CASE

Big Sky Brewing Company

Jeffrey P. Shay
Tony Crawford
Keith Jakob
University of Montana

At 7:00 A.M. on Wednesday May 23, 2001 Neal Leathers and Bjorn Nabozney, two of the three founders of Big Sky Brewing Company (BSBC), sat at the long cherry conference table at the offices of Montana Business Capital Corporation. BSBC was a craft-brewing company based in Missoula, Montana that experienced $729,309 sales growth (57 percent) over the past year and was trying to acquire the expansion capital necessary to develop in-house bottling capabilities. Montana Business Capital Corporation, a boutique[1] investment-banking firm, was retained eight months earlier to assist BSBC in its efforts to acquire the capital through the United States Department of Agriculture's (USDA) Business and Industry Guaranteed Loan Program. Tom Swenson, the president of Montana Business Capital Corporation, called Leathers and Nabozney the night before and requested a special meeting to discuss the status of their loan application.

Swenson entered the conference room and explained the situation:

> "Thanks for coming in so early guys. As I told you yesterday, the bad news is that the USDA loan was not approved. The good news is that I was told that we could reapply…and that there is a chance that we could still get the loan. However, we are going to have to move quickly because your company may no longer qualify for this USDA program once the new census data is approved. I am thinking that approval of the new census data could come as early as next week. The guy that I spoke with

[1] Montana Business Capital Corporation described itself as a "boutique" investment banking firm because it provided highly specialized financial services and products for businesses located in rural parts of the northwestern United States.

This case was prepared as a basis for class discussion rather than to illustrate either effective or ineffective management. The case benefited from the suggestions of several anonymous reviewers from the *Case Research Journal*. The authors also wish to acknowledge Bjorn Nabozney, Tom Swenson, and Rick Wishcamper for their assistance in gathering data for the case.

> over at the USDA indicated that the application documentation did not provide enough evidence that the expansion was needed at this time or that the expansion made good financial sense. One specific area that they noted is the 4 page summary business plan that we submitted with the application. They said it wasn't adequate. Given that information, I propose that we review the information we included in the original application, conduct a more thorough analysis of the company and the project, and develop a more compelling set of arguments for expansion and document them for the new application. So, I would like to start at the beginning by asking you why you think you should go ahead with the project."

Leathers and Nabozney, clad in shorts and company t-shirts, watched as Swenson walked up to the flip chart in the room and reemphasized the urgency, "Gentlemen, we have until Friday afternoon to develop and document our arguments". Swenson loosened his tie and began outlining what they should try to accomplish during the meeting. The thirty-one year old Nabozney remarked, "Whatever you need us to do, we'll get it done. I'm surprised that they seem to be giving us a hard time. We've had tremendous growth, we're turning away orders, we're earning a profit, and, in a business where every penny counts, we shouldn't be cornered into outsourcing our bottling."

THE BEER INDUSTRY IN THE UNITED STATES

In 2000, *Beverage Industry* estimated that beer was an $83 billion industry in the United States and that the beer industry was projected to grow 1 percent annually through 2003. Companies competing in the U.S. beer market were classified into four industry segments: national, import, regional, and microbreweries. The four largest national breweries (Anheuser Bush, Miller, Coors and Pabst) accounted for 87 percent of the total U.S. beer production in 2000. Anheuser Bush, the largest player in this segment, produced five of the ten most popular brands, held a 48 percent market share in the U.S., and was the largest brewery in the world. National breweries generally realized profits by using inexpensive ingredients and taking advantage of large purchasing, production, and distribution economies of scale.

Before the introduction of microbrews, imports were considered premium beer products. In comparison to the products sold by national breweries, imported beers were brewed using higher quality ingredients, were available in a wider variety of styles, were usually more flavorful, and were shipped into the country, thus incurring higher per unit distribution costs. As a result, imported beer was often priced at a rate double the per unit price of beer sold by national breweries.

The *Institute for Brewing Studies* defined regional breweries as those breweries with an annual 15 thousand barrel to 2 million barrel brewing capacity (1 barrel = two kegs = 13.78 cases of beer). Regional breweries were similar to national breweries in that their products were widely available to consumers, had considerable advertising budgets, and earned profits by producing large quantities of inexpensive beer. However, regional breweries limited their distribution to a specific geographic region and leveraged their image of a "local" company in advertising to differentiate their products from those offered by national breweries. Generally, regional breweries produced a beer that was very similar to national breweries although their smaller size allowed more freedom to produce specialty brews as well.

The microbrewery segment consisted of breweries that produced less than 15 thousand barrels of beer annually. Because their distribution centered on the brewery itself, microbreweries tended to be a truly local product. By brewing small batches and using only top quality ingredients, microbreweries produced beers with quality equal to the imports. However, local production and distribution resulted in a product that was much fresher than imported beers. In addition, smaller batch production afforded microbreweries with greater flexibility and resulted in the production of a wider variety of beer styles. Over the past six years, this segment of the industry experienced significant consolidation.

THE CRAFT BREWING INDUSTRY

The craft-brewing industry was comprised of microbreweries and those regional breweries that produced high-quality, flavorful beers. After experiencing rapid sales growth of 30 to 50 percent per year from 1990-1994, the rate of sales growth declined to single digits over the next six years. Despite the declining rate of sales growth, this segment accounted for 3 percent of the total U.S. beer market sales in 2000. More recently, the industry grew 4.1 percent in 2000, more than doubling 1999's 1.9 percent increase over 1998 (Exhibit 1), and brought total annual sales for the segment to more than 5.9 million barrels. Craft-brewing sales generally came from four different sources. In addition to the regional brewery and microbrewery sources described above, sales in the craft-brewing industry were also comprised of sales from contract brewing companies and brewpubs.

Contract brewing companies provided brewing and bottling facilities for smaller craft brewers who did not have sales sufficiently high enough to warrant the capital expenditure associated with acquiring their own facilities and equipment. As a result, these smaller companies outsourced brewing and bottling activities to contract brewing companies. Craft beers were also brewed onsite by brewpubs and sold as draft beer to their patrons. Sales levels for each of the four sources of the craft-brewing industry are presented in Exhibit 2.

Exhibit 1: Annual Growth in Craft Beer Market (percentage growth in sales)

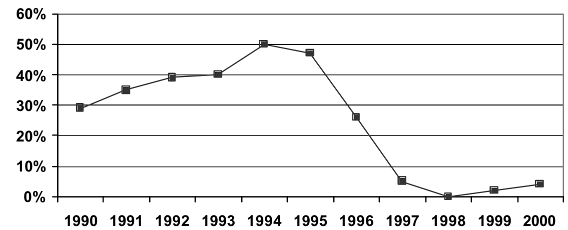
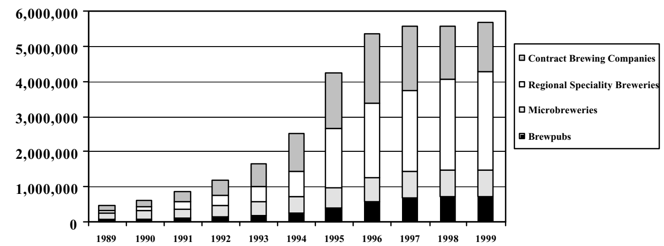


Exhibit 2: Craft Beer Sales (in barrels)



GETTING THE PRODUCT IN THE CONSUMER'S HANDS

Leathers and Nabozney described the malt beverage industry as being structured into a three-tier system: 1) brewers produced the product and then sold it to distributors, 2) distributors then sold the product to individual or chain retail outlets, and 3) retail outlets then sold the product to the consumer. As a result of this structure, breweries had to meet the demands of three distinct groups of customers. *Distributors* were generally looking for high sales volume brands that pulled other brands into their portfolio. Developing a portfolio of strong brands and having an efficient distribution system were essential for distributors to gain and maintain control in their target market.

Retailers were also interested in high sales volume brands that pulled consumers into their stores. High sales volume in retail outlets was critical due to finite shelf space and the low margins associated with this industry. Products that did not sell in high volumes were considered a waste of valuable shelf space.

The third tier consisted of the *consumers* who drink beer products. Leathers and Nabozney suggested, based on their review of industry research, that microbrew consumers were generally seeking products that offered high quality, provided a consistently good taste, and projected a favorable image on the individual. Leathers and Nabozney broke this tier into two segments: on-premise consumers and off-premise consumers. On-premise consumers purchased microbrews, usually served as draft beer, at bars and/or restaurants and were generally between the ages of 21 and 27. Because beer served draft style was not readily identifiable, the management team believed that taste and quality were a greater concern for these individuals than was image.

Off-premise consumers purchased microbrews in bottles from retail outlets for consumption at home or at a social function (picnic, sporting event, etc.). Because these beers were identifiable during consumption through the labeling provided on bottles, the management team believed that image was as important for these individuals as taste and quality. Purchasers in this segment were generally between the ages of 21 and 45.

BIG SKY BREWING COMPANY

Big Sky Brewing Company (BSBC) was founded in 1993 and began producing and selling craft-brewed ales in mid-1995. In its first six years, the company grew to become the largest brewery in the Northern Rockies region, which included Montana, Idaho, and Wyoming. This was despite the fact that until March 1, 2000 the company's ales were only available in kegs. Even before selling bottled beer, BSBC sold more beer than any of the other forty-plus breweries located in the Northern Rockies. With the addition of bottled beer sales in early 2000, BSBC sold more than three times as much beer as any other brewery in the region. The company realized strong sales growth from the beginning, with annual growth rates of 52% in 1997, 30% in 1998, 18% in 1999, and 57% in 2000. The slower than average growth in 1999 was caused by the entry of New Belgium Brewing's Fat Tire Ale into the Montana market.

Nabozney believed that BSBC's initial and continued success was primarily the quality of its beer:

> "There have always been quality issues in the craft brewing and micro-brewing. That's why we focus much of our efforts on quality. Simply put, we don't skimp….if something is bad, we pour (discard) it.

> Fortunately, this has only happened two times in our brief history. But we have a simple rule here…if it (the beer) doesn't meet specs (specifications), then we don't sell it. However, we're not beer snobs. There is a serious side around here, but we like keeping a fun atmosphere."

By May of 2001, BSBC sold its various ale products throughout Montana, Idaho, Wyoming, Washington, Oregon, Alaska, North Dakota, and South Dakota. For 2001 BSBC expected continued revenue growth of 104% for the year, with on-premise and off-premise purchases accounting for about 45 and 55 percent of BSBC's total sales respectively. Exhibits 3-8 provide historical financial statements for BSBC and select financial ratios for a peer group for the years 1998 through 2000.

The founders established the main brewery and distribution center near the Orange Street Bridge in downtown Missoula, Montana. This location was selected based on its easy access for distributors' and suppliers' vehicles and the fact that it would allow the founders to maintain their permanent residences. The facility was designed with offices in the front and a 5,000 square foot manufacturing space in the rear that provided the capacity necessary for the brewery to meet its production projections for all keg beer for the near future. However, the brewing facilities were not sufficient for brewing enough beer for the company's bottled beer projections, and there was no space available on the company's small lot for the necessary additional bottling equipment. Moreover, BSBC management expected that the product mix would change from the 44 percent keg beer sales, 55 percent bottled beer sales, 1 percent taproom beer sales that they experienced in 2000 to about 28 percent keg beer sales, 70 percent bottled beer sales, and 2 percent taproom beer sales in the next two years.

BIG SKY BREWING COMPANY ENTERS THE BOTTLED BEER MARKET

In order to penetrate the bottled beer market without expanding brewing its own site or opening a bottling facility, BSBC examined several northwestern contract brewing companies. BSBC eventually signed a contract with Portland Brewing Company (PBC) on March 1, 2000. PBC was selected primarily based on the fact that it had enough excess capacity to meet BSBC needs. Under the contract, BSBC products were to be brewed and bottled in PBC's plant in Portland, Oregon. Nabozney recalled the decision to enter the agreement with PBC:

> "Portland Brewing Company provided an inexpensive opportunity for us to test the bottled beer market without having to take on the debt necessary to finance the new equipment and larger facility required for us to bottle our own beer. We (senior management) agreed that if the market demonstrated enough demand for our bottled ales, we would look into the possibility of bottling our own beer in-house."

During the first ten months bottled beer sales surpassed draft sales by nearly ten percent. By January 2001, BSBC had contracts with 56 distributors and several hundred retail outlets. Major retail chain outlets carrying BSBC products included Safeway (350 outlets throughout Montana, Washington, Idaho, and Oregon), Costco (BSBC is its #1 microbrew product in the only two states that currently sell BSBC products – Montana and Idaho), Albertson's, Tidyman's, Fred Meyer's, Rosauers, QFC, Brown and Cole, Topcut, Larry's Markets, Yokes, Smith's, and many others. Leathers was clearly excited about how fast BSBC's product was moving off the shelves, "We're selling an average of 4-6 cases per week in each store…the industry average is only 2 cases per week for other microbrew brands! This puts us in a great position to continue expanding."

Exhibit 3 - Big Sky Brewing Historic Income Statement
Years 1998-2000
(In full dollar amounts)

	1998	1999	2000
Revenues	**$1,091,480**	**$1,290,903**	**$2,020,212[1]**
Costs of Goods Sold	**716,148**	**731,656**	**1,030,708**
Gross Profit	**375,332**	**559,247**	**989,504**
Total Sales and Admin Expense	**389,497**	**446,203**	**745,192**
Earnings Before Interest and Taxes	**-14,165**	**113,044**	**244,312**
Interest Expense	**18,755**	**47,035**	**51,812**
Earnings Before Taxes	**-32,920**	**66,009**	**192,500**
Taxes[2]	**0**	**0**	**0**
Net Income	**$-32,920**	**$66,009**	**$192,500**

[1] This was the first year that BSBC sold bottled beer. The following represents the breakdown of sales for 2000:
Wholesale beer = $798,160
Bottled beer = $997,700
Taproom beer = $18,140
Merchandise and Other revenue = $206,212

[2] BSBC paid no taxes in 1998-2001 because of loss-carry-forwards accrued in previous years.

Exhibit 4 - Big Sky Brewing Historic Balance Sheet
For Years 1998 to 2000
(In full dollar amounts)

	12/31/1998	12/31/1999	12/31/2000
Assets			
Current Assets			
Cash	$5,647	$69,922	$71,010
Accounts Receivable	61,268	75,852	187,562
Inventory	38,155	39,379	71,333
Other Current Assets	15,917	11,547	10,706
Total Current Assets	$120,987	$196,700	$340,611
Fixed Assets			
Gross Fixed Assets	835,317	1,100,439	1,369,138
Accumulated Depreciation	-411,394	-480,364	-574,592
Net Fixed Assets	$423,923	$620,075	$794,546
Other Assets	$5,354	$4,717	$3,946
Total Assets	**$550,264**	**$821,492**	**$1,139,103**
Liabilities & Equity			
Current Liabilities			
Accounts Payable	$72,333	$65,290	$144,719
Line of Credit	0	0	0
Other Current Liabilities	24,657	18,351	16,603
Current Portion of LT Debt	35,000	0	0
Total Current Liabilities	$131,990	$83,641	$161,322
Long-term Liabilities			
Loans	$238,452	$469,020	$492,450
Other LT Liabs	0	23,000	47,000
Total Long-term Liabilities	$238,452	$492,020	$539,450
Total Liabilities	**$370,442**	**$575,661**	**$700,772**
Stockholder Equity			
Capital Stock	510,355	510,355	510,355
Earnings	-330,533	-264,524	-72,024
Total Equity	**179,822**	**245,831**	**438,331**
Total Liabilities & Equity	**$550,264**	**$821,492**	**$1,139,103**

Exhibit 5
Big Sky Brewing Company
Historical Statements of Cash Flow
Years 1999 and 2000
(In full dollar amounts)

	1999	2000
Cash from Operations		
Net Income after tax	$66,009	$192,500
Plus Depreciation	68,970	94,228
Accounts Receivable Decrease (Incr.)	-14,584	-111,710
Inventory Decrease (Incr.)	-1,224	-31,954
Other Current Assets Decrease (Incr.)	4,370	841
Accounts Payable Increase (Decr.)	-7,043	79,429
Accrued Expenses Increase (Decr)	-6,306	-1,748
Total Cash from Operations	**110,192**	**221,586**
Cash from Financing		
Long Term Debt	230,568	23,430
Other Long Term Liabs.	23,000	24,000
Notes Payable	0	0
Current Portion LTD	-35,000	0
Paid in Capital	0	0
Total Cash from Financing	**218,568**	**47,430**
Cash from Investing		
Property, Plant & Equipment	-265,122	-268,699
Other LT Assets	637	771
Total Cash from Investing	**-264,485**	**-267,928**
Change in Cash	64,275	1,088
Beginning Cash	5,647	69,922
Ending Cash	$69,922	$71,010

Exhibit 6
Common Size Income Statement Data For Malt Beverage Industry
Provided By Robert Morris Associates*

	Peers
Revenues	
Total Revenue	100%
Total COGS	62%
Gross Profit	38%
Total Sales and Admin Expense	32%
Earnings Before Interest and Taxes	6%
Interest Expense	2%
Earnings Before Taxes	4%
Taxes	NA
Net Income	NA

* Peer data obtained from Robert Morris Associates Annual Statement Studies 2001-2002. Peer Group is classified as Malt Brewing Industry and includes 29 companies ranging in size from below $1 million in sales to over $25 million in sales.

Exhibit 7 - Common Size Balance Sheet Ratios For The Malt Beverage Industry Provided by Robert Morris*

	Peers*
Assets	
Current Assets	
Cash	10.00%
Accounts Receivable	8.80%
Inventory	11.50%
Other Current Assets	3.50%
Total Current Assets	33.80%
Fixed Assets	
Net Fixed Assets	49.40%
Other Assets	NA
Total Assets	**100.00%**
Liabilities & Equity	
Current Liabilities	
Accounts Payable	8.60%
Line of Credit	3.30%
Other Current Liabilities	NA
Current Portion of LT Debt	3.90%
Total Current Liabilities	22.80%
Long-term Liabilities	
Loans	27.10%
Other LT Liabs	NA
Total Long-term Liabilities	NA
Total Liabilities	**56.40%**
Stockholder Equity	
Capital Stock	NA
Retained Earnings	NA
Total Equity	**43.60%**
Total Liabilities & Equity	**100.00%**

Exhibit 8 - Malt Beverage Industry Peer Financial Ratios From Robert Morris Associates*

	Peers
Gross Margin	38.40%
Operating Margin	6.20%
Asset Turnover	1.5
Inventory Turnover	11.3
Days Sales Outstanding	22.95
Fixed Asset Turn	2.2
Payables Period	28.29
Leverage	3.00
Debt Ratio	66.67%
Times Interest Earned	3.3
Current	1.60
Quick	0.70

* Peer data obtained from Robert Morris Associates Annual Statement Studies 2001-2002. Peer Group is classified as Malt Brewing Industry and includes 29 companies ranging in size from below $1 million in sales to over $25 million in sales.

Nabozney had mixed emotions about the demand for BSBC's products. "It's great to see that our product is in such high demand. But we're being forced to turn down orders from some of the largest retail chains because we don't have enough capacity in our contractual arrangement with Portland Brewing (Company). Costco, for example, recently placed an order for 100,000 cases for its California stores but we can't fill such a large order…PBC simply doesn't have enough excess capacity to give us." The management team projected that its bottle sales could increase to as much as 80 percent of its total sales in the near future. BSBC based these revised projections on a combination of actual sales realized and the number of orders that could not be met because of the constraints imposed by the contractual arrangement with PBC. The contract required a six-week lead-time for orders, minimum orders of 1,750 cases, and only allowed bottling to take place every third week. As a result of these constraints, BSBC was unable to meet market demand, particularly during the peak demand months of June, July, and August.

BIG SKY BREWING COMPANY'S PRODUCTS

BSBC sold a variety of beers in draft and bottled form. The vast majority of BSBC's beer sales came from four brands: Moose Drool Brown Ale, Scape Goat Pale Ale, Powder Hound Winter Ale, and Slow Elk Oatmeal Stout (see Exhibit 9 for a description of the brands). Together, the four brands made up over ninety-seven percent of BSBC's beer sales with its Moose Drool brand accounting for nearly 80 percent of the total. BSBC has experienced overall sales growth since its introduction to the market, rising from just over 2,000 barrels in 1996 to over 15,000 barrels in 2000 (Exhibit 10).

In addition, BSBC generated revenue through the sale of branded merchandise in its own store as well as in retail stores throughout Montana and the surrounding states. Based on industry data, Leathers and Nabozney believed that BSBC quite possibly sold more branded merchandise than any other craft brewery in the USA. In addition to increasing the company's income, these items also served as advertising mediums for the brewery. T-shirts, drinking glasses, and hats were the most popular items with BSBC's customers. In 2000, BSBC sold over 15,700 barrels of beer, $380,000 in merchandise, and generated over $2.0 million in gross revenue.

BIG SKY BREWING COMPANY'S MAIN COMPETITION

BSBC's main craft-brewing competitors in its primary marketplace were: Bayern (Missoula, MT), Deschutes (Bend, OR), and New Belgium (Boulder, CO). In the Western Washington area, other breweries including Redhook, Pyramid, and Full Sail were also strong competitors. In its home state of Montana, BSBC sales in 2000 surpassed the combined sales of all other craft-breweries. The only downturn in BSBC's local sales growth was caused by the entry of New Belgium Brewing's Fat Tire Ale into the Montana market in early 1999. In 2000, BSBC beer outsold New Belgium by more than two-to-one in Montana, indicating a reversal in the trend. BSBC beer has experienced similar results in 2000 in other markets. In Idaho, BSBC was ranked in the top five craft breweries in terms of overall sales. BSBC's sales ranked the company in the top 20 craft-breweries in the Washington market. Statistics for the nation's top craft-breweries in 2000 are provided in Exhibit 11.

The key characteristics of BSBC's closest competitors are summarized in Exhibit 12. Bayern was BSBC's only true Montana based competitor, but BSBC sales have grown to almost three times Bayern's. The Alaskan Brewing Company continued to brew and bottle all beer in Juneau, Alaska and has built strong levels of brand equity and customer loyalty in the Pacific Northwest region. "We're committed to use the Montana mystique as a unique selling point," Nabozney noted, "and bottling in Montana instead of Oregon would allow us to leverage that even further". Like Alaskan Brewing and BSBC, the Deschutes Brewery relied heavily on image-based branding, building its brand image based on its association with the natural pristine beauty of the Oregon high plateau where the beer was brewed.

Exhibit 9 – Big Sky Brewing Company's Description of Products

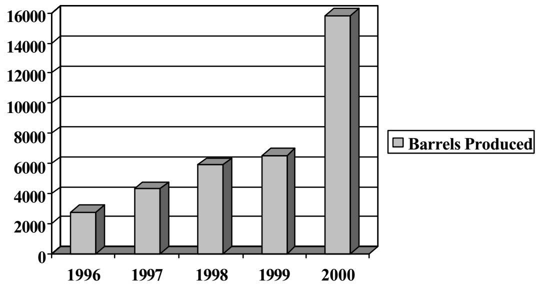
MOOSE DROOL Moose Drool is our Brown Ale. Far and away the best selling draft beer brewed in Montana, Moose Drool is chocolate brown in color with a creamy texture. Our brown ale is a malty beer with just enough hop presence to keep it from being too sweet. The aroma also mostly comes from the malt with a hint of spiciness being added by the hops. Moose Drool is brewed with pale, caramel, chocolate, and whole black malts and Kent Goldings, Liberty, and Willamette hops. It has an original gravity of 13 degrees Plato, and is 4.2% alcohol by weight, 5.3% by volume.

SCAPE GOAT Scape Goat is our award-winning Pale Ale. It is a very smooth, refreshing, and well-balanced brew. Scape Goat took home the Gold Medal from the 1997 North American Brewers' Association competition as the best English style Pale Ale brewed west of the Mississippi! Scape Goat is brewed with pale, crystal malts, and Kent Goldings and Crystal Hops. Scape Goat is 3.8% alcohol by weight and 4.7% by volume.

SLOW ELK Slow Elk is our Oatmeal Stout. It is a malty, creamy, and very smooth drinking beer. This is one stout that even people who "don't like dark beers" can love. By the way, a "Slow Elk" is a nickname for a cow, a few of which are mistaken for elk during hunting season every year! Slow Elk is brewed with pale, crystal, chocolate, and black malts, rolled oats, and Kent Goldings hops. Slow Elk is 3.9% alcohol by weight and 4.9% by volume.

POWDER HOUND Powder Hound is our Winter Ale. Available from November through March, Powder Hound is a deep golden colored ale brewed in the tradition of English Old Ales. It is a strong beer designed to warm up the coldest winter night, yet not so full bodied that you cannot enjoy a couple runs down the mountain. Powder Hound is brewed with Hugh Baird's Pale and Crystal malts, and then hopped with Kent Goldings and Willamette hops. Powder Hound is 4.6% alcohol by weight, 5.7% by volume.

Exhibit 10
BSBC Sales Growth



New Belgium was the largest of the seven competitors identified by Leathers and Nabozney, and its success story offered BSBC several insights. Leathers suggested that, "Both our and New Belgium's initial success are the result of our original flagship brands (BSBC: Moose Drool and New Belgium: Fat Tire) rather than to the introduction of several brands". New Belgium invested heavily in marketing and was rumored to have spent over $130,000 (mainly on neon signs) when it entered the Missoula market. According to Nabozney, "Although Boulevard and SLO Brewing do not sell in our markets and are unlikely to do so in the near future, we follow both companies closely." Boulevard and SLO were similar in size to BSBC's present position and recently invested approximately $2.5 million each into new bottling facilities. Both companies increased sales and gained market share over the past year. Among all of these competitors, BSBC was the only brewery that did not bottle in-house.

In comparison to most of its craft-brewery competitors, BSBC's products were usually priced at a level similar to Deschutes and New Belgium. A survey of prices in Montana supermarkets (Exhibit 13) illustrated that BSBC products typically sell for $6.49 per 6-pack.

Exhibit 11 - The Top 22 Craft Breweries Ranked by Share of Segment in 2000

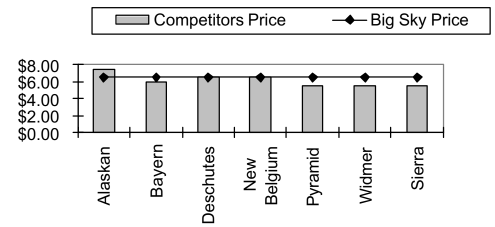
Company	*2000 shipments*	*% change in 2000*	*Share of segment*	*Change in share*
1. Sierra Nevada Brewing Co.	498,986	+14	8.44	+ 0.76
2. New Belgium Brewing Co.	165,000	+12	2.79	+ 0.18
3. Deschutes Brewery (2)	95,000	+10	1.61	+ 0.07
4. Alaskan Brewing Co.	81,300	+16	1.37	+ 0.14
5. Harpoon Brewery (2) *	63,100	+18	1.07	+ 0.13
6. Gordon Biersch Brewing Co. (packaging brewery only)	60,237	+13	1.02	+ 0.08
7. Boulevard Brewing Co.	46,060	+17	0.78	+ 0.08
8. Brooklyn Brewery*	35,100	+10	0.59	+ 0.03
9. BridgePort Brewing Co. (subs. of Gambrinus Co.)	30,720	+17	0.52	+ 0.06
10. Hops Restaurant, Bar and Brewery (74) (subs. of Avado Brands)	27,387	+18	0.46	+ 0.05
11. Gordon Biersch Brewery Restaurant Group (25-all brewpubs)	26,502	+17	0.45	+ 0.05
12. Magic Hat Brewe ry	26, 100	+21		
13. Kalamazoo Brewing Co.	24,600	+16	0.42	+ 0.05
14. Otter Creek Brewing Co.	24,500	+10	0.41	+ 0.02
15. Rogue Ales	23,687	+31	0.40	+ 0.08
16. Odell Brewing Co.	20,592	+12	0.35	+ 0.03
17. SLO Brewing Co. (2) *	20,600	+56	0.35	+ 0.13
18. Mac and Jack's Brewery	20,163	+26	0.34	+ 0.06
19. Anderson Valley Brewing Co.	17,737	+10	0.30	+ 0.01
20. Lagunitas Brewing Co.	17,099	+16	0.29	+ 0.03
21. Ram/Big Horn Brewery (20) (C.B. & Potts/ Humperdink's)	16,306	+18	0.28	+ 0.04
22. Big Sky Brewing Co.*	**15,741**	**+57**	**0.27**	**+ 0.14**

Notes: Figures in parentheses indicate number of breweries/brewpubs operating during 2000, if more than one. Shipments also refer to taxable removals at brewpubs. * Denotes all or partially contract brewed during 2000.
Source: Association of Brewers

Exhibit 12 - Key Characteristics of BSBC's Major Craft-brewing Competitors

Company	*In-House Bottling*	*# Barrels (2000)*	*Focal Markets*	*% sales increase (2000)*	*Differentiation*
Big Sky Brewery	No	15,741	Regional Northwest	57%	In 2000, achieved the largest increase in sales (57% growth) of any of the top 50 craft brewers. For the fourth straight year, Big Sky Brewing Company sold more beer than any other Montana Brewery. Moose Drool continues to be the best selling draft beer brewed in Montana.
Alaskan Brewing	Yes	81,300	Regional Pacific Northwest	16%	In 1986 they were the only brewery in Alaska. They use pure malt, premium hops, glacier-fed waters and continue to brew all beer in Juneau, Alaska.
Deschutes Brewery	Yes	95,000	Regional Pacific Northwest	10%	Deschutes was named for the wild and scenic Deschutes River. Produce handcrafted, traditional style ales and lagers.
New Belgium Brewing	Yes	165,000	Regional Western	12%	Its brewing facility is a nationally recognized paradigm of efficiency. 1998 NBB made the financial commitment to make its facility the first wind powered brewery in America.
Boulevard Brewing	Yes	46,060	Regional Midwest	17%	The brewery is in a historic district of Kansas City, Missouri, in a turn-of-the-century building which had originally housed the laundry of the Santa Fe Railroad. The beer has distinctive hop characteristics.
SLO Brewing	Yes	20,600	Regional West Coast	56%	Fourth largest brewery in California. Pushing draft sales in restaurants and bars helped SLO Brewing triple its accounts in Northern California to 60 in the past year.
Bayern	Yes	5,600	Regional to Montana	0.94%	They are the only German brewery in the Rocky Mountains. Bayern does not contract brew or bottle outside its own brewery and they brew strictly according to the German Law of Purity of 1516. Big Sky's largest Montana based competitor.

Exhibit 13 - Retail Prices per 6-pack



MANAGEMENT TEAM AND KEY PERSONNEL

BSBC had four employees on its initial management team. All four managers were with BSBC since production began, and three were the company's founders. The company added several key employees over the past few years and planned to add a controller within the next year. The current management team consisted of:

Neal Leathers – President and Founder. Neal was involved in brewing since 1985 and was the President and one of the founders of BSBC. In the 15 years Neal was involved in the micro-brew industry, responsible for literally every aspect of the business – from brewing to marketing to financing. At BSBC, Neal was responsible for company oversight, long-term planning, financial projections, industry relations, and project management. Neal held a B.A. in Telecommunications from Michigan State University.

Bjorn Nabozney – Vice President and Founder. While a student in business school at the University of Montana, Bjorn wrote the original business plan for BSBC. He then spent the next four years trying to raise the initial seed capital to make his dream a reality and start the business. As a founder and vice president of BSBC, Bjorn has spent the past six years performing all the various functions required to grow the business into the largest brewery in the Northern Rockies. Throughout the process of growing the business, Bjorn has shown the same enthusiasm, passion, and resourcefulness he did as a student writing the plan and raising the initial capital. Bjorn was primarily responsible for beer sales and marketing, project implementation, equipment evaluation and purchasing, and long-term planning. Bjorn's talent in sales and marketing were illustrated by his acquisition of major accounts such as Safeway and Costco. He has been a Vice President since 1997. Bjorn has a B.S. in Finance from the University of Montana.

Kris Nabozney – Vice President. Kris was employed by BSBC since production began in the summer of 1995. Kris was primarily responsible for production operations, quality assurance, and long-term planning. Kris has been a Vice President since 1999. Kris was working towards his B.S. in Management at the University of Montana.

Brad Robinson –Founder. Brad has been involved in brewing since 1985 and was one of the founders of BSBC. Brad was primarily responsible for advertising, retail and wholesale merchandise purchasing and management, public relations, and long-term planning. Brad has a B.A. in Zoology from the University of Montana.

Matt Long – Head Brewer. Matt has worked at BSBC for nearly five years. Matt was named Head Brewer at BSBC in 2000. Matt earned a B.A. in Microbiology from the University of Montana, and has graduated from an intense six-month brewing course offered by the American Brewers' Guild. During Matt's tenure at BSBC, the company has won numerous awards for its hand crafted beers.

Kevin Keeter – Bottling Line Manager. Kevin has been a professional brewer for over ten years. During that time, Kevin has been involved in a major expansion that included purchasing and installing a bottling line for a Washington based craft brewery. He also was the lead on that bottling line for over two years. Because of his experience installing, maintaining, and operating a bottling line, Kevin is playing a major role in the upcoming expansion of BSBC.

Chad Hania – Regional Sales Manager. Chad was an experienced regional sales manager within the beverage industry. Prior to coming to BSBC, Chad worked for four years as the regional sales manager of A&W Bottling Co. of Spokane, WA. During that period Chad was largely responsible for the tremendous increase in sales of SoBe products in the four-state region of Montana, Idaho, Washington, and Wyoming. Also, during those four years, Chad made numerous contacts within store chains in BSBC's primary geographic region, which will prove invaluable in getting BSBC's bottled products on grocery and convenience store shelves.

EXPANSION PLANS

BSBC's constraints on growth during 2000 forced management to consider an in-house alternative to the contract brewing arrangement with PBC. All of BSBC's bottled beers were brewed and bottled at PBC's 130,000 total barrel capacity facility in Portland. Although PBC provided contract brewing services for several smaller companies, most of its capacity was devoted to production of its own portfolio of beers. Accommodating its contract brewing and bottling services required carefully arranged schedules for the facilities and frequent meetings with breweries. BSBC's 18,000 barrel maximum production contract with PBC, for example, stated that orders needed to be placed a minimum of six weeks in advance, allowed access to the bottling line every third week, called for minimum orders of 1,750 cases, and required bi-weekly visits to Portland by one or more of BSBC's management team. One or two management team members

traveled to PBC every second week at a cost of $1,000 per manager in addition to the lost work time during travel to and from PBC. Nabozney expressed his concerns about this arrangement: "These constraints are difficult for us. We're still in the process of pegging rapidly growing demand levels in each market we enter. Our current arrangement doesn't allow for much flexibility. This amount of travel is also difficult on our families."

Leathers noted that there were additional constraints regarding accounts payable and inventory handling costs:

> "The contract with PBC stipulates payment terms of net 20. This means that we need to pay for all of our bottled beer orders within 20 days of production. Meanwhile, our contract with our suppliers for in-house brewing calls for payment terms of net 30. By bringing bottling in-house we will have ten extra days to pay suppliers at no additional cost. We also have to pay penalties to PBC for long-term storage of our products. These penalties can really add up, so we've worked hard to avoid them".

These constraints, coupled with the initial success in the bottled beer market, led the management team to develop plans for bringing bottling activities in-house. This was consistent with the management team's original plan to discontinue outsourcing these activities once the company's sales volume reached a point at which they believed in-house bottling and brewing would afford significant economies of scale and thereby reduce the high per unit costs associated with outsourcing these activities.

The project being considered involved constructing a 30,000 square foot facility that, combined with its existing 8,000 square foot facility, would provide enough room for the company to expand production fourfold before requiring additional external expansion. In addition to moving much of BSBC's current production equipment to the new site, over $1.3 million dollars of brewing equipment would be purchased and installed in the new facility. This equipment would allow BSBC to brew more than twice as much ale per day as its current facility and contract with PBC permitted, as well as allowing BSBC to package its ales in bottles. All of the equipment to be purchased was selected based on its ability to allow continued expansion as BSBC's production needs grow. The project included enough land to allow BSBC to more than double the building's size for future expansion. In addition, an option was negotiated that would permit BSBC to purchase additional adjoining acreage within the first two years. This 2.5-acre parcel would make it possible for BSBC to more than double its brewery's size and ensured that this location would remain BSBC's long-term home.

Leathers looked optimistically toward the new facility, "We expect to gain significant flexibility as a result of this project. For example, we're going to be able to bottle every week, produce smaller orders of 450 cases, and we'll be able to reduce our lead time on orders from 6 weeks to 2 weeks." A comparison between existing operations and operations with the new facility is provided in Exhibit 14.

Exhibit 14 – Improvements from bringing bottling in-house

Parameter	Current Operations	Operations After Expansion
Bottling	Every three weeks	Every week
Minimum size orders	1,750 cases	450 cases
Lead time for orders	6 weeks	2 weeks or less
Payment terms	Net 20 on all orders (can surpass $150,000 payable per order)	Net 30 is standard
Total Capacity	34,000 Barrels 18,000 at PBC 16,000 at BSBC	Up to 100,000 Barrels

Nabozney and Leathers were proud of BSBC's human resource record; only one employee had left the organization since the company was founded. Nabozney estimated that the expanded facilities would create an additional 22 jobs (an increase from 14 currently employed to 36 employees once expansion is completed), most of which would be well-above the state's average income level per capita. Moreover, Nabozney argued, "In a sparsely populated state like Montana, expansion by a business like ours has significant spillover effects into other industries. For example, due to the amount of paper we use for cardboard case boxes and six-pack holders, we will become one of the largest users of paper in the state. We're excited about being able to help these suppliers while we expand."

FINDING FINANCING – A JOB FOR MONTANA BUSINESS CAPITAL

BSBC founders were drawn to Montana Business Capital Corporation based on the company's reputation for helping Northwestern United States businesses find more attractive financing alternatives than readily advertised by commercial lenders. Swenson described his company as "a boutique investment banking and consulting services company". As he put it, "we provide consulting services regarding optimal funding strategies to expanding businesses. Once a strategy is developed, we package the funding request and act as an agent for the borrower".

Swenson's company excelled when working with clients who could benefit from some level of government enhancement. The company's Web site highlighted these specialized skills:

> "We are uniquely adept at applying these government augmentation products to commercial credits. There are many details and exceptions inherent to these applications, which can make the difference between a successful application and a denial. Montana Business Capital Corporation supplies "high touch" services to its clients. This complete and thorough suite of services includes extensive work with the client on business plans, projections, pricing, management techniques, etc. Montana Business Capital Corporation's services also include utilizing an extensive background in the usage of various programs, as well as dedicating time to client specific research related to the implementation of these programs."

One government program that Swenson had been particularly successful in using was the USDA's Rural Business-Cooperative Service Business Program (RBS BP). This program worked in partnership with the private sector and community-based organizations to provide financial assistance and business planning to projects that create or preserve quality jobs. As RBS BP described the program, "the financial resources of RBS BP are often leveraged with those of other public and private credit source lenders to meet business and credit needs in underserved areas". In fiscal year 2000, the program disbursed a total of 721 loans and 473 grants totaling over $1.1 billion. This resulted in over 73,000 jobs either being created or saved, and over 2,500 businesses assisted in rural America. Swenson planned to use RBS BP's Business and Industry Guaranteed Loan Program for BSBC. This program provided guarantees up to 90 percent of a loan made by a commercial lender. Loan proceeds were to be used for working capital, machinery and equipment, and buildings and real estate.

BSBC's expansion project required a total of $2.6 million. Swenson determined that this amount would be raised through $350,000 from an equity infusion from current investors, $2.0 million from a USDA RBP BP Business and Industry Guaranteed Loan, $150,000 from a Missoula Area Economic Development Corporation loan that was already approved but contingent upon approval of the loan from the USDA, and $100,000 from BSBC's cash reserves. The loan was to be used to purchase land, build the new brewery, and purchase and install new brewing and bottling equipment. Exhibits 15-17 provide projected financials obtained from information in the original loan application. The expansion project was expected to result in total company sales of $6.8 million and net income of $581,000 by 2004. Throughout the first three years BSBC expected to maintain a positive cash flow. Expected operating cash flows for 2002-2005 are provided in Exhibit 18.

There was also a brief discussion about the appropriate cost of capital to use in evaluating projects. The new loan would have a blended interest rate of 3.125%. Swenson believed that if BSBC did not obtain the loan a more traditional loan would carry a minimum interest rate of about 10%. Swenson also added that more traditional lenders would most likely not approve the loan because the company was already highly leveraged. As a result, if the company was unable to acquire the loan from the USDA's program, BSBC would have to rely on more expensive equity financing. Currently the owners thought that they should earn about 30% on equity investments. One team member argued that based on his research of competitors, a cost of capital of 15% would be appropriate for BSBC. Another opposing position argued that venture capitalists typically seek an expected return of 35% or more for new ventures.

Exhibit 15 - Big Sky Brewing Forecasted Income Statements
For Years 2001-2004
(In full dollar amounts)

	2001[1]	2002	2003	2004
Revenues				
Beer Revenue				
Wholesale Beer	1,215,000	1,302,750	1,552,500	1,721,250
Bottled Beer	2,440,944	2,915,902	3,925,199	4,328,932
Taproom Beer	63,800	84,400	84,400	92,200
Other	12,500	12,000	12,000	12,000
Merchandise Revenue	425,000	500,000	550,000	605,000
Total Revenue	**4,157,244**	**4,815,052**	**6,124,099**	**6,759,382**
Cost of Goods Sold:				
Manufacturing				
Wholesale, bottled, taproom Beer Costs	2,433,469	2,433,491	3,029,977	3,339,625
Excise Tax	63,000	163,800	217,000	239,750
Depreciation	159,720	274,020	296,736	314,652
Total Manufacturing COGS	2,656,189	2,871,311	3,543,713	3,894,027
Total Retail Sales COGS	265,625	312,500	343,750	378,125
Total COGS	**2,921,814**	**3,183,811**	**3,887,463**	**4,272,152**
Gross Profit	**1,235,430**	**1,631,241**	**2,236,637**	**2,487,230**
Selling and Admin Expense				
Sales Costs	515,045	616,200	742,200	803,000
General and Admin Expense	360,870	438,901	531,888	547,996
Total Sales and Admin Expense	**875,915**	**1,055,101**	**1,274,088**	**1,350,996**
Earnings Before Interest and Taxes	**359,515**	**576,140**	**962,549**	**1,136,234**
Interest Expense	90,000	130,743	142,620	132,855
Earnings Before Taxes	**269,515**	**445,397**	**819,929**	**1,003,379**
Taxes	**60,580**	**187,068**	**344,372**	**421,420**
Net Income	**208,935**	**258,329**	**475,557**	**581,959**

[1] Note: As mentioned in the case, BSBC experienced a significant product mix shift between 1999 and 2001. 1999 data represents a product mix that did not include bottled beer. In the 2nd quarter of 2000, BSBC entered its bottling agreement with PBC and began selling bottled beer. And, 2001 represents the full year in which BSBC was selling bottled beer as part of its product mix. It should also be noted that the revenue generated per barrel of beer is much higher when sold in bottles versus when sold in kegs. Correspondingly, the cost of goods sold is higher for bottled beer than for keg beer.

Exhibit 16 - Big Sky Brewing Forecasted Balance Sheets
For the Years 2001-2004
(In full dollar amounts)

	12/31/2001	12/31/2002	12/31/2003	12/31/2004
Assets				
Current Assets				
Cash	19,297	384,134	781,169	1,346,448
Accounts Receivable	152,264	177,264	202,264	227,264
Inventory	126,333	146,334	166,335	186,336
Other Current Assets	8,064	8,064	8,064	8,064
Total Current Assets	305,958	715,796	1,157,832	1,768,112
Fixed Assets				
Gross Fixed Assets	4,046,014	4,056,014	4,256,014	4,406,014
Accumulated Depreciation	-734,312	-1,008,332	-1,305,068	-1,619,720
Net Fixed Assets	3,311,702	3,047,682	2,950,946	2,786,294
Other Assets	6,917	6,917	6,917	6,917
Total Assets	**3,624,577**	**3,770,395**	**4,115,695**	**4,561,323**
Liabilities & Equity				
Current Liabilities				
Accounts Payable	83,145	108,145	133,145	158,145
Line of Credit	35,000	35,000	35,000	35,000
Other Current Liabilities	78,887	77,887	77,887	77,887
Current Portion of LT Debt	126,783	122,980	119,291	115,713
Total Current Liabilities	323,815	344,012	365,323	386,745
Long-term Liabilities				
Loans	2,403,496	2,270,788	2,119,220	1,961,467
Other LT Liabs	0	0	0	0
Total Long-term Liabilities	2,403,496	2,270,788	2,119,220	1,961,467
Total Liabilities	**2,727,311**	**2,614,800**	**2,484,543**	**2,348,212**
Stockholder Equity				
Capital Stock	760,355	760,355	760,355	760,355
Retained Earnings	136,911	395,240	870,797	1,452,757
Total Equity	**897,266**	**1,155,595**	**1,631,152**	**2,213,112**
Total Liabilities & Equity	**3,624,577**	**3,770,395**	**4,115,695**	**4,561,323**

Exhibit 17 - Big Sky Brewing Forecasted Statement of Cash Flows
For Years 2001 to 2002
(In full dollar amounts)

	2001e	2002f	2003f	2004f
Cash from Operations				
Net Income after tax	208936	258329	475557	581959
Plus Depreciation	159720	274020	296736	314652
Accounts Receivable Decrease (Incr.)	35298	-25000	-25000	-25000
Inventory Decrease (Incr.)	-55000	-20001	-20001	-20001
Other Current Assets Decrease (Incr.)	2642	0	0	0
Accounts Payable Increase (Decr.)	-61574	25000	25000	25000
Accrued Expenses Increase (Decr)	62284	-1000	0	0
Total Cash from Operations	352306	511348	752292	876610
Long Term Debt	1911046	-132708	-151568	-157753
Other Long Term Liabilities	-47000	0	0	0
Notes Payable	35000	0	0	0
Current Portion LTD	126783	-3803	-3689	-3578
Paid in Capital	250000	0	0	0
Total Cash from Financing	2275829	-136511	-155257	-161331
Property, Plant & Equipment	-2676876	-10000	-200000	-150000
Other LT Assets	-2971	0	0	0
Total Cash from Investing	-2679847	-10000	-200000	-150000
Change in Cash	-51712	364837	397035	565279
Beginning Cash	71010	19297	384134	781169
Ending Cash	19297	384134	781169	1346448

Exhibit 18 - Project Cash Flows Resulting from Expansion
Operating Cash Flows for the Years 2001 to 2002
(In full dollar amounts)

	2001	2002	2003	2004	2005
Project Investment	$-2,600,000				
Operating Cash Flows with Expansion		$663,092	$914,913	$1,029,466	
Operating Cash Flow w/o Expansion		$504,521[1]	$554,973	$610,470	
Marginal OCF		$158,571	$359,940	$418,996	$439,946[2]
Total Project Cash Flows 2001-2005	$-2,600,000	$158,571	$359,940	$418,996	$439,946

Calculation of OCF With Expansion (2002-2004):	For 2002
Net Income:	$ 258,329
Plus: Depreciation:	$ 274,020
Plus: Interest	$ 130,743
Total Operating Cash Flow	$ 663,092
Calculation of OCF With Out Expansion (2001):	For 2001
Net Income:	$ 208,935
Plus: Depreciation:	$ 159,720
Plus: Interest	$ 90,000
Total Operating Cash Flow	$ 458,655

[1] Assumes that OCF will increase at a rate of 10% a year from 2002 to 2004 if BSBC does not expand and continues to outsource.

[2] Marginal operating cash flows beyond 2004 are calculated assuming a constant 5% growth rate.

Finally, Swenson suggested that a break-even analysis should be conducted to illustrate any increases in operating risk associated with in-house bottling. In-house bottling would increase fixed costs such as interest expense, depreciation and other salary and maintenance expenses associated with bringing bottling in-house. Swenson examined BSBC's cost structure and determined that depreciation, interest expense, and general administration expense were predominately fixed costs in the near term. A large portion of BSBC's sales costs were also fixed in the short term. Finally a portion of manufacturing costs, (predominately rent, leases, salaries, maintenance and some utilities), were also categorized as fixed. Exhibit 19 illustrates the breakdown of fixed and variable costs for BSBC from 2001 to 2002.

Exhibit 19 - Breakdown of BSBC costs into Fixed and Variable Costs 2001-2004

	2001	2002	2003	2004
Forecasted Revenues	$4,157,199	$4,815,052	$6,124,099	$6,759,382
Fixed Costs	$1,189,631	$1,664,624	$1,938,857	$2,046,993
Variable Costs	$2,763,298	$2,892,099	$3,709,686	$4,130,430
Variable Costs as Percent of Revs.	66%	60%	61%	61%

MAKING THE CASE FOR EXPANSION

As the four hour meeting began to wind down, Swenson, Leathers, and Nabozney summarized their conclusions. Swenson's remarks captured the essence of their conclusions:

> "I think that the USDA was right in terms of what we were lacking in the original application…especially in terms of the supplementary documents. We know that the expansion makes sense but we need to do a better job of convincing them. In the original document you only included a four-page summary of the business and the expansion plan. We need to use the information we discussed today to convince them that the combination of your team, the market opportunity, and their financing will lead to success. To do this, we need several things. First, we need to assess what components we might be missing on the team. They (the USDA) indicated that they are not convinced that you have all the pieces in place to pursue such a large expansion. Second, we need to do a better job of analyzing the market. You've provided some data regarding the market, but we need to analyze in greater depth and in a more organized way. And third, we need to provide evidence that this expansion is necessary at this time. This means that we need more analysis regarding the expected hard and soft results from pursuing the expansion project. The hard results entail analyzing the value of the project, breakeven points, etc. The soft results include what you believe will be gained operationally from expanding".

As the three rose from the table, Swenson reminded Leathers and Nabozney that they had three days to get the new application and analysis together. They knew that completing this work within such a short time-frame posed a real challenge, but realized that the alternative of not getting the USDA guarantee would likely pose even greater challenges for obtaining the necessary financing for expansion.