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Alltech Lexington Brewing and Distilling Company

Early September 2015 was an exciting time for Pearse Lyons, serial entrepreneur and founder of Alltech, the Lexington, Kentucky-based animal health company. Having recently completed an acquisition that lifted Alltech global revenues to $1.6 billion,[a] Lyons had just announced a sales target of $100 million for Alltech Lexington Brewing and Distilling Company, the craft brewing and distilling business he founded in 1999. Achieving this target would place Alltech among the top five craft brewers in the United States. Lyons had regularly used ambitious sales goals to motivate employees and allocate capital. Few within Alltech doubted this latest goal would be achieved given his track record of previous success. Lyons had no doubts: multiple beer and whiskey awards, sales of $12 million, and a 45 percent growth rate in 2014 confirmed this view. As he turned out of his drive on his daily 5 am run, Lyons reflected on two major choices: Should he invest in the American market, where the uniqueness of his flagship brand, Kentucky Bourbon Barrel Ale, drove overall brand sales? Or should he focus on international growth, using a mix of Alltech's global sales network and acquisitions? As he ran, he knew making the right decisions on this issue would provide strong direction for the business.

The U.S. Beer Industry

Beer was originally brewed in the U.S. by Native American tribes with Dutch, British and German immigrants later reinforcing beer as the nation's most popular alcoholic beverage. In 2013, 23.4 billion liters of beer were sold in the U.S.,[1] the second largest beer market in the world behind China. Roughly two-thirds of adult Americans consumed alcohol; however, Americans were not indulgent beer drinkers. The average U.S. adult consumed just 77 liters of beer each year, far behind their Czech (148.6 liters) and Irish counterparts (98.3 liters). **(See Exhibit 1)**. American beer drinkers favoured light beers, light in colour and flavour, although not in calories. In recent years drinkers' tastes had changed as imported and craft beers grew in popularity. Premium beers had also grown, partly as a result of higher prices for craft and import and a willingness of consumers to experiment with higher quality products, consumed in lower volume.

a All dollars in this case are U.S. dollars unless otherwise noted.

This case was prepared by professor Damien P. McLoughlin, Anthony C. Cunningham Professor of Marketing, UCD Michael Smurfit Graduate Business School and Aidan Connolly, Chief Innovation Officer and Vice President, Alltech Inc.

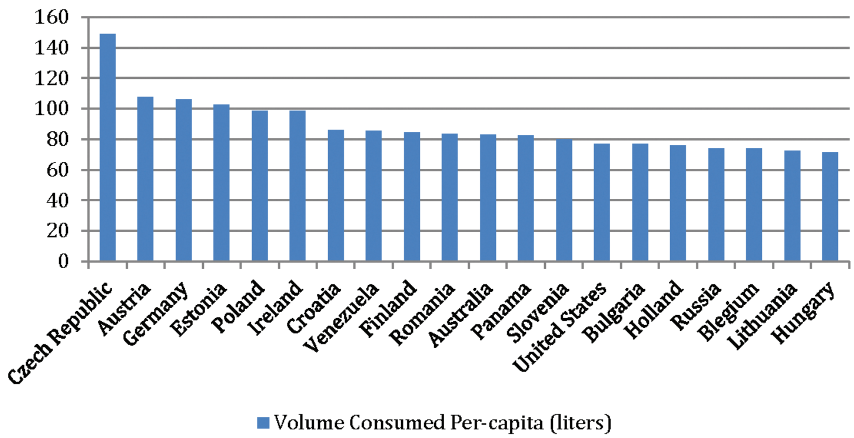

Exhibit 1. Global beer consumption by country (top 20 as of 2012)
Source: Adapted from Kirin Beer University report 2012. http://www.kirinholdings.co.jp/english/news/2014/0108_01.html#table3

Industry structure

By 2014, a decade-long consolidation of the global beer industry in response to generally slowing growth in beer consumption in developed markets and the need for scale to respond to strong growth in emerging markets, meant four firms–Anheuser-Busch InBev (ABInBev), SABMiller, Molson Coors Brewing and Heineken–controlled more than 80 percent of 2013 volume in the US market.[2] **(See Exhibit 2)** Anheuser-Busch InBev, the largest beer manufacturer in the world, had 47 percent volume share in 2013[3] and owned three of the six best selling brands. The four leading brands–Bud Light (ABInBev), Budwesier (ABInBev), Coors Light (owned in the U.S. by a joint venture between SABMiller and Molson Coors called MillerCoors) and Miller Lite (Miller Coors)–all competed in the domestic beer/mid-priced segment where the intensity of competition meant that price differences had been eliminated. Imported beers were a small but fast growing segment, increasing more than 11 percent in the first quarter of 2015, with two-thirds coming from Mexico, with the Netherlands, U.K. and Ireland also prominent.

Distribution

The U.S. beer market had an unusual distribution system. Following the repeal of Prohibition[b] in 1933, the U.S. government established a three-tier distribution system in which beer and spirits producers could sell only to distributors, which in turn sold to retailers for the final sale to consumers. In 2014, there were 3,300 independent beer distributors[4] operating in the United States. Three-tier distribution and the strength of the distributor channel, in principle, provided an opportunity for even the smallest brands to gain access to distribution. Larger competitors inevitably wished to protect their brands and built strong relationships with distributors to ensure growth continued. Historically, most regional markets had distributors affiliated with either AB Inbev

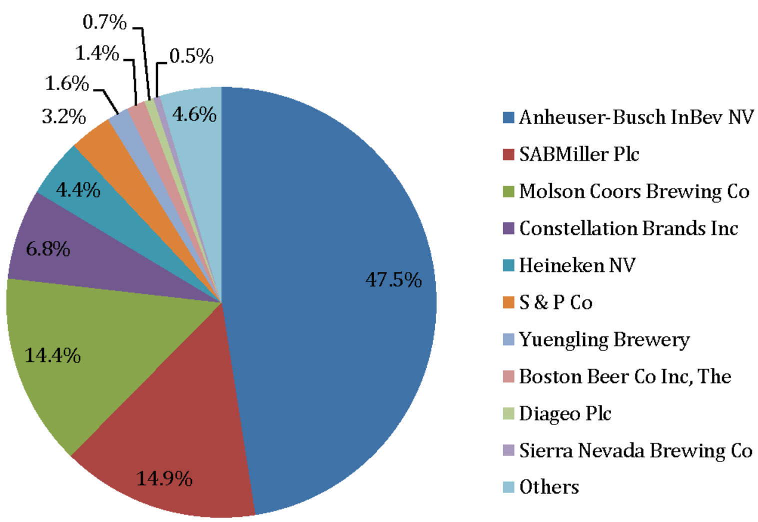

Exhibit 2. Top ten brewers in U.S. by market share 2013
Source: Adapted from Euromonitor International "Passport: Beer in the US." July 2014

b Prohibition was a national ban on the production, importation, transportation and, in certain circumstances, con sumption of alcohol in the United States between 1920 and 1933.

or MillerCoors (so-called red or blue distributors, referring to the label colour of the respective brands), but which also carried other brands. As craft beer brands, such as Sam Adams and Sierra Nevada, began to build sales in the mid-1990s, Anheuser Busch adopted a policy known as “100 percent share of mind”[5] that encouraged distributors to carry their brands exclusively.[6] At the peak of the scheme, more than 70 percent of its distribution was through such partners.[7] Consumer demand for a wider variety of beers and other beverages meant that distributors gradually moved to stocking other brands. According to the National Beer Wholesalers Association, in 1996 an average distributor carried 190 unique SKUs[c] from nine suppliers. In 2010, SKU count had increased to 536 from 18 different suppliers.[8] One mid-sized distributor noted its historical SKU count of 120 had grown to 1,250 by 2015, and over the course of a year totalled 3,000 when seasonal offerings were included.

Beer sales were categorized as on-premises (bars and restaurants licensed to sell beer for consumption on premises) or off-premises (grocery and convenience stores licensed for consumption only off premises). Volume sales were concentrated heavily in off-trade, with 75 percent of 2013 sales.[9] Higher pricing power on-trade meant value was split roughly 50:50 between channels. **(See Exhibit 3)**

Consumer demand

Beer consumption in the U.S. had been declining over the last decade as part of a general trend toward healthier beverage consumption. Sales of bottled water grew rapidly while soft drinks, juices, and beer fell. In particular, millennial consumers (in the 18-29 age group) were abandoning the beer category and displayed a 30 percent fall in their preference for beer between 1994 and 2013.[10] Increasing ethnic diversity and a 19 percent decline in preference for beer amongst nonwhites[11] was also significant. **(See Exhibit 4)** Competition also came from outside the category as liquor/spirits increased in preference by 15 percent and wine by 10 percent, respectively. **(See Exhibit 5)** As a result, beer sales volume in the United States fell by 6 percent between 2008 and 2013. Despite the volume fall, the overall value of beer sales increased as brewers used price increases to compensate and consumers switched to super premium and imported lagers. Substantial growth in the super premium market in 2014 saw volume sales grow by 9.4 percent, with some brands achieving spectacular double-digit growth[12] as consumers sought quality and variety in their consumption experience. Imported beers also grew strongly in 2014, driven particularly by the demand for Mexican beers amongst Hispanic consumers, the rising popularity of Mexican cuisine, and the ability of Mexican beers to maintain price competitiveness due to their relative proximity to the United States and cheaper logistics. Both super premium and imported beers were part of a wider trend toward variety and beer style that had also seen craft beer volume sales grow.

The U.S. Craft Beer Industry

Craft brewers were defined by the Brewers Association on three dimensions: (1) size (craft brewers produced less than 6 million barrels of beer); (2) ownership (less than 25 percent of the brewery was owned by a brewer who was not a craft brewer; and (3) production (the majority of product must come from traditional or innovative ingredients). Craft beer sales in the U.S.

c SKU refers to Stock Keeping Unit, the unique items stocked by a wholesaler or retailer

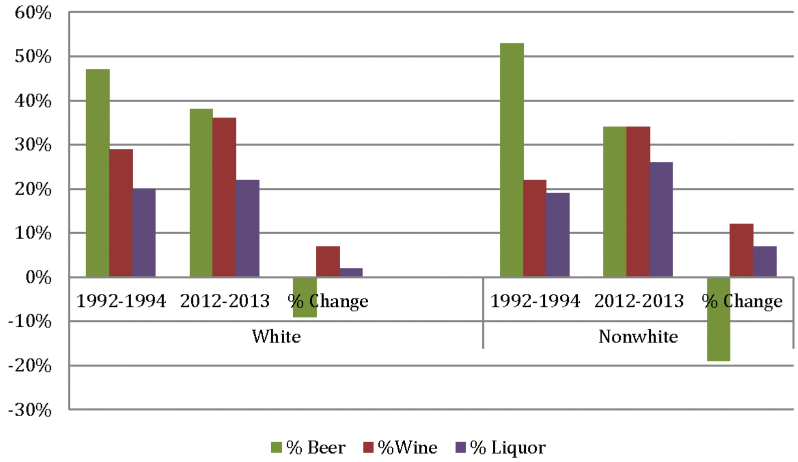

Exhibit 4. Alcoholic beverage preference by ethnicity

Source: Adapted from Gallup Charts http://www.gallup.com/poll/163787/drinkers-divide-beer-wine-favorite.aspx

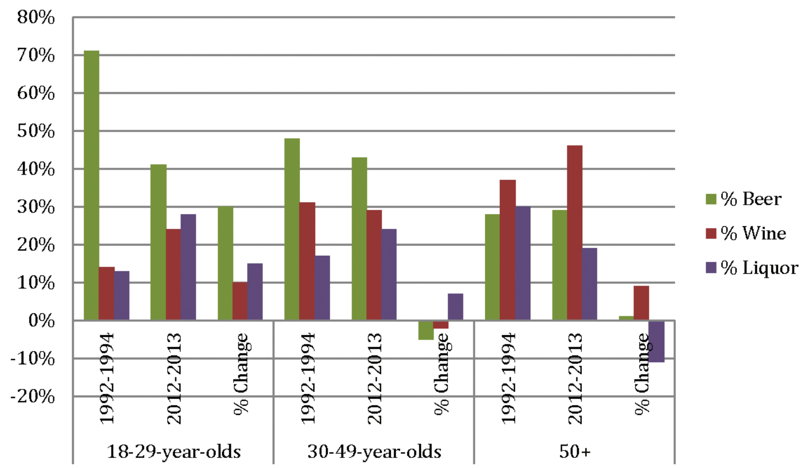

Exhibit 5. Alcoholic beverage preference, by age

Source: Adapted from Gallup Charts http://www.gallup.com/poll/163787/drinkers-divide-beer-wine-favorite.aspx

doubled between 2009 and 2014 reaching 11 percent of total volume share and breaking double-digits for the first time. At the same time, value share was 19.3 percent at $19.6 billion.[13] Growth in 2014 was 11 percent in volume and 22 percent in value terms.[14] By 2020 craft beer was expected to be 20 percent volume market share,[15] valued at $36.3 billion.[16]

Industry structure

In 2014, there were 3,418 craft breweries in the United States, with more than 1.5 opening each day and planning underway for 2,051 new operations.[17] The market comprised 1,871 microbrewers,[d] 1,412 brewpubs,[e] and 135 regional craft breweries. Concentration was relatively low, with the six largest craft brewers holding 25 percent volume share in 2014. **(See Exhibit 6)**

The best-known craft brewer and the fifth largest brewer in the U.S. in 2014 was Boston Beer Company, owner of the Samuel Adams brand. The brewery was founded in 1984 by Harvard MBA graduate and former Boston Consulting Group consultant, Jim Koch. Sometimes referred to as the Steve Jobs of the craft beer market, Koch played an important role in introducing drinkers to the craft beer product. The sixth generation of a brewing family, Koch brewed his first beer from the family recipe in his kitchen. By 2014, Boston Beer Company had more than 60 brands on the market, including its flagship Samuel Adams Boston Lager, and sales of $966 million. As the market developed, simply being a craft beer provided less differentiation and Boston Beer developed capabilities in marketing innovation. Founder Jim Koch coined the term "extreme beer" in 1994 for brews that pushed category boundaries and a wider commitment to differentiation based on experimentation. More recent marketing innovations included promotions, such as one-day-only limited release beers. In 2014, it was a Belgian style 'bride ale.'

d Microbrewers generally make less than 15,000 barrels of beer per year.

e Brewpubs produce beer and sell more than 25% directly to consumers on site, often with food.

Distribution

Craft brewers were subject to the rules of three-tier distribution, although some states provided exemptions for brewers with volumes below certain levels and also for brewpub operations. Craft brewers faced a number of distribution challenges. Distributors typically carried 500 to 1,000 SKUs—beers from 18 suppliers. Craft brewers were challenged to influence distributor strategy and focus. Many brewers responded through product innovation, which caused tension with distributors who wanted variety but disliked SKU proliferation. Another problem was limited shelf life. Mainstream beer shelf life could be up to two years if chilled. The production process of craft beer meant that the taste and quality, particularly of IPA (India Pale Ale) and "hoppy" beers, degraded substantially after 90 to 150 days. Brewers were in a race to get and keep fresh beer onto the market. The largest craft brewer, Samuel Adams, replenished wholesalers on a next-day basis.

Retail distribution was strongest in on-premises channels that could pair beers with food offerings. This meant that on-premises buyers typically had a consistent requirement for original and unique offerings. Consequently, the largest 20 craft beer brands accounted for 36 percent of volume in the on-premises trade in 2014, but grew by only 0.3 percent, while the remaining craft brands grew by 4.4 percent.[18] With overall on-premises growth of 3 percent for craft beer in 2014, and a 13 percent year-on-year increase in the number of brands on the market, sales per brewer and brand were lower in 2014.[19]

Off-premises sales for craft beer were also challenging. Convenience stores were growing fast as a beer channel, accounting for 59 percent of retail beer sales in 2013[20], but these retailers often lacked the shelf space to offer a craft beer selection wide enough to achieve the level of sales and profit they required.

Consumer demand

Just 23 percent of beer drinkers drank craft beer[21] in 2014, **(See Exhibit 7)** but the consumer behaviour of craft beer was not simply an extension of the beer market. One industry analyst explained:

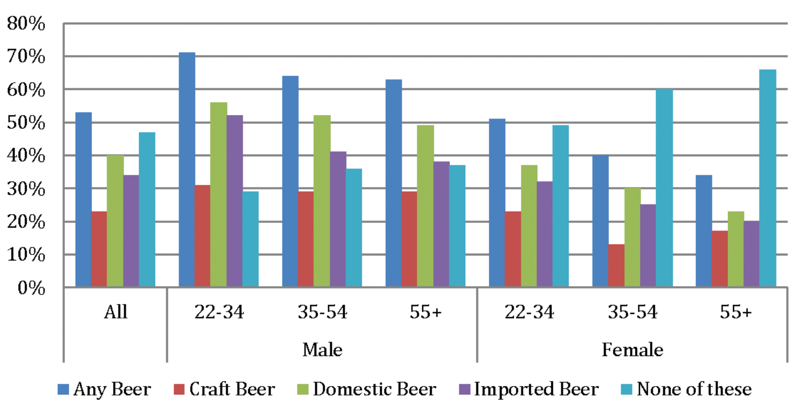

Exhibit 7. Type of beer consumed by gender and age

Source: Adapted from "Craft Beer – US – June 2014", Mintel, http://store.mintel.com/craft-beer-us-june-2014

"There is a strong sense of community in the craft beer world. Consumers like to share knowledge with one another and are highly invested in the products that they choose. Not only that, but craft brands share exposure through collaboration, a practice almost wholly unique to the craft beer market. As such, tap rooms, bottle shops, and beer-garden-style breweries, where craft beer can be discovered, discussed, consumed on-site, and even purchased for at-home enjoyment, make for a complete, customizable experience. Craft beer is not only a beverage choice; it appears to be a lifestyle choice."[22]

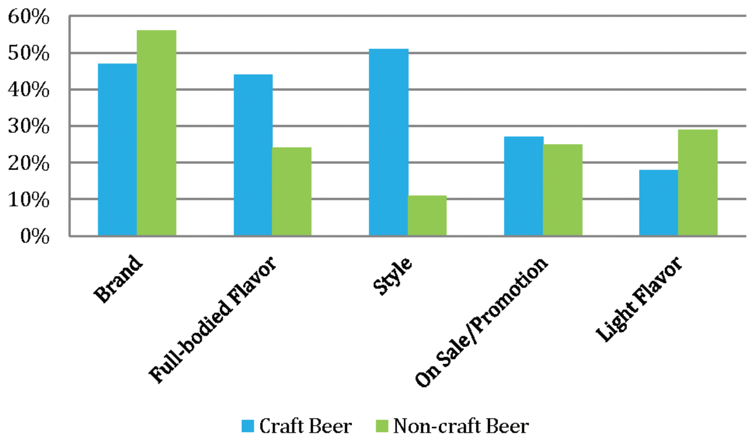

Exhibit 8. Purchase influences, craft beer consumers versus non-craft beer consumers
Source: Adapted from Mintel Report. "Craft Beer – US – June 2014." http://store.mintel.com/craft-beer-us-june-2014

Brand was less important in choice for craft beer, with flavor and style being more prominent. **(See Exhibit 8)** Taste, knowledge of brewer history, and on-pack product descriptions were also identified by craft drinkers as important factors in choice. Consumers of craft beer were also more likely to try new products, including 83 percent who were willing to drink non-craft beers.[23]

International demand for American craft beer was also growing, with a 36 percent increase in overall exports, exceeding $100 million for the first time in 2014.[24] Exports to Europe grew 37 percent, Asia-Pacific grew 38 percent, and Brazil grew 64 percent.[25] By 2017, exports to China were expected to be worth up to $12 million.

One challenge to craft beer consumption was its lower "sessionability," or the willingness of a drinker to consume the same beer multiple times in a single sitting. Drinkers of premium regular beers consumed 3.1 beer units per consumption occasion, compared to craft drinkers who consumed 2.6 units.[26] The high alcohol content (measured as alcohol by volume or ABV) of some craft beers was one barrier to sessionability.

Pricing

Craft beers typically retailed at twice the price of mainstream beers. Uniqueness, scarcity, brand and ingredient costs up to six times higher all contributed to higher prices. Price was no barrier to sales, with beers in the higher quartile of prices ($6.50 and higher on-premises price per bottle) growing 16.7 percent in 2014[27]. Craft brewers generally operated on 30 percent gross margin. **(See Exhibit 9)**

Competition

Continuing strong growth in the craft beer market and stagnation or decline in the overall beer market intensified competition from mainstream brewers. Many mainstream brewers used their brewing expertise to produce craft-style beers, with limited production, high quality and high ABV to compete in the craft segment. They also used marketing spend and expertise to directly take on craft beers. Anheuser-Busch InBev had been particularly aggressive in marketing. Budweiser used its Super Bowl 2015 advertising slot to declare it was "Proud to be a Macro Beer" (watch the commercial here https://www.youtube.com/watch?v=siHU_9ec94c). The ensuing social media storm saw Budweiser tweet "we are not anti-craft, just pro-Budweiser."[28] Large brewers were also buying independent craft brewers. Leading craft brewing figures questioned the motivation for these acquisitions. Sam Calagione, founder and president of Dogfish Head Brewery, commented:

> "I do think the world's largest breweries are disingenuous in their intentions moving into the craft beer world. They'll buy a once-independent brewer—not naming names—and suddenly its IPA's kegs are on the street for half as much as a true indie craft beer. It really shows they're using these once-craft brands as pawns in their game to knock the true indie breweries off the board."[29]

Alltech

Irish-born Lyons founded Alltech in 1980 to supply ingredients to Kentucky's alcohol industry, using insights learned in his master's studies in brewing and PhD research on yeast fermentation. By 1985, Lyons was using the same fermentation technology to make a range of animal nutrition products. In 2003, with Alltech sales in the region of $165 million, Lyons sold the alcohol ingredients business to fund a growth strategy of selling six technologically advanced ingredients to feed companies and expanding geographic coverage rapidly around the globe. With an annual growth goal of 20 percent, Alltech had sales of $650 million by 2011. Increasing concentration in the global animal protein business put pressure on the strategy of selling to feed companies and led Lyons to change focus and begin selling solutions directly to farmers. Initial success with this strategy led Lyons to consider options for rapid scaling. In 2012, Alltech began a series of feed company acquisitions globally, culminating with the April 2015 agreement to acquire Ridley Inc., one of the top three animal nutrition companies in North America, for CAD521 million (about U.S. $420 million). In September 2015, Alltech had global sales of $1.6 billion and 3,500 employees in 128 countries.

Thirty years of growth in Alltech provided Lyons, an inveterate entrepreneur, with the resources and infrastructure to pursue a variety of non-core commercial opportunities. Lyons acquired Lexington Brewing and Distilling Company in 1999 after he called to arrange some work experience for his son, Mark, who also completed master's and PhD degrees in brewing. Hearing that the brewery was to close, Lyons visited the same evening and bought the business. Lyons had always believed that beer provided a way to build new relationships and engage customers. Alltech booths at trade shows offered visitors a beer. Alltech's history in the alcohol business meant Lyons was not the only one with technical expertise in brewing and distilling. Mark Phipps, Alltech's Master Brewer and Distiller, joined Alltech's alcohol production division in 1990 from Hudepohl Schoening Brewing where he had been Master Brewer since the mid-1970s. Phipps was passionate about beer and recalled the days after Alltech acquired Lexington Brewing and Distilling:

> "Pearse told us we were going make some beer and we had great fun doing it. Crafting a beer is like a chef making a dish: A brewer puts his own flair, personal characteristics and passion into it. Pearse wanted to make something called Kentucky Ale. We sat together as brewers and asked, 'What is it?' I assumed he wanted something like his favorite beer, Bass[f], but he wanted it to be Irish. By mid-spring 2000, we had a brew we were happy with and Pearse said, 'That's it.' It was copper colour like an Irish red but tasted like English pale ale in the mouth. We kegged up half barrels[g] and served it during a customer night in Kentucky."

Alltech's history as a supplier of yeast to the alcohol industry provided credibility within the industry. Early in 2000 it had secured licences to both brew and distill. The following 10 years

f An English pale ale that was once the biggest selling beer in the United Kingdom.

g A half barrel was 58 liters.

were exciting years for Alltech as the core business grew rapidly. Although the view of the beer business among some within Alltech was, "We only need make as much beer as we can drink," as one executive explained, beer sales were growing rapidly by the mid-2000s. Seeing an opportunity, Lyons twice invested in expanding production capacity, hired a distributor for the first time and employed experienced beer sales manager, Matt Cordle, as sales director. Alltech's sponsorship of the FEI World Equestrian Games in Lexington in 2010[h] provided an important springboard to beer sales growth. "Before the Games, we only had real sales in Kentucky and Ohio. Now people from all over the world were exposed to the brand and wanted to buy it,"explained Cordle. "We had capacity constraints but Dr. Lyons cannot turn down a sale."

Alltech Lexington Brewing and Distilling Company 2015

Alltech Lexington Brewing and Distilling Company produced 1.2 million gallons of beer and 38,000 gallons of spirits in 2014 with annual sales of $12 million and sales growth of 45 percent, split 80/20 between the United States and international markets. In the U.S., product was available in 31 states with Kentucky accounting for 21 percent of sales, Ohio 25 percent, and Wisconsin, Georgia and Massachusetts contributing strongly. The global reach of Alltech's core business made internationalization easier. Dedicated sales teams were established in China, where Lyons' son Mark was vice president, and Ireland. International sales in Canada, United Kingdom, France and Taiwan were handled by local Alltech offices.

Products

Alltech produced beer and spirits at its Lexington breweries and distillery. Like most craft brewers, Alltech's beer portfolio included year-round beers and seasonal beers (See http://www.kentuckyale.com for a full list and description of company products). The company's flagship brand, Kentucky Bourbon Barrel Ale, accounted for 80 percent of sales in 2014.

Kentucky Bourbon Barrel Ale

Introduced in 2004, Kentucky Bourbon Barrel Ale was a "sipping beer" aged for six weeks in freshly decanted bourbon barrels[i] after brewing. The young beer absorbed the leftover bourbon in the wood, leading to a distinctive taste and an ABV of 8.19 percent. The elaborate production process **(See Exhibit 10)** resulted in a differentiated product that had a substantially higher cost of production, as Phipps explained:

> "Kentucky Bourbon Barrel Ale is our flagship product and its uniqueness comes from the technique of barrel aging we use. Most brewers are not crazy enough to buy barrels, we do. They cellar for two weeks, we cellar for six weeks. They filter once, not twice like we do. All of this adds 50 percent to our cost of production but we want flavor in our beer from bourbon and the barrel wood, and this takes time and money."

h Held every four years, the FEI World Equestrian Games were the biggest event in the industry. The 2010 Alltech World Equestrian Games in Lexington, Kentucky, were attended by 420,000 visitors from all 50 states and 63 countries. http://www.kentuckytourism.com/!userfiles/Industry/research/WEG%20Economic%20Impact%20Report.pdf, accessed July 2015.

i Bourbon could be produced anywhere in the United States but was particularly associated with Kentucky. The industry contributed $3 billion to Kentucky's economy and employed more than 15,000 people.

Common with many craft brewers, the flagship product played an important role in obtaining growth. “Alltech’s success in the craft beer market is down to Kentucky Bourbon Barrel Ale,” explained George Fisher, founder/owner of Cavalier Distributing, Alltech’s largest beer distributor. “It is an eye-poppingly good beer.” Kentucky Bourbon Barrel Ale drove Alltech’s success in a number of ways. First, it was a difficult product to imitate for brewers with less experience than the Alltech team. Second, Cordle and his team used the scarcity that arose from the common early problems of craft brewers—limited production capacity and marketing resources—to create sales velocity for all Alltech products. Cordle said:

> “It was hard to make the product. And it was local, so it was a real novelty. We placed Bourbon Barrel Ale in a local restaurant or bar for one month and then moved on to the next venue. We turned up with an easel for outside the bar saying for ‘limited time only,’ and provided special glassware and a tapper unit. Demand took off. It became a very strong on-premises brand, driving footfall and revenue. I had a waiting list of restaurants and bars in Lexington wanting to stock the draft Bourbon Barrel Ale.”

Word of mouth and social media exchange between beer enthusiasts created further velocity in sales and brand name recognition. Restaurants and bar owners wanted Alltech products and were willing to stock other beers from the range that were simpler and quicker to produce in order to get access to Kentucky Bourbon Barrel Ale. When a draft version of Kentucky Bourbon Barrel Ale was introduced in 2005, pent-up demand led to an immediate sales boost. Fisher explained that pricing power also contributed to the popularity of Kentucky Bourbon Barrel Ale:

> “The sweet spot for craft beer is $36 per case or a $9 per six-pack, price to consumer retail. Kentucky Bourbon Barrel Ale retails at $75 per case, double the average. There are few other beers priced at this level, available year-round, that sell with such velocity. The revenue and margin numbers are compelling for retailers and bars.”

The Alltech team prepared a profitability card for salespeople outlining the revenue benefits for customers **(See Exhibit 11)** and also used Kentucky Bourbon Barrel Ale to encourage bar owners and retailers to add other Alltech products.

Year-round beers

Alltech’s year-round range included beers common to other craft brewers such as a 6.5 percent ABV Kentucky IPA and a 5 percent ABV Kentucky Kolsch (a brightly coloured pale larger).

Seasonal beers

Seasonal beers were the quintessential craft beer: made with fresh ingredients, produced for a limited time and tied to a season. They were important in keeping attention on the flagship and year-round beers, building brand awareness and securing a second tap handle. Hal Gervis, former director of Alltech Lexington Brewing and Distillery, explained:

> “For craft beer customers, it is all about local, what they can’t have. Most bars have the local beer on tap and then whatever is cool. If the cool beer gains velocity, it stays and the challenge is to get a second tap handle. We introduce seasonal beers to help with that.”

Popular seasonal beers in the Alltech range included a 10 percent ABV Kentucky Pumpkin Barrel Ale produced in the fall and an 8 percent ABV Peach Barrel Wheat Ale distributed in summer. Seasonal products accounted for 10 percent to 15 percent of sales depending on the time of year.

Alltech's beer customers wanted a steady flow of new products to keep up with customer demand for original beer experiences. Alltech introduced four seasonal ranges each year and two to three other products during the year. New beers were generally formulated by the brewing team, first on paper with flavours and colors specified, and then in experimental brews. A new laboratory-size brewing facility was under construction in 2015 to enable 50-liter experimental production runs and increase experimentation.

Spirits

Alltech began producing spirits in the mid 2000s in the Lexington distillery. Alltech's portfolio of three whiskeys and a whiskey product, Bluegrass Sundown, accounted for 10 percent of total sales. Town Branch Bourbon, named for the river that ran close by the distillery in Lexington, was the best seller, selling 10,000 cases in 2014. The spirits portfolio was entirely produced by Alltech in the Lexington distillery. Demand meant the distillery ran 24 hours per day, seven days a week, producing three barrels or 53 gallons of whiskey each day.

Marketing and Sales

Cordle led a 16-person sales team, distributed geographically to the largest markets (a region required sales of $1 million to support a sales person), selling directly to distributors. Sales people also called directly on more valuable accounts to support the distributor and tell Alltech's brand story. As the market developed, some larger accounts preferred to meet the supplier directly rather than the distributor, although sales were still processed through the three-tier distribution system. One barrier to expanding the sales team was a shortage of talent as bars, wholesalers and producers all competed for the small group of people with expertise in craft beer and the ability to build demand, not just take orders. Distributor marketing support was provided by a national distributor relations manager. Marketing came from a two-person team with one focussed on advertising and sponsorship and the other on events.

Brand story

As sales grew, wider distribution and increased production capacity made brand-driven selling more important for Alltech. Every craft brewer brand story was unique and Alltech's was built upon three connected elements: Kentucky, the bourbon barrel, and a distinctive combination of sensibility and profitability.

Kentucky was known worldwide as the home of bourbon whiskey[j]. While bourbon could be made anywhere in the United States, 95 percent of global production was in Kentucky. Bourbon's popularity had grown over the previous 25 years as product quality improved and

j Bourbon whiskey is whiskey produced at not exceeding 160° proof from a fermented mash of not less than 51 percent corn, rye, wheat, malted barley, or malted rye grain, respectively, and stored at not more than 125° proof in charred new oak containers; and also includes mixtures of such whiskies of the same type. (Source: http://www.ecfr.gov/cgi-bin/text-idx?SID=57b5394734f53825e7e126b2cf0883bb&mc=true&node=se27.1.5_122&rgn=div8)

discerning drinkers switched from clear spirits, such as vodka, to brown spirits, including bourbon and other whiskeys. Clever marketing and brand repositioning by producers opened new international markets for bourbon. The desire of consumers to understand the provenance and experience the heritage of the beverages they consumed had been identified by vineyards decades before. Beginning in 1999, the Kentucky Bourbon Trail offered visitors the opportunity to visit distilleries and see bourbon in production. By 2015, more than 3 million visitors had visited 18 distilleries, including nine craft distilleries on the trail, with 725,000 visiting in 2014 alone.[30]

Lyons claimed this heritage for Alltech's beer by branding every product as Kentucky, such as Kentucky Bourbon Barrel Ale and Kentucky Bourbon Barrel Stout. "Bourbon is doing very well," Fisher explained. "Kentucky is cool as a result, which helps the beer sell." In 2012, Alltech opened a visitor center, designed by Lyons' wife Deirdre, in the Lexington downtown area, providing a significant boost to the local economy.

"Our brand story rests heavily on our proximity to bourbon barrels and we use this to sell to our customers' senses," explained Cordle. Straight bourbon had to be aged for at least two years (although most were aged for at least four years) in a new, charred oak barrel. In warm temperatures, liquid expanded into the wood and contracted in cooler temperatures, allowing the scent and flavours from the wood to infuse the liquid. During this maturation, 5 percent of the volume of alcohol soaked into the barrel. This so-called "angel's share" was clearly seen as a black line on an individual wooden stave of the barrel. "We ride out to meet customers with our distributor's salespeople and carry a barrel stave to explain soakage into the barrel and how that gives us a unique taste and smell," explained Cordle. "Alltech is the only brewer in the middle of bourbon country able to do that."

The Alltech team used a 10-ounce snifter glass (shaped like a cognac glass) to showcase the unique opportunity presented by Kentucky Bourbon Barrel Ale. **(See Exhibit 12)** Cordle explained:

> "We show new customers the snifters. The wide body and narrow opening of the glass really focuses the bouquet. They smell the strong bourbon aroma and we sell sensibility. Then we sell profitability by explaining the product is served in a 10-ounce glass rather than a pint.[k] With the right-sized beer head, they can take $1,000 profit per barrel."

Master Distiller Mark Coffman explained how the barrel story also carried over to the spirits brands:

> "When Pearse wanted a malt whiskey, we gave the Bourbon Barrel Ale casks a quick rinse and then put Pearse Lyons Reserve in. Today we have some barrels that were used three times now maturing Alltech rum in Kentucky and Irish whiskey in Ireland. Others have used bourbon barrels to mature Irish and Scotch whiskey, but those barrels have often been lying in a yard for months. We use them when they are still wet from freshly decanted bourbon then Bourbon Barrel Ale. Our whiskeys have a noticeable sweetness as a result. It's a great story and unique to us."

k An American pint is 16 US fluid ounces. The British pint is 17% larger.

Distribution

Responsibility for sales of Alltech products in 31 states ultimately lay in the hands of its 35 regional distributors, who sold products to bars and retail outlets under the three-tier distribution system. Major retailers, such as Kroger, Meyer, Walmart, Whole Foods and HEB, all stocked Alltech beer. Launching products with a new distributor typically involved a "crew drive" of four or five Alltech beer sales people visiting the new region. Educational seminars for local distributor salespeople were used to explain the brand story of Kentucky Bourbon Barrel Ale and to outline the sales incentives that could be expected for sales above the agreed targets. Distributors typically agreed to stock a certain number of Alltech brands for the first month. Bonus payments to encourage sales of Alltech products beyond Kentucky Bourbon Barrel Ale were also common.

As sales grew, the challenge of working in a business-to-consumer environment became more pronounced for Alltech, which was historically a B2B company. After opening a new market with targeted accounts, scaling was achieved by focussing on corporate chains and larger retailers. Craft beers were popular with supermarkets as consumers searched for them in-store, particularly for local brands, and they were typically 40 percent more expensive than national beer brands. Larger buyers also appreciated Alltech as a supplier. "Bigger buyers are concerned about the consistency of supply and appreciate our size," Gervis said. Larger customers also wanted data on sales, return for shelf space and product development plans.

Marketing through education

Lyons particularly valued events that provided an opportunity to educate customers, a strategy he called "marketing through education." In 2013, he held the first Alltech Craft Brews and Food Fair in Dublin, Ireland, featuring a wider range of craft beers, local food and music. In 2015, the event attracted 10,000 attendees and 500 craft beers from 60 breweries. In 2014, the event was repeated in Kentucky as part of Alltech's annual customer symposium. In March 2015, the Alltech Brewing and Distilling Academy was launched in Kentucky[31] to educate brewers and distillers with every level of experience.

Production

Brewing and distilling operations were originally located at Cross Street in downtown Lexington. At the time of acquisition in 1999, capacity was between 5,000 and 10,000 barrels but this had been increased to 30,000 barrels in 2005 and then to 60,000 barrels in 2010. A second Lexington site, on nearby Angliana Avenue, was added in 2012 primarily as a packing facility and to provide cold storage for 5,000 to 6,000 barrels of Kentucky Bourbon Barrel Ale. Over time, sales had outgrown production capacity and the packing system had become disconnected. For example, production capacity had been split 55/45 between beer and whiskey to meet demand. Beer brewed in Cross Street was transported to Angliana Avenue by tanker for filtering and packing. Filtering capacity at Angliana Avenue was 9 gallons per minute, matched to a bottling capacity of 28 gallons per minute and a kegging rate of 15 to 20 kegs (232.5 to 310 gallons per hour).

Lyons made a number of investments to resolve these bottlenecks. Two new brewhouses were installed in Angliana Avenue and Cross Street with 100,000 and 35,000 barrel capacity, respectively. The latter to be used for both beer and whiskey fermentation, boosting annual production capacity in Lexington at 150,000 barrels. New packing, cannoning and bottling facilities were also installed and aligned to production output. Under the leadership of Deirdre Lyons, Alltech began construction of a 30,000 barrel brewing and distilling facility in Pikeville, Kentucky in February 2015. Finally, Pearse Lyons appointed Marty Lamb, a 24-year Alltech operations veteran, as operations manager in 2015 to resolve these issues and oversee the successful integration of new capacity.

What's next?

According to Lyons, Alltech's strength is in its ability to identify and exploit market opportunities:

> "We have always been able to see the woods for the trees. Today, complacency is the only barrier to sales of $100 million. I need to find insiders who are not complacent. To do that, I look into the middle of the organization for young people in a hurry. When I find them, it is my job to protect them from complacent people and from complacency."

Lyons could see two ways for Alltech to achieve $100 million sales: focused investment on marketing and production in the United States and taking advantage of Alltech's existing global reach to build an international business while demand for American craft beer was growing fast.

Within the Alltech team, the voices for investment in the United States were loud. "The success of Alltech to date has given them a voice with major grocery chains," explained George Fisher, founder/owner of Cavalier Distributing, Alltech's largest beer distributor. "They have the reputation and relationships to call a large chain like Kroger and talk about how they can serve hundreds of stores. The question is what to do with that voice?"

A competing view was that retailers had their craft beer displays in place and that the future would see an expensive struggle for shelf space. This battle would be against the largest craft players and also the mega brewers who acquired craft brands and used their channel relationships to secure placement. While Alltech had the resources to compete, in the past Lyons generally had avoided battles of this kind. Looking at the challenges the consumer faced—the need to invest a great deal of time in understanding the ever-growing range of in-store options—he could still see plenty of room for innovation. Alltech invested in educating brewers and distillers about production and the industry.

Lyons wondered if there was there an opportunity to lead a consolidation of the market around particular criteria, like New World wines had done. Or was there a way to further differentiate Alltech's beer? He also wondered if acquisition might offer a way to achieve differentiation through building a more compelling portfolio of beers. As a craft brewer, an Alltech acquisition might also be less likely to attract negative attention from consumers. The cost of acquisition in 2015 was $1,000 per barrel of production.[32] In July 2015, Lyons acquired two craft brewers, in Ireland and the U.K., with sales of $2 million, two strong brands and a route to market with major retailers such as Tesco and Aldi. Could this route be cheaper and more effective? Alltech's recent acquisition of Ridley for $400 million had been driven by Lyons' wish to control his route to market for his core business. He also wondered if there was a way to achieve a similar level of control in craft beer. What options did he have under a three-tier distribution model?

Growth through global expansion had long been part of Alltech's playbook. Lyons saw the fast-growing demand for craft beer outside the United States as an untapped opportunity that fit the Alltech skillset well. One approach being discussed was to franchise Alltech production to bars and restaurants and allow them to brew onsite. The benefits were significant, including lower capital intensity and the ability to use existing Alltech office infrastructure and management. Plus, working with other entrepreneurs could provide the speed of expansion that Lyons craved.

Some challenges included a lower level of control over a brand that was still in formation and the reliance on others to drive Alltech sales. The development of individual markets was already underway with successful markets already established in Europe and Asia. China, under the leadership of Mark Lyons, who was based in Beijing, was already close to $1 million in sales, growing 10 percent each month, and had a strong distribution network. Lyons knew from the core animal health business that investment in local production was needed to drive growth. Craft beer was defined by location, and a scaled beer business required local production. Industry practice was to subcontract production until scaled sales were achieved, but would he ultimately have to build a brewery in every major market? Building a brewing and distilling capacity to support sales of $10 million to $15 million cost $9 million to $10 million. Could the brewing and distilling business generate the cash to support this itself or would he have to divert capital from the core business and step away from opportunities there?

There was one more thing on Lyons' mind as he thought about the future. A Brazilian employee had recently commented during the Alltech Mini-MBA that the beer was "Pearse Lyons in a bottle." Growth opportunities in Alltech were identified and driven by Lyons and he had personally communicated and demonstrated the need for, and process of innovation, to employees. Every Alltech employee could recite Lyons'mantra of "Don't get it right, get it going" and offer multiple examples of how they and the company had done this. As company sales grew and more new employees joined the company through acquisition, he needed to find other ways to transmit the central role of innovation in Alltech's culture. Was the story of the beer a good way to communicate what Alltech was about? If so, what were the messages about innovation, entrepreneurship and proactivity that he needed to share and how could they be communicated?

As his $5 watch turned to 5:45 am, Lyons reached home and slowed from run to walk, invigorated and ready to make big, bold decisions.

Discussion Questions

1. What has driven the growth of craft beer over the past ten years? What are the growth opportunities for the coming decade?

2. Alltech has been built around consistent investment in technology. Should it be investing in craft beer and spirits?

3. Pearse Lyons faces a number of strategic options, to invest in the United States or internationally, to grow through acquisitions or to rely on organic growth. How would you advise him to proceed?

4. What are the lessons from craft beer and the craft brewing industry for the wider food industry?

Exhibits

	Off-premise		On-premise	
	Million Liters	**USD Million**	**Million Liters**	**USD Million**
2008	18,498	$42,476.10	6,350	$45,382.50
2009	18,276	$42,707.20	6,169	$44,939.20
2010	18,018	$42,871.50	5,870	$43,567.00
2011	17,699	$42,569.70	5,852	$43,529.70
2012	17,833	$44,641.10	5,950	$45,451.30
2013	17,542	$45,419.40	5,880	$46,524.10

Exhibit 3. On-premise versus on-premise volume and pricing

Source: Adapted from Euromonitor International "Passport: Beer in the US." July 2014

Rank	Brewing Company	Location	Production (Barrels)	Volume Market Share
1	D. G. Yuengling and Son, Inc	Pottsville, PA and Tampa, FL	2,917,992	19%
2	Boston Beer Co	Boston, MA	2,550,000	17%
3	Sierra Nevada Brewing Co	Chico, CA	1,069,694	7%
4	New Belgium Brewing Co	Fort Collins, CO	945,367	6%
5	Gambrinus	Shiner, TX	675,997	4%
6	Lagunitas Brewing Co	Petaluma, CA	601,420	4%
7	Deschutes Brewery	Galesburg, MI	337,094	2%
8	Bell's Brewery, Inc	Bend, OR	319,550	2%
9	Stone Brewing Co.	Escondido, CA	287,075	2%
10	Minhas Craft Brewery	Monroe, WI	265,374	2%
11	Brooklyn Brewery	Brooklyn, NY	252,000	2%
12	Duvel Moortgat USA	Kansas City, MO and Cooperstown, NY	234,596	2%
13	Dogfish Head Craft Brewery	Milton, DE	227,986	2%
14	Matt Brewing Co	Utica, NY	218,830	1%
15	Harpoon Brewery	Boston, MA	209,000	1%
16	Firestone Walker Brewing Co	Paso Robles, CA	208,343	1%
17	Founders Brewing Co	Grand Rapids, MI	193,000	1%
18	SweetWater Brewing Co	Atlanta, GA	192,400	1%
19	New Glarus Brewing Co	New Glarus, WI	162,287	1%
20	Alaskan Brewing Co	Juneau, AK	161,700	1%
21	Abita Brewing Co	Abita Springs, LA	161,000	1%
22	Anchor Brewing Co	San Francisco, CA	159,000	1%
23	Great Lakes Brewing Co	Cleveland, OH	149,948	1%
24	Oskar Blues Brewery	Longmont, CO	149,000	1%
25	Shipyard Brewing Co	Portland, ME	146,869	1%
	Others	Various	2,308,389	15%

Exhibit 6. Top 25 craft brewers in the U.S. 2014

Source: Adapted from Brewers Association https://www.brewersassociation.org/statistics/brewery-production/

Cost	Percentage of price
Retailer margin	30%
Distributor margin	20%
Packaging	13%
Ingredients	10%
Brewer margin	8%
Federal, state and sales taxes	9%
Logistics	6%
Labor	1%

Exhibit 9. Cost structure of craft beer

Source: case study interview

Exhibit 10. Alltech brewing process

Source: Company documents

Product	Keg Size	Retail Price per Keg	Ounces Per Keg	Price Per Serving	Serving Size (oz)	Servings Per Keg	Gross	Net
Domestic	Half bbl	$87	1984	$3	16	124	$372	$285
Prem. Import	50 liter	$145.70	1690	$5	16	105	$525	$379
Craft	Half bbl	$130	1984	$4	16	124	$496	$366
High-end Craft	Half bbl	$170	1984	$5	16	124	$620	$450
Belgian Ale	30 liter	$200	1014	$6.50	10	101	$656	$456
Kentucky Bourbon Barrel Ale	Half bbl	$189	1984	$6	10	198	$1,188	$999

Exhibit 11. Alltech beer profitability card

Source: Company documents

Exhibit 12. Alltech's beer snifter glass

Source: Company documents

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