liquor Permittee Policy Manual*, Saskatchewan Liquor and Gaming Authority, effective June 2, 2015.

Sales Policy – National Manufacturer vs. Craft Producer

Producer Category	Sales Options
National	<ul style="list-style-type: none"> • Through SLGA's special order process. • Through SLGA's retail channel (i.e. SLGA retail stores and franchises, commercial permittees, off-sales, and private retail stores). • By export to another province or country.
Craft	<p>All Craft</p> <ul style="list-style-type: none"> • Through SLGA's special order process. • Through SLGA's retail channel (i.e. SLGA retail stores and franchises, commercial permittees, off-sales, and private retail stores). • By export to another province or country. <p>Micro-brewery, micro-distillery, cottage winery</p> <ul style="list-style-type: none"> • By obtaining a manufacturer's off-sale endorsement, a micro-brewery, micro-distillery or cottage winery may resell its manufactured product packaged under its own label in closed containers to commercial liquor permittees, special occasion permittees and the general public: <ul style="list-style-type: none"> ○ From a retail store owned by the manufacturer at or adjacent to the manufacturing site. ○ At a farmers' market with written consent from the farmers' market and the municipality. ○ Through online sales for shipping within Saskatchewan using Canada Post or another common carrier that requires proof of age as a condition of delivery. <p>Brew pub</p> <ul style="list-style-type: none"> • May resell manufactured product in open containers for consumption within the brew pub premises. • By obtaining a manufacturer's off-sale endorsement, a brew pub may resell its manufactured product packaged under its own label in closed containers to commercial liquor permittees, special occasion permittees and the general public: <ul style="list-style-type: none"> ○ From a retail store owned by the manufacturer at or adjacent to the manufacturing site or tavern brew pub. ○ Through online sales for shipping within Saskatchewan using Canada Post or another common carrier that requires proof of age as a condition of delivery.

Distribution of Manufactured Product

Generally, sale and delivery of alcohol products through SLGA is mandatory for national alcohol manufacturers. The single exception allows an agreement to be made between a national brewery and SLGA that permits the brewery to deliver its own product directly throughout SLGA’s retail channel. All other types of national alcohol manufacturer (i.e. distilleries, wineries) must sell and deliver their product through SLGA.

While craft producers may distribute their products through SLGA, they also have additional distribution options available to them through obtaining a manufacturer’s off-sale endorsement. With the endorsement craft producers are eligible to deliver their own products directly to commercial permittees, special occasion permittees and the general public rather than having the products distributed by SLGA.

As with the sales advantages offered to craft producers, these distribution advantages are also intended to reflect the fact that smaller craft producers do not have the economies of scale that result from national level production. SLGA alcohol delivery policy for national manufacturers and craft producers is further outlined in table that follows.

Delivery Policy – National Manufacturer vs. Craft Producer	
Producer Category	Delivery Options
National	<ul style="list-style-type: none"> • National breweries may be eligible to enter into an agreement with SLGA to deliver their own product directly throughout SLGA’s retail channel. • All other manufacturers must sell and deliver their product through SLGA.
Craft	<ul style="list-style-type: none"> • With a manufacturer’s off-sale endorsement, a craft manufacturer is eligible to deliver its own product directly to commercial permittees, special occasion permittees and the general public rather than having the product distributed by SLGA. • Brew pubs that hold a general off-sale endorsement and wish to deliver other manufacturer’s products to the general public for consumption in a private place may do so only under a home delivery special use permit. • Delivery under a manufacturer’s off-sale endorsement may be carried out by any of the following parties: <ul style="list-style-type: none"> ○ An employee of the manufacturer permittee who is not a minor. ○ A courier, Canada Post or another common carrier that requires proof of age as a condition of delivery. ○ A home delivery permittee.

Marketing support within the retail Channel

SLGA offers an in-store marketing program to highlight Saskatchewan’s craft producers within the SLGA retail channel. This program began as “Cheers to Local” in June, 2014 and was focused on creating awareness for Saskatchewan produced products. The program was rebranded to “DrinkSask” and launched on April 23, 2015. The goal of the program is to increase consumer awareness of Saskatchewan craft products and their availability in SLGA retail liquor stores.

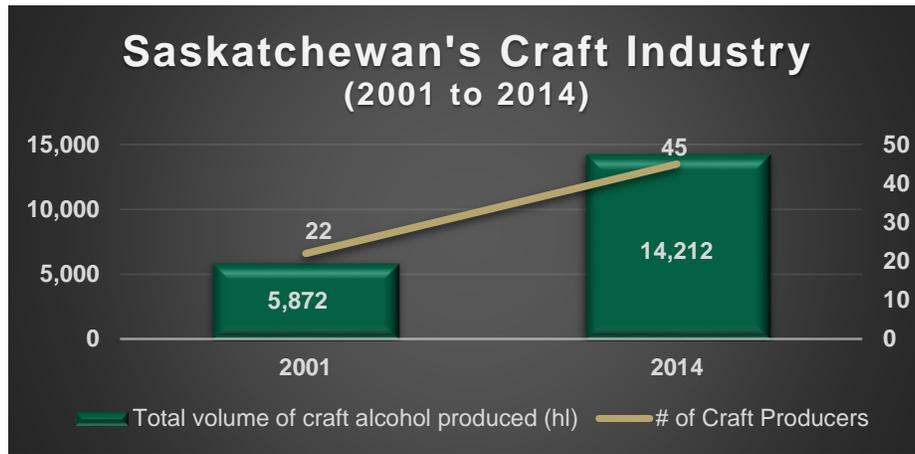
Under the DrinkSask program, SLGA promotes craft products through dedicated shelving displays and other promotional materials in its stores. Currently seventeen SLGA retail stores have craft displays located in

prominent locations. These displays contain a selection of products (i.e., wine, spirits and beer) from local producers. The program also contains additional promotional material to advertise the craft producers on display such as dedicated secondary shelving, door posters, shelf advertisements, and rotating cooler doors.

The following table provides an overview of the DrinkSask presence within retail stores:

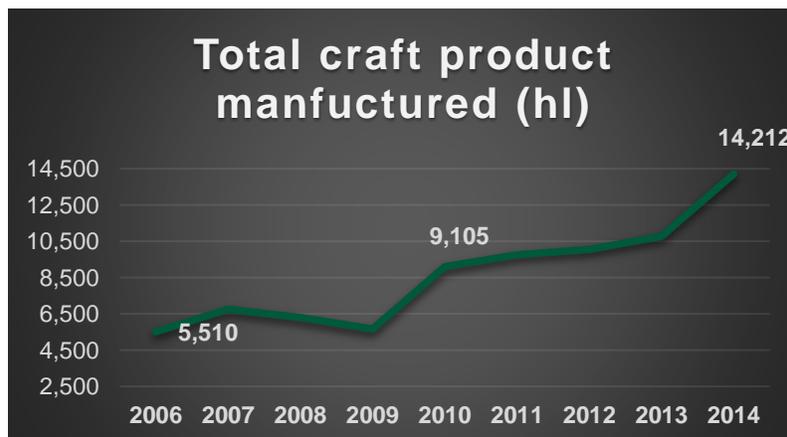
Availability	10 SLGA Signature Stores	17 SLGA Stores (includes 10 store group)	58 SLGA Stores (contains 17 store group)
	45% of SLGA Retail Sales	57% of SLGA Retail Sales	94% of SLGA Retail Sales
Dedicated secondary shelving (6-12 linear feet)	X	X	
DrinkSask shelving signage	X	X	
Hanging Saskatchewan provincial flags	X	X	
DrinkSask door posters at entrances	X	X	X
DrinkSask shelf talkers at regular shelving locations	X	X	X
Producer profile shelf talker	X	X	
Rotating featured producer display	X		
Cooler doors rotating shelving locations	X		

GROWTH IN CRAFT IN SASKATCHEWAN



Between 2001 and 2010, Saskatchewan's craft alcohol industry remained relatively unchanged. There was 1 micro-brewery, 1 cottage winery and approximately 20 to 25 brew pubs in any given year during this timeframe. The total amount of craft product manufactured in Saskatchewan averaged 5,872 hectolitres per year, or approximately 783,000 - 750 millilitre bottles of beverage alcohol.

In 2010, the craft alcohol landscape in the province began to grow rapidly. This was reflected in both the number of producers as well as the total volume of beverage alcohol being produced. This trend would continue throughout the following five years in Saskatchewan. As of 2014/15 there were 30 brew pubs, 4 cottage wineries, 6 micro-breweries and 5 distilleries, and total production had grown to 14,212 hectolitres, representing a 202% increase in production from 2001.



This growth also represented an increased presence of craft geographically across the province. In 2001 craft producers were in six communities across Saskatchewan. By 2010 craft producers had grown to include nine communities in Saskatchewan. This trend would continue as the craft industry expanded rapidly between 2010 and 2015.

Craft Alcohol Producer Locations in Saskatchewan

Craft alcohol producers are currently operating in 19 communities in Saskatchewan from Prince Albert in the north to Estevan in the south.



Craft Communities in Saskatchewan

Battleford	Blain Lake	Corman Park
Dundurn	Estevan	Kindersley
Lumsden	Maple Creek	Moose Jaw
Nokomis	Purdue	Prince Albert
Regina	Rudy	Saskatoon
St. Louis	Swift Current	Unity
Yorkton		

The notable growth of the craft alcohol industry in recent years and its significant presence in the province currently was an important driver in SLGA's desire for a review of the craft industry in order to better understand the current state and to ensure its future sustainability.

KEY FINDINGS OF THE REVIEW

Economic Impact

The operations of Saskatchewan’s craft alcohol producers impact the Saskatchewan economy through expenditures on goods and services (e.g. operating supplies and professional services) and the employment of staff. The total revenues of the Saskatchewan craft alcohol industry in 2014 are estimated to have been \$13.3 million.² Based on that value, the Saskatchewan craft alcohol industry is estimated to have generated the following economic impacts based on the input-output economic model:

Economic Impacts of Saskatchewan’s Craft Alcohol Industry in 2014						
	Output	GDP	Employment (FTEs)	Federal Tax	Provincial Tax	Municipal Tax
Direct	\$13,292,400	\$6,340,300	119	\$743,900	\$604,900	\$45,600
Indirect & Induced	\$6,398,500	\$3,657,700	36	\$369,400	\$377,000	\$130,500
Total	\$19,690,900	\$9,998,000	155	\$1,113,300	\$981,900	\$176,100

Strategic Vision for the Craft Industry

During the review it became apparent that substantial growth in the craft alcohol industry was largely unanticipated by many stakeholders and interested parties, including government. Craft producers were nearly unanimous in identifying a positive change in tone and responsiveness at SLGA during the past several years; producers also described a relationship with SLGA that reflected the challenges of responding to unanticipated growth from a regulatory perspective. This included confusion over existing production, distribution and retail policies from a producer standpoint, and in some cases, it appeared as though policies were being developed in reaction to emerging growth rather than in anticipation of it. This policy development context is indicative of the larger problem facing craft alcohol in Saskatchewan, namely the absence of a strategic vision for the industry.

As the facilitators of this review and the associated consultation process, MNP encountered repeatedly raised questions from stakeholders regarding the intent of the review as well as government’s plans for craft alcohol producers in the province. We heard questions asking whether SLGA wants to raise revenue through craft alcohol, whether this review is intended to make Saskatchewan’s craft producers more viable relative to national producers, and whether or not the review is intended to level the playing field amongst the different categories of craft producers in the province. These are all valid questions, and ones that we in turn presented back to SLGA for consideration during the review. Typically these questions can be considered relative to the vision or strategic plan for the industry; however, there is currently no strategic

² MNP estimated current, historical and projected industry revenues using a combination of survey and production data. For more information on the extrapolation process and related assumptions please refer to the Methodology section of the report.

vision in place for craft alcohol in Saskatchewan. This is largely the result of the significant and unanticipated growth in the industry that began in 2010.

A strategic direction should serve as the benchmark for measuring the efficiency and effectiveness of policies, as it will help to ensure that intended outcomes are being delivered. This is particularly true when developing policies in response to a rapidly growing industry such as craft alcohol in Saskatchewan. Without a strategic plan for craft alcohol, it is difficult to assess how appropriate the current policies are, and their likelihood to produce the intended results for the craft industry.

MNP approached SLGA about the strategic vision for craft alcohol in Saskatchewan, which led to several discussions about a potential vision for the industry. These discussions, coupled with the completed research on craft alcohol industries in other jurisdictions, have helped MNP to develop a several key statements about how the industry could look in 2020. We have provided the key statements below:

Proposed Strategic Vision for Craft Alcohol In Saskatchewan

- Saskatchewan has a strong, vibrant craft alcohol industry which allows consumers to enjoy local products.
- Product quality is highly regarded overall for the sector.
- Craft alcohol products produced in Saskatchewan are accessible to residents in the province based on market demand.
- Some established and emerging producers seek opportunities to export their product out of province and contribute to the *Saskatchewan Plan for Growth*.
- Craft producers serve as assets to their local economies for growth and, in some cases, as tourism destinations.
- There is a culture in the industry focused on the needs of the customer and on effective management practices that contribute to a self-sustainable industry with self-sustainable producers.

Options to Achieve the Strategic Vision

There are several actions that SLGA can take in order to fulfill the strategic vision for the industry outlined above. These actions have been considered in the context of the changes required to ensure that craft producers in Saskatchewan have a leading policy environment in Canada to enable producers to establish and grow vibrant and self-sustainable businesses. SLGA has the opportunity to contribute to a strong, robust craft industry that continues to be a contributor to the provincial economy as well as to regional economies throughout the province.

As SLGA looks to these options, it will need to consider how to achieve an appropriate balance between supporting Saskatchewan's craft producers and national producers that sell products in Saskatchewan, while minimizing negative impacts to provincial revenue. Saskatchewan's craft producers are local producers that play an important role within their communities, regions, and the province as a whole. As shown above, the economic contribution that the craft alcohol industry makes each year to the provincial GDP is significant, and will continue to grow as the craft industry. However it should also be noted that the sale of craft alcohol products represents a loss of mark-up revenue to SLGA. Each bottle of craft wine, spirits, or beer represents foregone revenue for SLGA (i.e. potential lost sale of a national producer which

is subject to a higher mark-up rate). Appendix A provides an overview of foregone revenue in Saskatchewan. SLGA will need to balance the foregone revenue against the strategic vision for Saskatchewan's craft alcohol industry, and the economic impact it will have in the province.

The options have been separated into three categories: production, retail and distribution. Each option has been listed and is described in greater detail below.

Options for Craft Alcohol In Saskatchewan	
Production	<ol style="list-style-type: none">1. Eliminate retroactive mark-up for producers2. Restructure the current craft alcohol production and mark-up system
Retail	<ol style="list-style-type: none">3. Deliver craft education for SLGA employees4. Expand growler sales within the SLGA retail channel5. Create a regulatory environment that supports craft cider producers in Saskatchewan6. Simplify the permitting process for craft producers in Saskatchewan7. Promote the availability of single-serve SKUs for craft products8. Allow producers to charge for product samples year-round
Distribution	<ol style="list-style-type: none">9. Allow for third-party private warehousing and distribution for craft producers

Production options

1. Eliminate retroactive mark-up for producers

Summary

- Producers that exceed their production limit are subject to an increased mark-up charged on all units produced rather than just the additional units produced beyond the production limit.
- This policy creates an artificial disincentive to producer growth, as their growth will negatively impact profitability.
- Several producers indicated that the cost associated with the retroactive mark-up would force them to lay-off staff, and that they would rather scale back production levels. As an example, the estimated cost for a micro-brewery that exceeds their production limit is \$428,000.

Impact: Increased growth and sustainability for producers

- Producers would be able to continue producing past the production threshold and would only pay increased mark-up on each unit produced beyond the production limit.
- Producers no longer have an artificial barrier to growth and are supported in growing their production levels and their business.

2. Restructure the current craft alcohol production and mark-up system

Summary

- Throughout the review, craft producers consistently expressed their view that SLGA's production and mark-up regime should be structured to ensure transparency and promote administrative ease for producers and SLGA.
- Under the current system, producers are charged a single mark-up from their first hectolitre produced all the way until the point that they reach the production maximum, depending on several factors such as whether it was sold on the manufacturer's premises or in the SLGA retail channel, and what container it was sold in (e.g. bottles and cans, or kegs). The amount of mark-up charged and the amount of product that craft producers are able to manufacture varies depending on whether the producer is a micro-brewery, distillery, cottage winery or a brewpub, however all producers are charged a flat mark-up from their first hectolitre until they reach the production maximum.
- Producers have argued that the current system is opaque and that they are not aware of what happens when they reach and exceed their production maximum (e.g. what the mark-up rate will be, whether or not it's tiered, etc.)
- The current system places an administrative burden on both producers and the SLGA relative to neighboring jurisdictions. The mark-up structure in Saskatchewan differentiates between whether a product was sold in the SLGA retail channel or directly by the manufacturer and triggers a different mark-up rate accordingly. For products sold in the SLGA retail channel, the mark-up structure also considers what format the product was sold in and triggers a different mark-up rate for beer sold in cans and bottles than for beer sold in kegs.
- We have developed a proposed framework for SLGA's mark-up system based on progressive elements from neighboring jurisdictions that have the greatest suitability for Saskatchewan, and that are most likely to position Saskatchewan's craft alcohol producers in achieving the strategic vision outlined above. The framework includes the following items:

- 1. No retroactive mark-up**
- 2. Graduated production and mark-up for craft producers**
- 3. Detailed production tiers for microbreweries**
- 4. Compliance with trade agreements**

Impact: Saskatchewan's craft producers contribute to a robust, sustainable craft alcohol industry.

- The current barrier to growth caused by the retroactive mark-up policy would be eliminated.
- The graduated mark-up system with a series of production and mark-up tiers allows producers to understand exactly what the mark-up rate will be for each stage of increased production. This supports the ability of craft producers to develop long-term business plans and to accurately plan for growth.
- Microbreweries will have an in-depth understanding of what the mark-up rate will be as they grow from start-up to a more established producer with higher production levels. The level of detail reflects the fact that beer is a low-alcohol product with high production levels, and that additional production and mark-up tiers relative to other producers are necessary.
- Saskatchewan's mark-up system will contribute to the development and establishment of craft producers in the province ensuring that SLGA complies with relevant trade agreements such as the New West Partnership and the Agreement on Internal Trade.

Retail Options

3. Deliver craft education for SLGA employees

Summary

- Craft alcohol is a rapidly growing industry and producers are continually developing innovative products ranging from fruit wines to infused spirits and beers.
- SLGA has implemented marketing programs designed to profile Saskatchewan's craft producers and products, but customers are required to research products on their own in order to understand which might be most appealing to them.
- SLGA should support its in-store marketing programs for craft alcohol by ensuring that staff are educated on the current state of craft products as well emerging products and trends.

Impact: Improved retail experience and expanded market reach

- This will improve the craft shopping experience for SLGA customers and provide customers the potential to make more informed decisions to initially try and then expand their enjoyment of craft products.
- More educated SLGA staff will assist customers in understanding the suite of craft products available and to make informed choices about products.

4. Expand growler sales within the SLGA retail channel

Summary

- Manufacturers with off-sale endorsements (i.e. brew pubs, micro-breweries, micro-distilleries and cottage wineries) can package product manufactured on the premises in containers provided by the customer. These refillable containers are seen most commonly among micro-brewers where they are referred to as growlers.

- Currently growlers can be filled at the producer's facility, in tasting rooms and at farmers' markets. There is a desire among producers and other stakeholders to expand the availability of growlers.
- SLGA should create a regulatory environment that enables businesses within the SLGA retail channel to make decisions regarding the expansion of growlers that fits their business model and that meets the needs of their customers. SLGA could consider following this by exploring the feasibility of expanding growler-fill stations more broadly beyond the SLGA retail channel.

Impact: Enhanced craft businesses and options for customers

- SLGA retail stores that are interested can implement growler-fill stations that will provide beer directly from the keg for customers on behalf of craft producers.
- Customers will have increased access to craft products.

5. Create a regulatory environment that supports craft cider producers in Saskatchewan

Summary

- There are currently eight cottage wineries in Saskatchewan that are licenced to produce cider, however only one of the eight is currently doing so. Producers have reported that there are several barriers in the current regulatory environment that makes cider products challenging to produce. Examples of these challenges consist of mark-up classification and production levels.
- Cottage wineries have a production limit of 450hl which includes both wine and cider products, however the profit margins are significantly different between cider and wine. As a result, the amount of cider that cottage wineries would have to produce in order to turn a profit would result in them being unable to produce wine without exceeding the 450hl production limit.
- SLGA should create a regulatory environment that enables craft producers to make decisions regarding cider production that fits their business model and that meets the needs of their customers.

Impact: Increased feasibility for cider products in Saskatchewan

- SLGA would review the existing regulatory environment for cider in Saskatchewan and consider potential regulatory and/or policy improvements that could be made to increase the feasibility of cider for Saskatchewan's craft producers.
- There will no longer be a regulatory barrier for craft producers that are interested in producing and selling cider in Saskatchewan.

6. Simplify the permitting process for craft producers in Saskatchewan

Summary

- SLGA has simplified the application process the licence application process in an attempt to assist producers in establishing their business and entering the retail market. This was done as part of the government's red tape review which included changes such as extending the permit length from one year to three years, and eliminating regulatory duplication in the application process in regards to fire, health and safety standards.
- The red tape reduction efforts can be enhanced further by simplifying the permitting process for craft producers in Saskatchewan and by providing additional communications and outreach to producers to ensure they are supported throughout the permitting process.

Impact: Increased efficiency for SLGA and craft producers

- SLGA would continue to continuously improve and review the permitting process going forward.
- SLGA would play a more proactive role in educating craft producers on the types of permits and the permit application process and would provide additional supports for producers as they undertake the permit application process.
- Craft producers would experience a simplified permitting process and would be confident in the knowledge that they understanding the permitting process including the requirements, and responsibilities for both craft producers and government.

7. Promote the availability of single-serve SKUs for craft products

Summary

- Micro-breweries sell their canned and bottled beer as a package (typically in packages of 4,6,12, etc.).
- Consumers may be reluctant to try new craft products as they are unsure of what the taste profile is for certain beer types and styles that are new to them.
- Craft producers were generally unaware of their ability to sell products in single serve SKUs within the SLGA retail channel.

Impact: Increases craft awareness and accessibility for retail customers

- Consumers would have the convenience of purchasing individual bottles of beer at SLGA retail stores.
- This will allow customers in order to sample a variety of new craft products and determine which they prefer without committing to purchasing a case of product.

8. Allow producers to charge for product samples year-round

Summary

- Craft producers are able to currently able to charge for samples in certain instances. In the first instance, a producer can obtain a sale permit from SLGA which allows them to hold up to six sale events per year and charge for samples. In the second instance, producers choose to operate at farmers' markets that hold a sale permit, in which case they can charge for samples up to 25 times per year.
- The costs associated with providing free samples outside of these two instances above can be prohibitive for producers, and customers are prohibited from paying for samples even if they would have preferred to reimburse the producer.

Impact: Product sampling for consumers in a manner that is affordable for producers.

- Producers will have to option to offer product sampling to consumers and to recoup a portion of the costs via a small fee.
- Consumers will have increased ability to sample products at a producer's facility and at farmers' markets across the province. Product sampling provides a low risk opportunity for consumer's to explore alternative craft alcohol options.

Distribution Options

9. Allow for third-party private warehousing and distribution for craft producers

This option is intended to provide additional choices for craft producers when considering how to introduce their products to the market. It reflects the fact the craft producers have small production volumes and require additional flexibility in their distribution channel. This option is not a judgement on SLGA's central warehousing or the relative merits of centralized vs private warehousing. It is intended only to provide a more-level playing field for craft producers relative to larger producers.

Summary

- Under the current model, craft producers have the ability to self-distribute their product to the consumer. This can be through a variety of means depending on who is purchasing the craft product. For example, craft producers can self-distribute directly to commercial permittees (i.e. bars and restaurants) and can also deliver directly to private residences with the proper permit. This ability to self-distribute ends however once a craft producer chooses to list their product within the SLGA retail channel. As a result, craft producers must currently weigh the benefits of listing their product within the SLGA retail channel (e.g. availability within stores, better access to consumers, etc.) against losing the ability to deliver directly to consumers. They are also directly responsible for the increased logistical challenges associated with wider distribution.
- This option consists of distribution policies that allow craft producers to decide how best to distribute their products. This would allow craft producers to list their product at the SLGA, while still being able to self-distribute. This eliminates the

need to make a choice between the two distribution models and removes a potential barrier to growth.

- Distribution costs are a key aspect of a craft producers overall profitability. Private third party distribution allows craft producers to reallocate resources and focus on other areas within their business such as marketing and product development.
- Third party distributors focus solely on product distribution. They have the advantage of economies of scale and can focus on moving product more efficiently and effectively than an individual craft producer. They have their own fleet of trucks, own distribution centre, they own all the necessary infrastructure. Craft producers pay for the service rather than all the associated costs of distributing it themselves.
- Third-party private warehousing and distribution has been established in several North American jurisdictions. In California and Colorado, alcohol manufacturers are allowed to deliver alcoholic beverages directly to retail outlets. In Oregon, wine self-distribution permit holders may sell and ship wine and cider directly to retail licensees of the OLCC.
- Jurisdictions such as Oregon (wine, cider and malt beverages only), British Columbia, Alberta and Ontario allow the operation of alcohol delivery services, which deliver alcohol directly to residents. While these services in Oregon, Alberta and Ontario require approval or licensing, no special license is required in British Columbia in order to operate a liquor delivery service, although there are regulations controlling the delivery of liquor which must be followed. In addition, British Columbia flower shops and gift basket or hamper businesses may offer the option to add liquor to their products for delivery.

Impact: Craft producers have the flexibility to choose the distribution model that ships product most efficiently and effectively and is sustainable for their business.

- Third party warehousing and distribution offers another avenue for profit and consumer reach for manufacturers. They can also assist in protecting an establishment from liability issues through having a proper invoice system and employee oversight.
- Craft producers would have assistance in managing stock. Third-party warehousing and distribution allows for increased ability to track freshness and quality as well as ability to recall product.
- There is the potential for a financial impact to SLGA due to decreased volume at the central warehouse. However, the decreased volume to the distribution centre may be offset by increases listing within SLGA's retail channel and additional volume of product sold independently by craft producers.
- It should also be noted that the current mark-up structure was developed with the understanding that craft producers who choose to list their product through SLGA's retail channel have access to additional supports (such as exposure to a broad client base that accesses the 75 SLGA liquor stores) that they would not otherwise have if they sold directly to consumers, and are charged a higher mark-up accordingly. In the event of changes to the distribution policies, SLGA may need to revisit the mark-up rate in order to ensure a level playing field for all craft producers.

APPENDIX A

The Impact of Craft Mark-up Rates on Revenue

Saskatchewan Craft: Market Displacement & Foregone Revenue (using current mark-up for all craft products)												
Craft Market Share	Total Revenue (\$000's)				Foregone Revenue (\$000's)				Total Volume (000's of L)			
	100%	75%	50%	25%	100%	75%	50%	25%	100%	75%	50%	25%
0%	\$440,078	\$440,078	\$440,078	\$440,078	\$0.00	\$0.00	\$0.00	\$0.00	90,043	90,043	90,043	90,043
Current (1.6%)	\$435,257				\$4,822				90,043			
5%	\$424,804	\$430,305	\$435,806	\$438,556	\$15,275	\$9,774	\$4,273	\$1,522	90,043	91,169	92,294	92,857
10%	\$409,529	\$420,531	\$431,533	\$437,034	\$30,549	\$19,547	\$8,545	\$3,044	90,043	92,294	94,545	95,671
15%	\$394,254	\$410,757	\$427,260	\$435,512	\$45,824	\$29,321	\$12,818	\$4,567	90,043	93,420	96,796	98,485
20%	\$378,980	\$400,984	\$422,988	\$433,990	\$61,099	\$39,095	\$17,091	\$6,089	90,043	94,545	99,047	101,298

Example 1: Assuming craft products were to grow from the current 1.6% market share to a 5% market share and the average displacement rate was 100%:

- SLGA total revenue from alcohol sales would be \$424.8 million and the foregone revenue from the difference in markup would be \$15.3 million.

Example 2: Assuming craft products were to grow from the current 1.6% market share to a 10% market share and the average displacement rate was 75%:

- SLGA total revenue from alcohol sales would be \$420.5million and the foregone revenue from the difference in markup would be \$19.5million.



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