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Canadian Industry Report

BREWERIES

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In addition to content provided by Welch LLP, the information contained in this report has been sourced from IBISWorld Inc - IBISWorld Industry Report 31212CA.

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In this report you will find information on the current state, trends and future growth of your industry to help gain a better understanding of the Brewery industry in Canada. The information within this document has been sourced by IBISWorld 2016.

You will also find information provided by Welch LLP on financial considerations for growing your brewery: raising capital, corporate tax, tax credits and more.

Key **Statistics**

W Due to changing preferences, consumers have shifted away from traditional light and premium beer brands. This is good news story for local and craft breweries.

246 # of Businesses	**$5.7B** Total Revenue
1.3% Annual Growth 2011-16	**$220M** Exports
0.4% Annual Growth 2016-21	**$533M** Total Profits

Industry **Overview**

Current Performance

Over the past five years, the Brewery industry benefited from substantial growth in the popularity of craft beer. This resulted in revenue and enterprise growth from a range of new small-scale breweries. This growth has now stabilized. Consumers are increasingly electing to buy less beer in exchange for higher-quality brands.

Per capita alcohol consumption has shown steady signs of decline

Due to the economies of scale that come with major brewing operations across the country, the industry's largest players hold tremendous market share despite concerns that the popularity of standard premium beer is waning.

Uncertain Input Prices Continued

Due to both the fickle nature of consumers' drinking patterns and the significant price volatility of the industry's key inputs, profit is prone to sudden fluctuations. Since grains such as barley, rye, and wheat (declined by an annualized rate of 9.3% from 2011-16) are significant expenses, increases in the cost will severely erode profit margins. The world price of aluminum (declined by an annualized rate of 8.8% from 2011-16) also poses a threat to breweries that package their products in aluminum cans.

Industry Structure

Life Cycle Stage	*Mature*
Revenue Volatility	*Medium*
Capital Intensity	*High*
Industry Assistance	*Low*
Concentration Level	*Medium*
Regulation Level	*Heavy*
Technology Change	*Low*
Barriers to Entry	*High*
Industry Globalization	*High*
Competition Level	*High*

Industry Outlook

Although the consumer shift toward craft beer has greatly benefited the industry's smaller producers, this has come at the expense of the premium beer brands that generate the majority of the industry's revenue.

Consumers are less likely to purchase craft beer in large quantities, unlike premium beer brands that are comparably more affordable and purchased in higher quantities. Beer is increasingly perceived as less healthy than wine, and substitution has slowed sales even as consumers have demonstrated significant interest in craft beer. Consequently, revenue is expected to grow at a minimal annualized rate of 0.4% over the next five years to $5.8 billion in 2021.

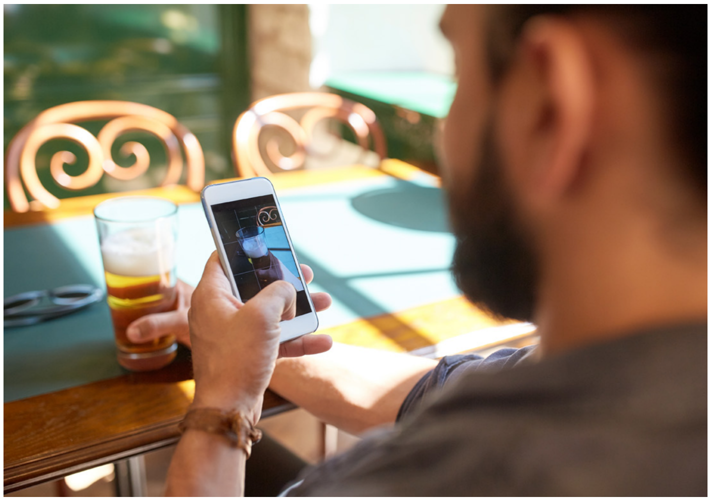
The industry's largest companies are consolidating to achieve greater market share

With input prices stabilizing and the industry's largest companies slowing their merger and acquisition activity, the industry is not expected to undergo a structural overhaul as it has in previous years.

The world price of aluminum is projected to increase over the next five years, but at a manageable 2.1% annualized rate.

The number of industry enterprises is estimated to increase at an annualized 2% to 272, while total industry employment will grow an annualized 0.7% rate to 9,215 workers by 2021.

The brewing process has experienced little technological change.



Products & **Markets**

Major Markets Segmentation 2016

	ages 19-34	ages 35-44	ages 45-64	ages 65+
MEN	31%	14%	24%	3%
WOMEN	15%	4%	8%	1%

Product Segmentation 2016

Canned Beer	Bottled Beer	Draught Beer
56%	34%	10%

Top Canadian Brewery Business Locations (%)

Ontario	British Columbia	Quebec	Atlantic Canada	Alberta	Manitoba + Saskatchewan
34%	27%	22%	9%	5%	2%

Profit/Cost **Structure**

W | *Competition in this industry is high and the trend is increasing.*

Marketing costs have escalated to an estimated 5.2% of revenue in 2016, due to rising advertising spending by the industry's largest companies. Brewers are competing against not only new industry entrants but also against an increasing number of wine, distilled spirit, and soft drink manufacturers. Other costs such as rent, utilities, taxes, fees, administrative expenses, and government licensing have been stable and will continue to represent a significant component of expenses.

9.4% Profit

Industry Costs

9%	40%	7%	5%	30%
Wages	Purchases	Rent & Utilities	Marketing	Other

Bottling Success
The Fundamentals of Brewing Your Business

You have reached the point where your beer finally tastes good, sales are ramping up, and you are starting to hit the limits of your production capacity. It is hard to argue that business growth is a bad thing, but if growth is not managed properly within the financial and operational capacity of the business, it can pose undue pressure on the business owner to continue to operate successfully.

Take your business to the next level by familiarizing yourself with the pros and cons of financing options for your brewery, corporate tax structuring, and tax credits you may be eligible for.

Raising Capital

Most start-up ventures almost always initially rely on personal savings or investment from friends and family, but as the business starts to grow, create value and, perhaps most importantly, begins to generate cash flow, the number of available financing options expands as well. Of course, the pros and cons that relate to each available option should be evaluated with care. While non-exhaustive, the list below should give you a sense of the various combinable financing methods available to your business.

Angel Funding

Before you have the ability to obtain a major funding round, angel investors can provide the capital and even some operational expertise to help grow your company. Angels are largely relying on the company increasing in value over time to generate a return and therefore do not generally expect structured re-payments.

However, most angels will likely want an equity component of your business and can often try to put additional pressure on management to produce returns.

Crowd Funding

Recent developments in the crowd funding model now allow for equity crowd funding – meaning that instead of receiving a traditional funding perk like a pre-sale access or a free t-shirt, you can now own a portion of the business. This becomes a true advantage when it comes to attracting investors. Where bringing angel investors on board could be a time-consuming process, crowdfunding platforms streamline the process by allowing companies to post their pitch in one spot where it can be viewed by a broad range of investors.
Be wary of the potential fees that the platform charges and also consider the potential implication of having a number of new shareholders (whether they have voting rights or not).

Federal Government Tax credits, Grants & Bursaries

One of the most overlooked resources offered by the Federal Government is the Concierge Program. Concierge is a single access point to funding, expertise, facilities, and global opportunities for small-businesses. While not all businesses will qualify for funding, you will have a dedicated consultant to help you navigate all of the government programs to figure that out. Most importantly, it is absolutely free!

Business Incubators

Often only associated with tech-focused start-up businesses, there are plenty of local economic development incubators that offer a number of services such as funding programs, consulting, and HR. These resources are offered to a wide range of businesses and are often available for a small membership fee.

Family & Friends

You have undoubtedly heard it said to never to do business with friends and family, but in a lot of cases they may prove to be your best access to capital. The interest rate and repayment options will likely be flexible and they might be willing to accept more modest returns than a typical angel investor.

Or course, the last thing anyone wants is to end up entangled in a heated lawsuit with a family member, but such unfortunate situations are certainly not unheard of when mixing business with family. Ensure that expectations are clear and formally documented from the start, and clarify that investment in your business does not equal decision making capacity.

Bank Loans

A traditional bank loan will generally be assessed based on a mix between the value of the underlying assets of the business, the amount of existing leverage, and the cash flow available to service the debt. Primary advantages are that the interest is tax deductible and there is no loss of equity.

One of the paramount disadvantages to bank loans is that they are very difficult to obtain unless a business has a successful track record or hard assets to serve as collateral. Further, banks are inherently risk averse meaning that in the event of default every attempt will be made to recover any lost funds including going after personal assets.

Equity

Equity financing is attractive because it does not demand repayments, but unfortunately it often represents the most expensive form of financing because you are giving up ownership of the business, the impact of which increases as the business grows in value. Equity funding can be particularly relevant if the business does not initially generate a profit and has no ability to pay off debt.

Structuring for Growth - Corporate Tax Considerations

It is never too early to start thinking about the appropriate corporate structure to facilitate growth for your brewery, plan for a possible exit strategy, or to pass the business on to the next generation.

One of the most important first steps is to ensure your corporation has the appropriate share classes authorized for issue. If it does not, then you should consider amending your business's articles of incorporation to allow for the appropriate types of shares to facilitate a tax planning transaction. If you are starting a new corporation then consider consulting with your lawyer and accountant to ensure the right types of shares are included in your original articles of incorporation.

Consider the most common corporate structures that facilitate growth and tax planning:

- Creating a holding company to hold the shares in your business is one option to keep in mind as your business grows and accumulates wealth. It is always a good idea to move some of your brewery's wealth outside of the company walls and into a separately owned holding company. This way, wealth can be accumulated in the separate holding company which ensures your operating company remains clean and creditor proofed.

- Creating a family trust to hold the shares in your business is an attractive option if you are beginning to consider family succession. With this in mind, this corporate structure may not be useful if an exit strategy is not something you are considering for the near future. Income splitting through different beneficiaries of the trust makes it easy to pass ownership on to the next generation. Another benefit of creating a family trust is the potential to multiply the capital gains exemption on the sale of qualifying company shares. Finally, similar to creating a holding company, through the creation of a family trust, you can also achieve a clean operating company that is creditor proofed.

When Audits/Reviews/Notice to Readers are required

It is not uncommon for a shareholder to impose an audit or review requirement for their business. Audits and reviews provide a level of assurance over the financial statements which can be relied upon by a shareholder when making decisions about their business.

Audits are a comprehensive inspection of an organization's books of account. The objective of an audit is for the auditor to obtain reasonable assurance that the financial statements are free from material misstatement. Examples of procedures that an auditor performs can include inspection of documents, inquiry and discussion with management, external confirmation, observations, and analysis.

Review engagement requirements are typically imposed by third parties; for example a lender may require a review engagement as opposed to an audit. Reviews are typically less costly than an audits, and are completed with the aim to conclude that an organization's financial statements are plausible or worthy of belief. The financial statements are also prepared during the review using an appropriate accounting framework. During the review, an accountant will perform inquiry, discussion with management, and analysis.

A notice to reader is the least expensive of the three options. During a notice to reader, the accountant does not provide any assurance that the financial statements are free of material misstatement. Instead, the accountant arranges the information provided by the company into a financial statement. Readers are cautioned that the financial statements may not be appropriate for their purposes.

Record Keeping

Keeping clean records is the key to executing a successful audit, review, or notice to reader engagement that is on time and on budget. Failure to have the appropriate record keeping and bookkeeping processes in place will result in a stressful year end close. To avoid the latter, consider hiring an experienced bookkeeper to help you with these needs which will allow you to focus on what you do best - running your business.

A good bookkeeper should be diligent with invoicing, entering bills, tracking inventory, and reconciling bank and credit cards on a regular basis. If your business is becoming very large, you should consider investing in additional bookkeeping assistance by way of a controller as well as a contract or full-time Chief Financial Officer to help oversee the financial accounting team at your business.

Tracking inventory in a brewery can be a complicated process. There are a lot of moving parts, raw materials, stages of production etc. that need to be considered. On a yearly basis, or more often if you can, count your inventory to ensure your financial statements reflect an accurate value for your inventory held. If you are required to provide audited or reviewed financial statements an inventory count is required. There are software options in the industry for tracking inventory specifically for breweries. The software should integrate with your existing accounting software package.

SR&ED Activities in the Brewing Industry

One of the best known tax credits offered in Canada comes from the Scientific Research and Experimental Development (SR&ED) program. The SR&ED program is an incentive program offered by both federal and provincial governments that provides refundable tax credits to companies engaged in scientific research and experimental development (activities that are the foundation of any brewery). A brewery may be eligible to claim refundable tax credits, above and beyond their regular deductions. For qualified projects, the refundable tax credits can be as high as 65% for eligible salaries and 43% for other eligible costs, including contractor fees, materials and overhead.

The unique perpetuity of evolution inherent in the nature of craft breweries makes them a perfect fit for SR&ED credit. With micro adjustments in recipes, the pioneering of new practices, and the introduction of surprising ingredients, they are the epitome of innovation in everything that they do. The SR&ED program was developed for businesses exactly like this. The spectrum of SR&ED eligible activities is vast, including, but not limited to:

- Developing innovative beer styles using local or atypical ingredients
- Enhancing stability parameters (i.e. the impact of barrel aging, filtration, bottling, kegging)
- Experimenting with yeast cultures
- Reducing environmental impact through modified processes

The SR&ED program is open to Canadian breweries performing qualifying activities in Canada.

Industry Report: **Breweries in Canada**

This Canadian Industry Report for Breweries has been brought to you by Welch LLP

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