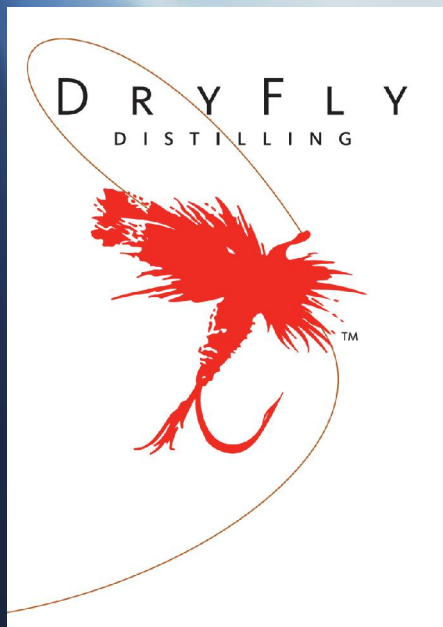


# Craft Distilling - The Business



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Dry Fly Distilling Inc.

# Presentation Outline

- Dry Fly 101
- Washington Craft Distilling Law
- Pre Submitted Questions
- Q and A from the Group

# Disclaimer

- We are only a year old
- I'll give the best answers based upon what I know or have been told
- We really only know our way
- Our limited success thus far is the result of 2 guys working 14 plus hours a day - 6 days a week.
- We are nowhere close to turning a profit - we are however closer than we were 12 months ago

# Our Philosophy

- We fully support the development of other craft distillers in Washington.
- Dry Fly nor anyone else associated with our company will ever talk down another craft distilled product.
- We welcome visits to our distillery and only ask that prospective distillers identify themselves.
- We are not in the position to teach anyone distilling, share our business plan, or help anyone with their planning process. We simply don't have the time.
- However, Once you have commercial equipment on order, and have secured space, we will do our best to help you with anything we can.

# Our Philosophy

- We believe distilling is an agricultural practice and that a Craft or Artisan Distiller takes a raw product all the way to the bottle without employing any shortcuts.
- We appreciate those whose business plan includes the use of purchased NGS, however what they do and what we do is very different.
- This is supposed to be fun - it's OK to relax and have a cocktail and work through our differences.

# Defining Craft Distilling

## Defined by the ADI

- Craft Distillers produce alcoholic beverage spirits by distillation, or by infusion through distillation or re-distillation. Maximum production for a “craft” or “artisan” distiller should not exceed 50,000 proof gallons per year. The “craft” or “artisan” distiller utilizes a pot still, with or without rectification columns, for distillation of Beverage Spirits. A distiller starting with neutral spirits produced by others, who redistills without substantially altering the neutral character of the spirit may not be said to be a “craft” or “artisan” distiller.

# Why all the talk on “Terminology?”

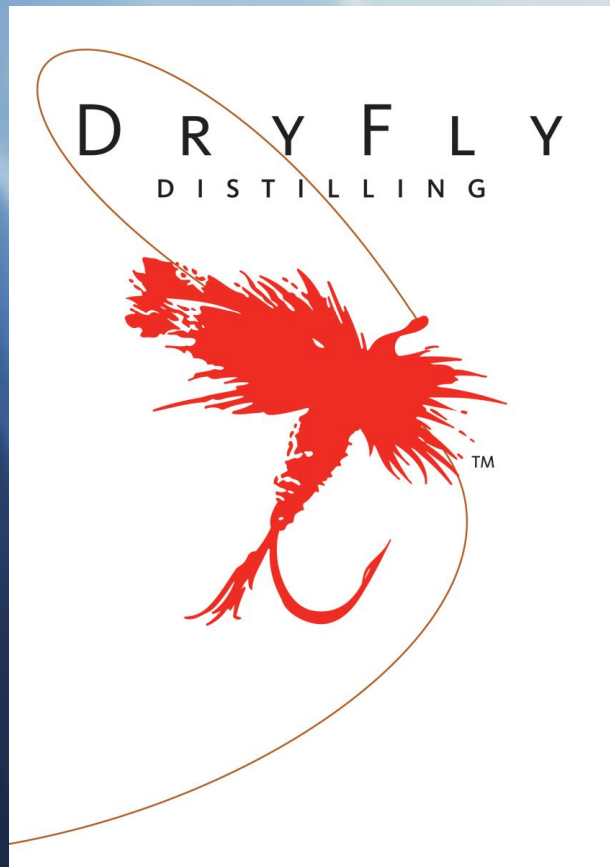
- It's possible to produce most products without ever distilling a drop
- Production volume is important because it separates us from major manufacturers
- Smaller manufacturers face difficulties that are far different than large producers.

# Small Distilling “Organizations”

- American Distilling Institute - ADI
- Washington Distillers Guild



# Dry Fly Distilling Inc.



- Project Started in 2005
- Incorporated in March 2007
- Fully licensed by September 2007
- First Distillation 9/25/07
- First bottling 10/13/07

# Dry Fly Product Line



- Dry Fly Vodka
- Dry Fly Gin
- Dry Fly Wheat Whiskey
- Dry Fly Single Malt Whiskey
- Dry Fly Bourbon
- Dry Fly Rye Whiskey
- Recently won a gold metal for our packaging

*Los Angeles International Wine & Spirits  
2008 Competition*

**WINNER**

Gold Medal Award

*Dry Fly Gin*

*Overall Package Design*

*Straight*

*Washington*

*Certified by Dr. Robert W. Small  
June, 2008*



# Our Equipment

- Two 450 liter CARL Pot stills
- Two 4 plate columns for Stripping
- One 21 plate column for rectification
- Hand Bottling Line
- Assorted blending tanks

# Dry Fly Expansion 2008

- Addition of Second Still for Stripping
- Addition of complete Wash House
- Fermentation capacity to 15,000 liters per week
- Annual capacity of 10-12,000 cases
- On site grain milling for increased efficiency
- Project will be complete in 4 weeks including the addition of our first full time employee

# Our Objectives

- 2000+ cases of sales in year 1
- Grain to bottle
- Strong Agricultural tie
- Precise and professional branding
- Appear much larger than we are
- 5 states by end of Y1
- Lose less money in month 12 than in month 1

# Dry Fly by the Numbers

- Total investment YTD is close to \$1 million (includes expansion)
- Total Sales YTD close to \$500,000
- Total cases YTD 2400
- Total investment in Marketing/Brand Development/Sales \$150,000+ YTD



# Dry Fly by the Numbers

- Washington grown raw materials used 275,000 pounds - 99.97% Washington grown YTD
- Bottles sold at the distillery - about 350 since July 1st
- Tastings Completed - 580
- Placed in 265 liquor stores in Washington
- Distributed in Oregon, Idaho, Montana, Alaska, and Illinois
- Pending distribution in Tennessee, Utah, Wyoming, Minnesota, and Colorado



# Washington Craft Distillery Law

- Aimed at agricultural and raw material to bottle producers
- 51% of monthly raw materials must be grown in Washington - NGS only if based on WA raw ingredients
- \$100 annual license fee
- Ability to sample product **ONLY** at the distillery
- Ability to retail your own product up to 2L per person daily
- 20,000 proof gallon annual production limit

# Washington Law

- Still plenty of work to do to balance what breweries and wineries are allowed to do, and what is still against WA law for distilleries
- Dry Fly is a member of DRAW - Distillery Representative Association of Washington
- DRAW has an active legislative group which will assist with new issues as they arise.

# Pre Submitted Questions and Answers

Answers are only as good as the  
answerer!

As I understand it all sales of craft distillery productions are sold to the State the Washington, but what are the regulations for selling to merchants outside of the state of Washington. How are internet sales of spirits regulated?

- Yes and No. Sales into Liquor stores must go through the state warehouse. Sales through the distillery can be done via transfer from bond.
- Your federal permit allows you to sell anywhere - WA has no input or control here
- Internet sales are basically non existent except for 2-3 companies - all outside of WA - not an easy thing to break into - distribution issues
- Binnys came to us - we hear trying to solicit them is very difficult

- Note: Sales/Marketing is the most overlooked piece of this business. Our selling 3000 cases in year one makes us one of the largest US small distillery startups thus far. Competition is fierce and from very well established companies with deep pockets. It is a complex system that requires significant daily attention. Marketing costs are both significant and real.

- Washington is a control State
- Initial orders are all special order
- Stores hate special orders
- Listing program requires that you approach the market just like a major manufacturer - PR campaign, Professional POS, Professional merchandising support, targeted and specific sales objectives
- Listings come in 3-4 formats 30-120 stores
- Bailment - you provide inventory at no cost to the state and are paid once it ships to a store.

What size still and equipment did Dry Fly start with and how much product did it produce?



- We started with 1 450 liter pot still, a 4 plate and 21 plate column and 5000 liters of weekly fermentation space. This allowed us to produce about 3000 cases.
- Note that 450 liter is an average fill rate at stripping (foaming) - we run these same stills at 650+ liters for finishing runs.

Is it feasible to sell 100,000 bottles of product a year? What could you expect with your first year in bottle sales?

- Anything is feasible.
- Apple brandy - Cranberry Schnapps - probably not. More main line products maybe. Whiskey - not for a couple of years!
- For a first year distillery to do that would be amazing. It would take a full time sales force of 3-4 people, \$400,000 plus in Y1 marketing, 24 hour plus distillation on a 1000 plus liter pot still or a small column still

- 100,000 bottles = 8333 12/750ml cases
- 30,000 bottles on a 450 liter pot still at an average of 42 hours of distillation time per batch.
- In distillation - flow rates do not vary, so 3 times our volume would require 126 hours of distillation time on a 1350 liter still (144 hours in 6 full days), plus a fermentation capacity of 15,000 liters weekly. Two 700 liter still could accomplish the same in half the total time. (Vodka/Gin for this example)
- Then you have to sell that production!

Could we locate the tasting room  
away from the Distillery?

- In Washington, No. The tasting room has to be part of the distillery. This requires a bit of TTB wrangling as you need to “unbond” that portion of your facility that holds retail product and sample product.



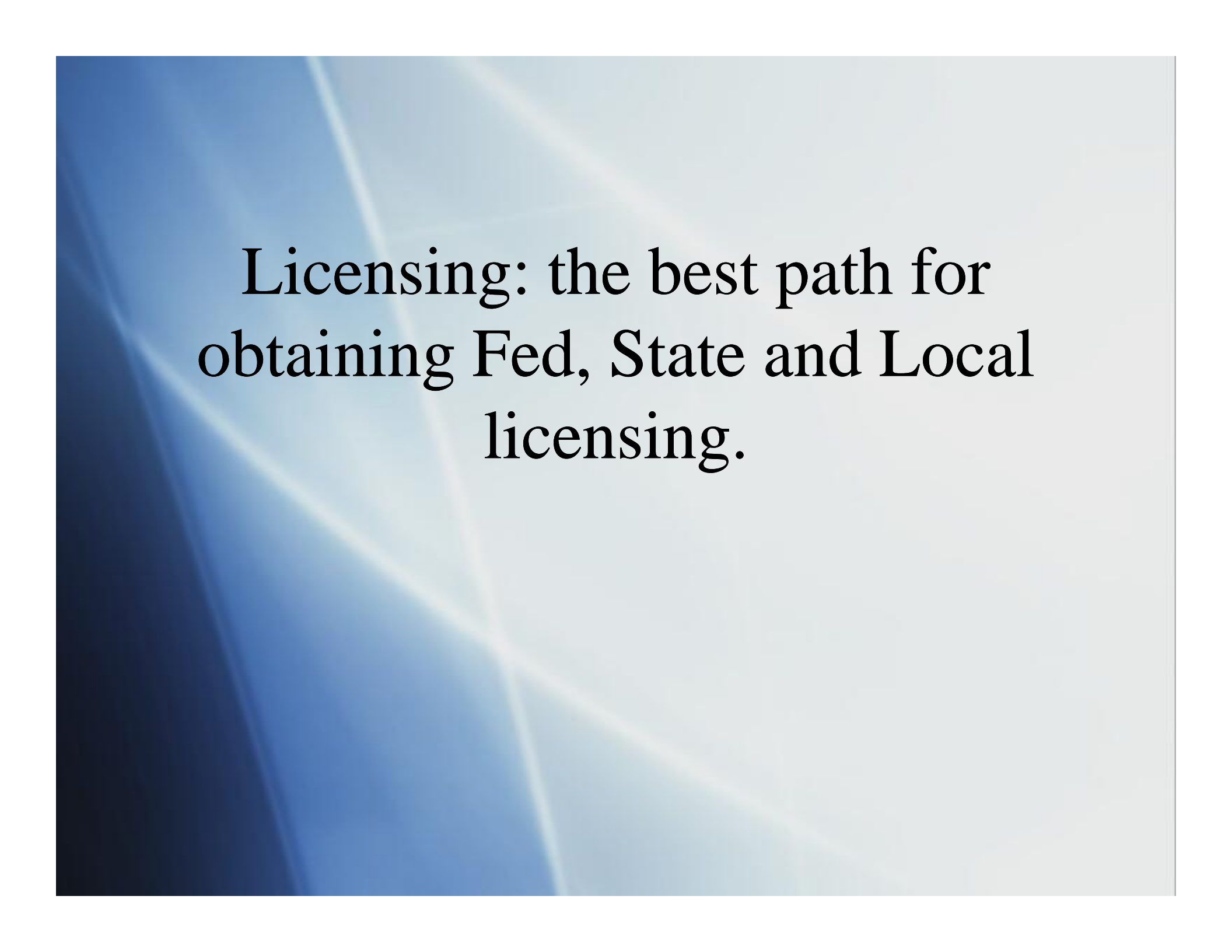
Could we make *Apple Brandy*?

- Absolutely !



The process of getting a federal & state license requires that we have a location, but we're not sure of what's required for the build-out of the facility, so we'd like to know what departments are involved with the oversight of developing a distillery and what their requirements are: i.e., Health Dep., Fire Dep, Building Department and Liquor Board requirements.

- I think that varies by locality.
- We spent 6 months prior to leasing our space working with all of these named agencies, insuring that we would not have any issues as we built out.
- The WSLCB really has no requirements
- The TTB requires that you have a “facility ready to produce” - all major equipment must be in place.
- Health department was no issue for us - at 80 proof everything is pretty much it’s own sanitizer.
- Fire Department is important. We had to file a special use permit and detail our warehousing plans.

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Licensing: the best path for  
obtaining Fed, State and Local  
licensing.

- Federal permit first
- 1 page application - ours had 247 pages of backup.
- Must be “ready to produce”
- State license last
- 5 year financial tracking on every dollar that goes into your distillery.
- Full financial disclosure for any investor

We're interested in knowing what the facilities need to look like; If it needs to meet professional kitchen requirements with stainless steel sinks, specific drainage, sprinkler systems, then it might make more sense to rent a facility with a professional kitchen.

- Somewhat depends on what you want to be!
- Look at any professional brewery or winery and model yourself after that.
- Sprinkler system will probably be required by your fire department.

Interested in knowing more about the "Craft" law. Can we sell our product off site from our distillery. Can we have a booth at Pike Place Market or a fair, or farmer's market?

- In short - No to all of these questions. You can only sell product in your distillery.



Interested in knowing an exact  
break down of State and Federal  
Taxes, per bottle.

- Federal tax is \$13.50 per proof gallon - 1 gallon of alcohol at 100 proof
- At 80 proof that equates to \$2.14 per bottle
- Washington adds all tax at the point of sale
- Average markup with taxes and commission at the State level is 100% - ie your \$16 bottle wholesale becomes \$32 on the shelf. And out of the \$16 you charge, you pay the federal tax and transport to the state warehouse.

# Federal Taxes

- Federal tax is \$13.50 per proof gallon - 1 gallon of alcohol at 100 proof
- Both Breweries and Wineries that are “small” producers pay a lower tax rate than “large” manufacturers.
- The ADI is working on lobbying efforts to get a reduced tax rate for small producers

Interested in knowing average  
production costs per bottle.

- This is an impossible question to answer - too many variables and too much proprietary information here to give you our costs.

Interested in knowing if this can be a viable business at low production and/or what level of production and sales needs to be met before profits can be realized.

- Viability depends on your investment and what kind of return you expect.
- Sales level for profit - Don't know - haven't got there yet!
- Our accountant tells us we lose less money each month! (except for this August)
- Our goal for our second year is to exceed \$1 million in annual sales - and we still will not probably see much profit. We expect to become profitable in year 3.

What happens once a Craft Distiller produces more than the WA Craft Distilling Law's designated 20,000 gal per year production capacity? Specifically, does the craft distiller lose the ability to sample & sell directly?



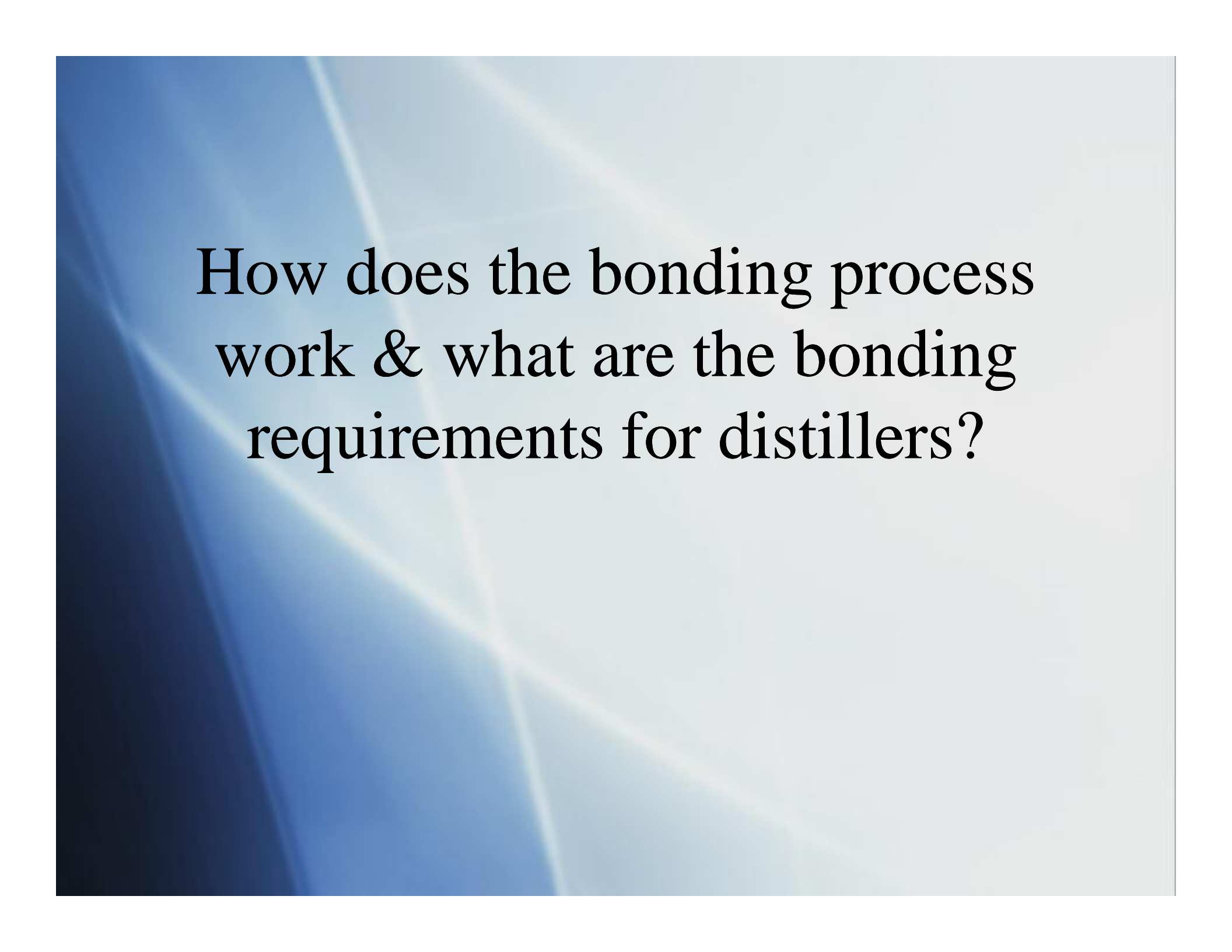
- As the law sits today, yes.
- There is a “National” movement to set this number at 60,000 pg annually.
- At some certain point you open the door for larger producers to work their way into our classification.
- This would have to be addressed via the legislative process.

How will the 20,000 gallons per year be measured under the WA craft distilling law? (i.e. proof gallons?)

- Yes, via proof gallons
- 20,000 proof gallons is about 10,500 - 12 pack 750 ml cases at 80 proof.

Does the WA Craft Distilling law have any guidelines regarding contract distilling? (i.e. producing a spirit product for a 3<sup>rd</sup> party— example being producing a private label product for a bar or hotel under contract)

- No. Although contract distilling is not a common practice. Each item produced requires it's own COLA (label approval) and the Washington system is really not set up to do specific shipments to specific stores that then go to specific accounts.



How does the bonding process  
work & what are the bonding  
requirements for distillers?

- A Federal Bond - minimum of \$15,000 I think, is required to cover you anticipated tax liability and storage bond.
- We have a \$25,000 bond that costs us \$1300 annually.

Who is our local TTB agent and  
how can we contact them?



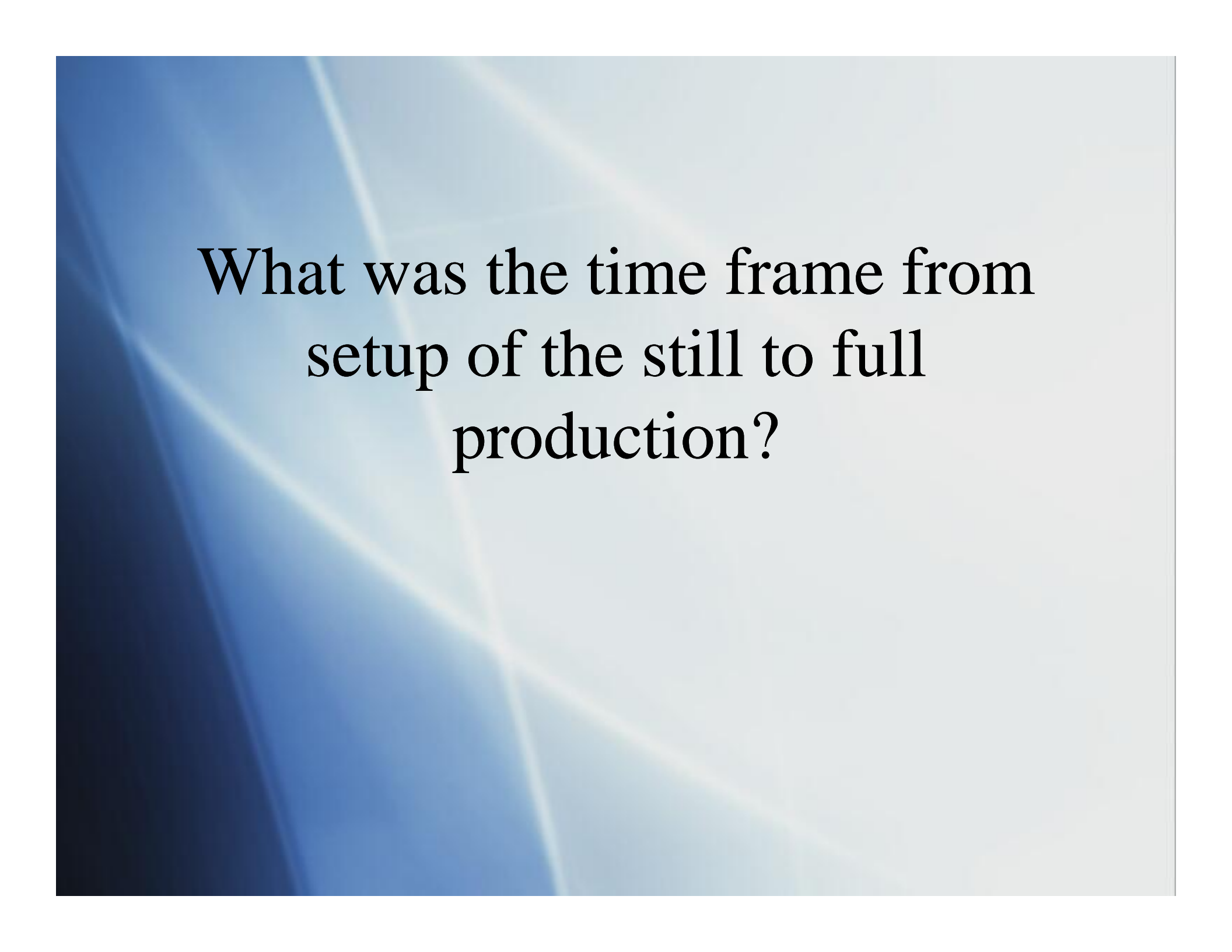
- The TTB assigns one of 2-3 people from the NW to work with each distillery. They usually don't work with you until you are in the licensing process. Those questions can be answered by the group in Cincinnati.

What are some best practices  
when communicating with the  
TTB and local WSLCB with  
regards to our distillery  
operations?

- TTB through Cincinnati
- WSLCB will assign an inspector to you once you enter the licensing process.

As long as we satisfy the 51%  
ingredient rule of the WA Craft  
Distillery Law ~ are there any  
limitations as to the ingredients  
we can use in our products? (any  
chance we can receive a copy of  
the TTB/FDA approved  
ingredient list?)

- To the best of my knowledge there is no TTB approved ingredient list.
- I also am not aware of any FDA approved list for alcoholic beverages.

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What was the time frame from  
setup of the still to full  
production?

- For us it was about 10 minutes. We had all licenses and permits in hand. We also had all of our COLAs approved.
- If the term “full production” means maxing our capacity - then that took a bit longer.

What additional item(s) did you forget to plan for when you started your production?




- 480 volt electrical service required our own power pole and about \$20,000 of electrical work.
- Packaging - Our average buy is 22,000 bottles - \$40,000 - printing, corrugated and shipping adds another \$40,000. Significant costs prior to one case being made.

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Did you create contracts with  
your suppliers for their raw  
materials and costs?

- Yes
- Annual commitment for grain this year is 500,000 pounds
- Annual glass commitment is 50,000 units
- Ditto on cork and corrugated.
- Commitment on capsules is 81,000 units
- Negotiated prices with other suppliers
- Kent was a VP of purchasing for Sysco Minnesota and is a professional buyer and negotiator.



What points do you have for dealing with the local agencies?

- The City of Spokane, via the Mayor's office assigned us an ombudsman to work through any city issue with us. Saved us months of work.
- Be proactive. Make sure you know the answer before you ask the question.
- Get all of the issues settled prior to taking possession of your space.



What is the biggest obstacle you  
faced or had to address?

- \$30,000 in freight damage on our first still shipment
- Utility placement costs
- Packaging inventory costs
- Marketing costs
- Expansion 10 months into a business plan



Q and A from the Group