

## **POSSIBLE MOTION**

**I MOVE TO** approve a loan in the amount of \$350,000 to the Baranof Island Brewing Company from the Southeast Alaska Economic Development Revolving Loan Fund with the following terms:

- 1) A term of 20 years with equal monthly payments of interest and principal;
- 2) An interest rate equal to the 30 year Treasury bill (currently 3.6%);
- 3) Collateralization of a superior lien on all assets of the business;
- 4) Personal guarantees of the owners;
- 5) A requirement that Baranof Island Brewing Company allow for the CBS Finance Director or Deputy Finance Director to inspect their financial records and discuss financial position and performance at such times as the CBS requests, but not more often than quarterly.

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## MEMORANDUM

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**To:** Mayor McConnell and Members of the Assembly  
Mark Gorman, Municipal Administrator

**From:** Jay Sweeney, Finance Director

**CC:** Mark Gorman, Municipal Administrator

**Date:** February 3, 2014

**Subject:** Baranof Island Brewing Company Economic Development Loan

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**Issue/Decision:**

The Baranof Island Brewing Company (BIBC) is requesting an additional loan in the amount of \$350,000.00 from the Southeast Alaska Economic Development Revolving Loan Fund (Stevens Fund). It is the purview of the Assembly as to whether or not to grant the loan. Administration is recommending approval of the loan..

**Background:**

On May 4, 2011, the City and Borough of Sitka (CBS) loaned \$282,080 from the Stevens Fund to the BIBC with terms of 3.5% interest and monthly payments for 20 years (240 payments of \$1,635.52) (enclosure)

In the spring of 2012, the BIBC approached the CBS for an additional loan of \$75,000. The Assembly approved a short-term, interest only loan of \$75,000.00 at 3.5% interest on April 6, 2012 to mature on October 1, 2012 (enclosure). The Assembly directed, however, that both the May 4, 2011 and the April 6, 2012 loans could be restructured and consolidated into one new loan if the BIBC prepared and submitted a business plan to the CBS which demonstrated how the restructured loan was to be repaid and the CBS's security for the loan.

Having prepared and submitted a business plan, the Assembly approved the restructuring of the May 4, 2011 and the April 6, 2012 loans into one new loan in the amount of \$345,796 on October 2, 2012 with terms of 3.5% interest and monthly payments for 20 years (240 payments of \$2,005.25).

In December 2013, the BIBC approached the CBS to borrow an additional \$350,000.00 to expand further. Specifically, the BIBC wants to purchase additional equipment to be able to meet demand for its products, including higher quality grain processing equipment and a canning line (enclosure).

During December and January, CBS Finance personnel met on several occasions with BIBC management and stressed that a much more detailed business plan and pro forma financial forecast to accompany the business plan would be required before the CBS would consider any additional loans. The BIBC submitted several business plans which were returned for being insufficient in detail and scope before a solid, well developed plan and pro forma was received on January 27 (enclosure).

On January 28, CBS Finance personnel met with BIBC management for 2 hours and discussed all aspects of the BIBC business plan in detail. The pro forma financial projections submitted by BIBC were thoroughly questioned and examined. Based on the refined final business plan and management discussion on January 28, CBS Financial personnel are satisfied with the BIBC plan and are convinced that adequate security and ability to repay have been demonstrated by the BIBC.

As of February 3, 2014, BIBC is current on all loan payments. The balance owed on the October 2, 2012 loan is \$330,456.90 plus accrued interest. BIBC and its owners are also current on all other financial obligations to the CBS.

### **Discussion**

BIBC management has demonstrated a willingness to engage in detailed financial planning to ensure the success of their business. In particular, BIBC has engaged financial consultants to advise them and assist them with the development of a realistic business plan and pro forma financial forecast.

BIBC has also explained what business opportunities they wish to pursue and why the additional loan is necessary in order to pursue the opportunities. In particular, BIBC has the opportunity to expand production to fill unmet need for their products but requires additional capital to do so. Without additional capital, this expansion can't take place.

In its business plan, BIBC provides for the employment of two additional Sitkans if it is able to expand and increase production. As the goal of the Stevens Fund was to diversify the local economy and provide for new jobs in non-timber harvesting industries, this proposed loan and business expansion meets the goals of the Stevens Fund.

In the opinion, the CBS will be adequately collateralized for the additional loan, as it has a priority lien on all assets of the BIBC, and CBS Finance personnel feel that the BIBC business plan is realistic and adequately demonstrates the ability to repay.

### **Recommendation**

CBS Finance recommend the approval of the BIBC loan request with the following terms: a term of 20 years with equal monthly payments of interest and principal; an interest rate equal to the 30 year Treasury bill (currently 3.6%); collateralization of a

superior lien on all assets of the business; personal guarantees of the owners; and, a requirement that BIBC allow for the CBS Finance Director or Deputy Finance Director inspect their financial records and discuss financial position and performance at such times as the CBS requests, but not more often than quarterly.



**Baranof Island Brewing Company**  
215 Smith Street  
Sitka, AK 99835  
907-747-2791



Baranof Island Brewing Company has come a long way since its very humble beginnings in 2009. What started as a dream to open a local Sitka brewery has developed into a successful company with 6 full time employees, 5 part time employees and distribution of Sitka beer throughout Alaska and Washington State.

Our plan for the next five years involves increasing production to meet current demand and grow distribution while decreasing costs and improving efficiency of production. We have identified several points along the production process that need to be addressed in order to meet the above goals.

The first area of production where efficiency needs to be improved is the malt mill. Our current mill gives us around 67% efficiency rate for the malted grains used. The purchase of a new mill that would crush malt more effectively would increase our efficiency rate from around 67% to between 87%-92%. This would decrease our grain bill and the associated shipping costs plus enable us to produce additional beer with the same amount of raw materials.

BIBCO's actual brewing equipment is currently at capacity. We produced 992 gallons of beer during 2010, our first year of operation. The following years we produced 2,635 gallons and 11,532 gallons. We finished up 2013 with production at around 21,700 gallons. Our conservative goal for 2014 is to produce 37,975 gallons. To reach this goal we plan to add four 15 barrel fermenters. (One barrel=31 gallons). This will amount to an additional 1,356 gallons of beer produced per month in compared to 2013. The additional beer will be packaged and sold outside of Sitka to meet the current demand. In addition to increased production, the new fermenters will increase the efficiency of production. The new fermenters can hold additional beer and can be used to ferment and condition the beer. Our current system requires us to transfer beer to separate conditioning tanks where the beer is chilled and carbonated. Labor and chemical costs incurred in the transfer and cleaning of the tanks will be eliminated.

Currently BIBCO packages its beer in kegs or 22oz bottles for distribution. Because of our location and the time, cost and logistics involved in returning the kegs, the majority of distribution outside of Southeast Alaska has been in 22 oz bottles. The 22oz bottles are expensive to ship in to Sitka empty and even more expensive to ship out full. This has cut into the profit margin as distributors are not concerned with the shipping expense and are more concerned with if our product can compete pricewise on the shelves with the other beers. Canning has emerged in the last few years as a popular and economical method to distribute beer in the craft beer industry. In order for us to remain competitive in the market we have identified the need to install a canning line. Shipping costs would decrease both in and out of Sitka making the product more attractive to distributors and beer drinkers alike. An additional benefit to a can versus a bottle is that a can is basically a mini keg. It doesn't allow light to spoil the product and increases





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the shelf life which is a concern to us when looking to increase our range of distribution. When asked for the opinion of our main distributor on cans he said the only problem is keeping it on the shelf. Consumers are familiar with canned microbrews and appreciate the portability as well as being friendly to the environment in terms of recycling and carbon footprint.

According to the Brewers Association publications in 2013, United States Craft Breweries production grew in volumes by 13% in 2011 and 15% in 2012 yet craft breweries still have only 6% of the entire beer market in the United States. The total amount of beer produced and imported in the United States in 2012 was 227,741,185 barrels. Craft Breweries made only 13,235,917 barrels of that total. Given our anticipated production of 1,225 barrels for 2014 we would only have .00000538 share of the market. It is difficult at this time to determine our true market share in Alaska. We have not been able to fill our orders to Anchorage for distribution and have only been able to fill half of our orders to Juneau with our current system operating at capacity.

Our distributors and customers have been more than receptive to our beer. Our product stands out from the rest due to our location, the draw of "Alaska" products and of course some outstanding beer.

We are requesting a loan for \$350,000.00 from the Southeast Economic Development fund. We would ask that we are able to consolidate the loans together and obtain the same terms. With this loan and the installation of the equipment we will be able to fill our current orders and expand our distribution while hiring 2 more full time employees.

We have provided the City Finance Director a proforma, profit and loss statement and balance sheet for Baranof Island Brewing Company. Please call or email us anytime with questions or concerns you may have at 907-747-2739 or [rick@baranofislandbrewing.com](mailto:rick@baranofislandbrewing.com) or [suzan@baranofislandbrewing.com](mailto:suzan@baranofislandbrewing.com)

Thank you for your time and consideration

Rick Armstrong and Suzan Hess Armstrong