

EASTSIDE DISTILLING, INC.
(NASDAQ: EAST)



Fourth Quarter and Fiscal Year 2018
Financial Results

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CORPORATE PARTICIPANTS

Grover Wickersham –Chairman and Chief Executive Officer, Eastside Distilling, Inc.
Steve Shum – Chief Financial Office, Eastside Distilling, Inc.
Robert Manfredonia –President, Eastside Distilling, Inc.
Robert Blum – Managing Partner, Lytham Partners

PRESENTATION

Operator

Good morning and welcome to the Eastside Distilling Fourth Quarter and Fiscal Year 2018 Financial Results Conference Call. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star (*) key followed by zero (0). After today's presentation there will be an opportunity to ask questions. To ask a question you may press star (*) then one (1) on your touchtone phone. To withdraw your question, please press star (*) then two (2). Please note this event is being recorded.

I would now like to turn the conference over to Robert Blum with Lytham Partners. Please go ahead.

Robert Blum

Thank you, Carrie. Good morning, everyone, and thank you for joining us today to discuss Eastside Distilling's financial results for the quarter and year-end December 31, 2018. I'm Robert Blum of Lytham Partners and I will be your moderator for today's call. Joining us on today's call to discuss these results are Grover Wickersham, CEO of Eastside Distilling; Robert Manfredonia, President; and Steve Shum, Chief Financial Officer. Following the remarks, we will open the call to your questions.

Before we begin with prepared remarks, we submit for the record the following statement: Certain matters discussed on this conference call by the management of Eastside Distilling may be forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 as amended; Section 21E of the Securities Exchange Act of 1934 as amended; and such forward-looking statements are made pursuant to the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995.

Forward-looking statements describe future expectations, plans, results, or strategies and are generally preceded by words such as “may”, “future”, “plan” or “planned”, “will” or “should”, “expected”, “anticipates”, “draft”, “eventually”, or “projected”. Listeners are cautioned that such statements are subject to a multitude of risks and uncertainties that could cause future circumstances, events, or results to differ materially from those projected in the forward-looking statements. Such matters involve risks and uncertainties that may cause actual results to differ materially includes but are not limited to the Company’s acceptance and the Company’s products in the markets, success in obtaining new customers, success in product development, ability to execute its business model and strategic plans, success in integrating acquired entities and assets, ability to obtain capital, ability to continue as a growing concern, and all of the risks and related information described from time to time in the Company’s filings with the Securities and Exchange Commission, including the financial statements and related information pertaining to the Company’s annual report on Form 10-K filed with the Securities and Exchange Commission for the year ended December 31, 2017.

Now, I would like to turn the call over to Grover Wickersham, CEO of Eastside Distilling. Grover, please proceed.

Grover Wickersham

Good morning, Robert, and welcome to everyone on the call. I’m Grover Wickersham and I’m the CEO of Eastside Distilling and it’s my pleasure to report on our 2018 results and also give some color as what we seen happening in 2019. Before I really officially launch the call, I wanted to thank the loyal shareholders who participated in our raise at the end of December of 2018. This was an amazing addition to our war chest and it has enabled us to put in place the Craft acquisition and we have lots of plans for 2019 and I wanted just to say that we recognize the responsibility that these shareholders have placed in us and we are working hard not to disappoint. I’m pleased with 2018 and I’m looking forward to an even better 2019.

For those who are new to Eastside, our business is working largely per the same plan that we drew up a couple of years ago when I took over as CEO. It’s a three-pronged plan. The first part is to create a cash cow in Oregon by way of our Oregon sales operation and also by way of our co-packing operation, and if you look at everything that we’re doing, it all falls within the strategy in one way or another. The strategy in Oregon is to generate cash flow and use Oregon as a providing ground for products that we could take national. And, it’s also to, and I would say that’s exactly what we’re doing with our new CBD mixer beverage product line, which we’re very excited about.

Co-packing is also part of the strategy and the first prong and we had a, I know the word transformational is used a lot, but a truly transformational acquisition of Craft, which is a company bringing, a very profitable company running at a very high rate of growth with a \$6 million run rate at the end of 2018.

Secondly, the second prong of our strategy is the, being the only public company in this space, in the craft distilling space, we want to be a deal maker, and I apologize for the Southern Pacific Railway going by here, but we’re in a low-cost building here and we try to pass the savings on to our customers and our shareholders.

As part of this acquisition strategy, we plan to take full advantage of the fact that we’re a public company and use our currency in acquisitions. And, I mentioned in the Craft acquisition, even though our stock



price was a lower price, the acquired company was excited enough to be joining us that they used a notional price of \$7.20 a share, which at that time was a premium.

The third aspect is the brand factory aspect of our strategy. The brand factory is really kind of our way of describing our relationship with Sandstrom Partners. When I took over, we closed out our internal marketing department because right across the river was Sandstrom Partners, which is a world-class, we think the best class branding firm in the spirits area, with credits to their record such as Bulleit and St-Germain, Stillhouse, Aviation Gin.

We had probably, by the end of last year, we had probably developed more brands with Sandstrom than they developed for other people in their last 22 years, and those are in the pipeline, we're hoping to get them out the door. So, that's a key part of our strategy. I would say balancing the three prongs, we intend to grow organically on average maybe 50% and focus on acquisition growth as being the other 50% of our growth.

Now, I'd like to just give a quick recap of how we did in 2018 on the top line. Obviously, Steve is going to get into this in more detail, but our gross sales totaled \$7.2 million for the year. This was versus \$3.8 million for 2017. Our gross sales in Q4 were \$2.4 million, which is more than \$1 million above the \$1.2 million in Q4 of 2017. For the year, we sold 58,000 cases overall. If you back out the 24,000 of these which were co-packing or private label, that leaves 37,000 cases. We exited 2018 like a rocket ship with the acquisition of Craft in the beginning of 2019.

But, let me pull back a little bit and explain that it all starts with the juice in the bottle. Mel Heim, Travis Schoney, and the team we have have done an incredible job developing award-winning products. We continue to bring in the gold and the silver. Last year, Eastside had entered its spirits in some of the largest, most prestigious brewer's competitions, and taken home best of category and double gold. Double gold is usually only awarded to one top spirit. Last year, we won double gold for our rye, beating out 150 other ryes.

Our success is not only in our brown spirits, where we consistently bring home medals, but also for our Redneck and Burnside products, but also the Portland Potato, 91 Gin, Hue-Hue Coffee Rum as well. Just this month at the Berlin Spirits Competition, received a double gold for American rye whiskey and were also named U.S. whiskey distillery of the year on the individual awards. This month also our Hue-Hue Cold Brewed Coffee Spirit was awarded best in the rum category by the American Distillers Institute, the ADI, and that's for the second year in a row. But I could go on, because we have well over 100, 125, I lose track, but well over 100 medals that we've won recently.

Next comes the handling and the packaging. We play this up a bit, but we are incredibly fortunate to have Sandstrom Partners as our branding partner. They are the best at what they do, and they have been key in getting customers who recognize our products on the shelf and in many cases get them to try the product for the first time. Once we have our packaging and product to the A+ category, we need to distill the spirits or source and produce the spirits on a mass scale. Many people don't quite understand the difficulties that go into this for a small craft distiller. In many cases, this is the most significant hurdle that we have to face. They simply cannot scale production efficiently.



We've struggled, as well. However, with the team of individuals that we have put in place, led by Tom Wood, our VP of Production; the integration of Motherlode and Craft Canning that brought us Todd Garrett, and the former owner, Owen Lingley, we're operating at a very, very high level. We have tremendous capabilities. I believe on the co-packing side, we are if not the leader in the Pacific Northwest, then certainly one of the top.

This is looked at, possibly as a sideline business, the co-packing, but people need to understand the efficiencies that are required to be a top level co-packer like Craft Canning, to be able to generate their profitability and pay for their Capex just through cash flow. I mean this is an amazing discipline. And, they have brought that now to our entire manufacturing organization. And, in a way, it's more like they acquired us because on the production side, the Craft Canning team under Todd Garrett is now going to be running all of our bottling, our canning, and even preparing spirits for production. And, this is going to pay huge, huge dividends starting right now.

I think what's also important about this is we can bring products to market very, very quickly. We don't have to rely upon others to produce them. This is a tremendous advantage in markets like CBD, that are moving very, very rapidly and where production can be very short supply.

Now, with product in hand we turn it over to our sales and marketing teams. More than anything over the last 12 months, we've made tremendous progress developing relationship with the country's most influential and most important distributors, both on a regional basis and a national basis. Nationally, we work with RNDC, Southern Glazer's, Breakthru Beverage Group, and Young's Market. On a regional basis, we not only have a strong presence in the Pacific Northwest, but we have established relationships with the likes of Central Distributors in Arkansas, M.S. Walker in the Northeast, Lohr's in Missouri, Johnson Brothers in the Upper Midwest, West Tennessee Crown and Lipman Brothers in Tennessee, and many others as well.

However, we are not only building relationships and having success with distributors, but with retailers as well. Through Robert Manfredonia and the team itself, we are on the shelves or are in the process of getting shelf space with some of the largest retailers in the country. And, if you follow our press releases you will notice that we are proud to make a point of this on a pretty much continual basis. Redneck Riviera Whiskey has tested and proven that our platform that we created for national sales works and we aren't going to claim it was the best spirits launch in history, but it was certainly a very significant one. We are successfully moving product from an idea to a store shelf and into people's bars or their glasses. This is no easy feat, but we are doing it, and I think we're doing it well. And, I think starting in 2019, we've never been better. Thanks to our loyal shareholders, we've been able to build this platform. And, we intend to make the most of it.

We are laser-focused on driving rapid growth of Redneck Riviera Whiskey to its fullest. I'm going to turn the call over to Robert momentarily just to give of us a cameo on Redneck Riviera, but that's not the only thing that Robert is working on. I rely on Robert heavily for every aspect of our business. It's a really unusual day when I don't -- Robert and I don't talk two or three times. Through Robert, who has an amazing sales background and incredible people skills, sales reaches into every nook and cranny of this business. We are a sales-directed company. Everything we do with Sandstrom and everything we do with new product development is influenced by sales. And, you see Robert's fingerprints all over our new CBD mixer line, and when we go outside Oregon to speak with our national distributors about that line, Robert will be leading the charge.



I will at this point turn it over to my good friend, Robert, and Robert will describe, again do a deep dive on Redneck, and then following that, Steve is going to jump in and then after that, I'm going to be the utility player, wrap up at the end, and tell you about our new products in more detail.

Robert, can I turn it over to you?

Robert Manfredonia

Yes, thanks, Grover, and thank you for the kind words and good morning everyone. Let's get right to it with the 2018 Redneck Riviera total shipments. The total shipments for 2018 are 14,684 nine-liter cases. The regional percentage breakdown is as follows: The Southeast region 41% of the total volume contribution, Southwest region 28%, the Midwest region 16%, and the remaining regions combined for a 15% share. Quarter four represented 44% of the total 2018 volume and the top 10 states represented 68% of the overall volume. 2018 package mix Redneck Riviera 750s accounted for 72% of the overall volume. The Redneck Riviera 750 value-added pack contributed 20% of the overall volume; 375 is 5%, and 50 milliliters 2%.

A few notes on the value-added pack. The package was extremely well received from wholesalers and retailers, and that's primary tactical purpose was availability, visibility, and trial in the very key fourth quarter where the display space is dominated by mature top-15 brands. The package was distributed in 18 states. And, I also want to commend John Rich, as always, for his substantial impact with supporting the value-added packs. That included social media messaging, point-of-purchase TV and radio interviews and bottle signings, and much, much more.

Moving forward in 2019, the Redneck package mix will change slightly with a new line and package extension that includes the following. Number one, Granny Rich reserve, a premium priced blended whiskey released in mid-February. Number two, Redneck Riviera 175s are shipping right now. The larger package will accommodate a growing size by our consumer in the market. And number three, we are scheduled to release a ready-to-drink brand, an RTD, which will be a 12-ounce four-pack can, and that is projected to be released at the 1st of June.

2018 distribution total year end was 7,662 points. The on-premise delivery was 863 points. The off-premise contributed to 6,799 points. 73% of the total distribution was secured in H2. Off-premise national account contribution, Redneck Riviera exited 2018 with 1320 points of distribution. 2019 Redneck will add 2150 mandated points of distribution by the end of May. So, this will be a first and second quarter onboarding process. All national account customers with the exception of Walmart are resetting shelves now. Walmart will reset shelves in May and complete all stores by May 27th. All in, 2018 and the first five months of 2019, Redneck will have in excess of 3450 points of distribution within the national accounts sector.

2018 and early 2019 noteworthy points include the following. Walmart acceptance, it's worth stating that Redneck in 2018 was a store-by-store authorization and because of the performance and the early proof of concept, was awarded a mandated position of over 850 placements. National grocery acceptance includes Albertsons and Kroger and other prominent regional grocers that include Winn-Dixie, Rouses, Save Mart, Lucky, Meyer, Schnucks, WinCo, and a few other smaller regional grocers, and it's worth noting usually the grocery sector takes a minimum of three to four years for brand entry based upon development. Redneck has entered the grocery sector in less than ten months. It's also worth noting



Redneck is entering all stores, all clusters within the grocery sector. Normally, only well-seasoned, mature brands have complete distribution. This reflects a tremendous retail confidence in the brand as a whole. And Steve, that is it on my end. So, I'll hand it over to you.

Steve Shum

Thanks, Robert. For 2018, as Grover mentioned previously, gross sales totaled approximately \$7.2 million for the year compared to \$3.8 million in 2017. During the fourth quarter, gross sales total \$2.4 million versus \$1.2 million in the fourth quarter of 2017.

Net sales, which exclude the excise taxes and customer incentives, increased 135% to \$6.1 million versus \$2.6 million in the prior year. And, fourth quarter net sales increased 143% over the prior year to \$1.9 million. For the year, we sold 58,746 cases overall. This consisted of 37,262 cases of our branded products and 21,484 cases of private label. The annual case volume reflects an increase of 90% over the prior year in our branded products and a 450% growth in private label. In the fourth quarter, branded products grew 135% to 13,949 cases, while private label cases increased 826% to 4,816 compared to the fourth quarter of 2017. As a side note, moving forward we intend to move to refer to this private label [audio break]

So, overall, we're pleased to see our 2018 growth rate increase nicely over what we experienced in 2017. This was a direct result of our key initiatives already underway. To break the growth down a little more, we look at our branded products business in two main sales channels, wholesale and retail special events. As many of you know, we only conduct the retail special event activities here in Oregon. Wholesale revenue grew by approximately 124% for the year and 227% in the fourth quarter. That success in wholesale was driven largely by our successful first-year launch of the Redneck Riviera whiskey product, as well as continued strong increases in wholesale traction within the Pacific Northwest, especially with our vodka and Burnside brands.

At \$4.35 million in gross sales, the wholesale portion represented approximately 60% of our overall business in 2018. Revenues derived from our retail and special events operations were approximately \$1.2 million in 2018, which represented a 20% decrease from a year ago and represented just under 17% of the overall business. As we've discussed on prior calls, we made some decisions to reduce certain unprofitable event activities along with closing one of our underperforming retail locations during the year. That said, we have just recently opened a new retail location located in Northwest Portland.

Overall, the average per-case sale price for the branded products for the year was about \$149 per case and \$152 in the fourth quarter. The private label or co-packing business benefited from an increase in canning projects as well as from the sale of both spirits throughout the year reaching \$1.6 million or an increase of just over 400% during the year versus 2017.

Gross profit for the year totaled \$2.3 million compared to \$977,000 in the prior year. Gross margin relative to net sales was 38% versus 37% in 2017. The overall gross margin in the fourth quarter of 2018 was lower than what we saw during the first three quarters. This was a result of a couple of key factors, including certain bulk spirit sales in the fourth quarter had virtually no margin. This was done to move some [audio break] legacy that we really didn't need for our current product lineup. In addition, we added additional footprint and staffing in our production facilities. Hence, we had lower relative utilization rates in the final fourth quarter compared to the prior periods. And lastly, we used up some older, more expensive spirit stock in the period that we hadn't used in prior periods.



Looking ahead, we are currently not anticipating much in the way of bulk spirit sales. The production facility utilization should improve with volumes as well as further efficiencies with a reduction of additional build outs like what was going on during the fourth quarter, and we have some better cost of spirit stock coming up. Hence, we believe that margins should normalize fairly quickly from that Q4 level. Advertising, promotional, and selling expenses for the year increased to \$4.3 million, up approximately 98% from \$2.2 million last year. As we noted all throughout 2018, we have been investment spending on key brands and making strategic decisions to ramp our marketing efforts and support the more-rapid-than-planned geographic expansion of the Redneck Riviera whiskey product.

We feel this has been important in order to develop our platform and position us for long-term success. We also firmly believe these efforts will become critical and highly valuable towards supporting our overall efforts to expand other key products both regionally and nationally. Also, as a reminder, under our agreement with John Rich, if and when the Redneck Riviera brand is sold, we are allowed to recover 50% of our direct marketing expenses in support of the Redneck brand build out.

During 2018, those reimbursable expenses exceeded \$1.5 million. G&A expenses for the period totaled \$6.2 million, an increase of 77% from last year, which was a result of additions to key personnel along with higher stock-based compensation and depreciation expenses. Net loss for the year totaled \$9.1 million or \$1.49 per share compared to a net loss of \$5.2 million or \$1.42 a share in 2017. Our adjusted EBITDA during the year was a loss of approximately \$5.6 million, which compared to a loss of \$3.4 million in 2017.

We ended the year in a strong working capital position. Cash at the end of the year totaled approximately \$10.6 million, inventories totaled just over \$11 million. Accounting for receivables and current liabilities, we closed the year with a positive working capital position of approximately \$21 million. As already discussed and highlighted, we also completed the Craft Canning acquisition in early January. We will be filing an 8-K later today that will report their audited financials for 2017 and 2018.

Just to give a couple of quick highlights, we also will reflect on that 8-K pro forma figures. To give a couple highlights on those, assuming we had owned Craft during all of 2018, on a combined basis gross revenues in 2018 would have been \$13.2 million, the net loss would have been \$8.6 million, and the adjusted EBITDA would have been reduced to a loss of \$4.3 million. We feel great about the addition of Craft, and they are performing at a very high level as we enter 2019.

In summary, we remain encouraged by our branded product activities and growth potential for 2019 along with our more substantial co-packing business thanks to the Craft acquisition and look forward to reporting our upcoming progress.

That covers my highlights. We will have the 10-K out here shortly with further details. I'll turn it back to Grover.

Grover Wickersham

Thank you very much, Steve. And, as Steve has said, during 2018, especially in Q3 and Q4, we made the strategic change in our approach to invest very, very heavily for the faster-than-expected rollout of Redneck Riviera, but I'd like to emphasize a point that Steve made is that if and when there's a sale of the brand, 50% of those expenses now would also include even the sales team salary expenses of the Redneck force, 50% of those are reimbursable.



Okay, so I'm just going to mention first Craft Canning and Bottling. Craft's operations and mobile canning and bottling give Eastside a major participation in co-packing in three states: Oregon, Washington, and Colorado. We would have the ability to go into California if we want. The acquisition also gives Craft access to, for the first time, to a fixed facility, mainly our very, very well-equipped operations in Milwaukee. And, Craft has been running at full capacity and it also doesn't have all the tools that we have available in Milwaukee, so they are able to leverage the overlapping capabilities of both.

Early indications are that they have been able to take our MotherLode assets and generate more revenue off those assets in Q1 than we were able to produce in the entire 2018. And, we believe that's going to be accelerating. So, Craft Canning is not a static business. It's very, very much a high-growth business, and we're in the sweet spot of the market with the particular packages and the services we're offering.

Now I would like to talk a little bit about RTDs. One of the key growth areas we've talked about for the last 12 months has been the RTD space, or ready-to-drink cocktail space. The reason we keep bringing this up is that it's a very, very high-growth area. So, we have been expanding on the skills of our distillers and creating what we think are perfect cocktails. And, then we've taken those cocktails to the thousands of people that go to our tasting rooms and verify whether they are or they aren't, and that gives us a great focus group on a daily basis.

So the first one that we've come up with is the, that we released, anyway, is the Portland Mule, and that's taken off like a shot. It's only been out for two weeks, but it's already getting quick market acceptance. It's the only Mule product or spirits product of the size, of this sort in the 250 ml can, which is an ideal glass-and-a-half wine size for a product like that.

Low-alcohol RTD drinks are expected to be one of the best performing sectors through 2021, and industry sources indicate a CAGR of 8.2% driven by changing lifestyle and alcohol consumption habits and the portability of the cans.

And by the way, I mention as just as an aside of course, our wine canning business is also doing extremely well. We've primarily been involved in just co-packing. And as one of the synergies that we get out of the co-packing operation, we get visibility into some very, very interesting young, starting-up wine producers that are canning their wines. And, some of those I would say highly likely could turn into very prime acquisition candidates. So, anyway just to summarize there, we think we're very well poised, and as Robert indicated, we planning to come out with national RTDs.

The other area we're going into, and we've been very careful not to talk about this until we actually had something to talk about, and that's the CBD area. And, we actually have sample cans right now out in the marketplace with our very large Oregon sales force sampling on-premises accounts. On-premises accounts are restaurants and bars. And, the initial line that we carefully crafted with Sandstrom's help is a 187 can. That's -- it's a small can. It's about the size -- I think it's about 6 ounces. It's about the size of a wine -- a glass of wine. Everyone else is in the 12 -- everyone else is either shots, pumps, or 12 ounce. And when you get a 12-ounce can, you usually get a lot of sugar and lot of other things that people may not want in addition to the CBD, whereas our product, a lot of bars and restaurants here in Oregon are using CBD to mix in the cocktails or even just in the seltzer water. Now, our product really hits the sweet spot of that, we think, because our product is designed to complement what the bartender is already doing, and it's going to either be a seltzer, which is our first few, a tonic, or a ginger or we have pretty adventurous flavors that we cooked up here in Oregon.



So, we are planning to have those all throughout on-premises in Oregon as fast as can. And, we hope that that's going to be a game changer for us just the way Redneck was. But, we don't know. It's too early to say, but we are very, very excited. And, following behind that, we have other CBD developments. We're partnering with some major – we're looking to partner with some major firms in that space where our beverage expertise and the fact that we have a very unique can size in this 187, the smaller cans, really appeals to that potential customer.

The Outlandish lineup of RTD cans includes three primary products, a seltzer-based, ginger-based, and a quinine-based tonic. And, as I mentioned, we've got further line extensions planned. Outlandish Beverages are formulated primarily by Mel, and they will begin with up to 25 mg of CBD. We, as I said, I think this is the first CBD beverage produced in a 187 ml slim-line can. Outlandish Beverages are in the process of being distributed in Oregon. This is not something that's going to happen in the future. When I say in the process, we have cans out there with customers. They can be used as a component or they can be used entirely on their own.

The next two years are shaping up to be critical for the CBD market as recent reports indicate that market is to be growing by 700% to \$625 million to 2020, according to *Hemp Business Journal*. Although, and this is where sometimes it helps to be a lawyer, we've been very careful about how we're coming out with Outlandish. The FDA is still regulating the adoption of CBD beverages. But, we have the advantage of being in Oregon, and we have the advantage of being very careful. We're going to be intrastate, meaning in one state instead of interstate, which means that we're going to be crossing borders. So, we have a 4 million population focus group here in Oregon. And, this is going to enable us to prove out the flavors, prove out our concepts, and get ready for a national rollout ahead of the pack.

We want to enter this potentially large market while taking all the precautions to ensure we are conservative in meeting state and federal regulations in launching Outlandish. And, I think as an Oregon company, they say sometimes it's better to be lucky than smart. I think being in Oregon turns out to be a very providential thing for Eastside Distilling. We see CBD as a logical extension of our beverage business. You notice that the first product that we're launching is designed to go to people who are selling alcoholic beverages. This is our distribution network, and we think it has great potential. We're leveraging our blending, our branding, our production, our canning, our distribution, and potentially our own retail infrastructure in bringing Outlandish to market. We are in close communication with our distribution partners in 41 other states, and we will seek to have a national presence the minute that federal regulators, particularly FDA, establish clear rules for interstate sales. We have other things that we're doing in CBD that, consistent with our policy, I'm not going to talk about.

Other upcoming initiatives, just to recap a few of them. We're going to accelerate the rollout of Redneck Riviera Whisky in chain stores. As Robert's indicated, this is a exercise for March, April, and May. So, we expect to see good things in Q2. We're going to hit the CBD business hard in Oregon, and begin discussion with national distribution pending FDA national approval. We're going to use our Oregon sales force. We're going to emphasize our other RTD products like the Portland Mule. We're going to put heavy resources behind that. We see that as a very exciting thing we can do. We see that as a precursor to products we're going to roll out nationally. We're going to further absorb the co-packing and spirits production operation that we've got into Craft Canning's control, thereby we're going to gain much-needed efficiencies and higher equipment utilization, and we're going to see that. You're going to see that Q1, but you're really going to see that also in Q2.

We're going to continue to introduce new product development, which is heavy mostly in the area of brand line expansion. We focused so hard on Redneck last year that, for example, I didn't touch much on Burnside during this call, but we're going to be expanding Burnside into Northern California very heavily. And, so those of you who've been patient and been with us, in some cases since 2015 or 2016, and you've heard about Burnside and you've heard about some of these other opportunities that we've had that we've talked about, and were wondering what happened in 2018, did they get lost in the shuffle? You're going to see a logjam of new activity, and I'm excited about how much we're going to be doing in 2019 in those areas.

So, anyway, I'm going to end the way I started, by thanking our loyal shareholders for supporting us. And, I think that there were obviously some questions about the raise that we did in December, about the timing and everything, but Steve and I and the rest of the team felt that, given everything that we see that we have visibility on in the business that it was something we had to do. And, I am very hopeful that you're going to agree with this, that we are being vindicated on that. And, so let me leave with thanking you for your support. I also participated in that, and I'm looking forward to have a great 2019.

So with that, Robert, we'll turn it over to questions.

Robert Blum

All right. Carrie, can you provide the instructions? Thanks.

QUESTIONS AND ANSWERS

Operator

Sure. We will now begin the question-and-answer session. To ask a question, you may press star (*) then one (1) on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star (*) then two (2). At this time we will pause momentarily to assemble our roster.

The first question will come from David Bain of ROTH Capital.

David Bain

Great, thank you. Congratulations on the quarter, and thanks for all the detail. One of the result metrics that edged our assumptions were the non-Redneck or more Oregon-targeted portfolio that, Grover, you just touched on at the end there, but can you give us a sense as to what's driving that growth within the portfolio, some trends there? And, then the overall strategy with what you've built out for Redneck in terms of distribution and when we can see proliferation into that chain of any sort of significance, how that cadence could look like or what the strategy is there?

Grover Wickersham

Well, I know Steve may want to add a little to this, but on your question about what we're doing with Burnside and the other -- we have several other brands besides Burnside in Oregon, is that last year we exited with 60% growth. We'd like to maintain growth in that neighborhood. And, what we're doing to



accelerate the growth, which I think is your question, is we're continuing with our branding activities, and we're also really for the first time devoting significantly to sales and marketing. So, as far as --

David Bain

And is this vodka that's -- I'm just trying to get a sense within the portfolio...

Grover Wickersham

Well, vodka is like the meat and potatoes. And, we're going to be re-branding it in May or June, and we should get an uplift out of that. We're also continuing to do brand extensions, so -- and I was really, really pleased to see that February, which is normally a slow month of the year, we actually did the same sales numbers -- actually beat the sales numbers for December for vodka, which is an awfully high bar. So, if anything the momentum on the vodka is increasing, but our focus on the marketing has been the brown spirits. We're really focusing on taking advantage of the fact that we won double gold on the rye. We've got a big campaign going on the rye whisky right now, the rye Burnside. And, we're promoting pretty heavily the family of the Burnside products.

David Bain

Okay, great. And, Robert, thanks so much for the detail on the Redneck. I'm going to ask you for one more detailed point if I could. If you could bifurcate the 8,000 points of distribution, I know that you did lay out on-premise, but I'm just wondering if you could them into categories, broad-based percentage of big box, grocery, that type of thing, and then discuss where you see most of the distribution growth coming from for the remainder of the year?

Robert Manfredonia

Okay, David, thanks for the question too. So, as I laid out, the on-premise business is a very small piece of the overall business. When you look at it, it's roughly, and I'm not looking at the exact number, about 15% of the total overall distribution. So, when you look at the off-premise and you break it down into corporate or independent, the corporate side of the business, David, will do, from a distribution standpoint, about 30% of the overall distribution. The volume contribution, though, will be about 50% to 55% of the overall volume by the end of the year. Just the rate of sale movement of these type of stores and the exposure lends itself to just an accelerated rate of sale versus independent mom and pop sort of independent stores.

So, you're going to start seeing that, as I mentioned, really we're setting stores in California, which we're adding 965 points of distribution. The lion's share of those, outside of Walmart, are being reset right now, and those will conclude by the end of April. As I mentioned, Walmart will start in May, and they will conclude on May 27th, Memorial Day. Does that answer your question or...

David Bain

Yes, no, that's very helpful, yeah. And, then just last one, if I could. Grover, you had mentioned the prong two where you laid out the strategy and M&A, I think, as the second piece there. Obviously, the balance sheet, never been more healthy. Can you give us your view on M&A strategies from here, has size of what you're looking at changed? Are you looking more towards a new brand, or how are you thinking about M&A right now?



Grover Wickersham

Well, honestly, David, we're taking the smorgasbord approach a little bit because we're seeing a lot of different things being offered to us, and we're trying to be picky. If we can do something that is a simple bolt-on at where we can get some EBITDA and basically have something that just bolts right on to our existing structure or sales force, either in Oregon or potentially nationally. The national ones are a bigger deal, obviously. But, those kind of bolt-ons are extremely attractive. And, we are seeing opportunities. We probably could've done five or six acquisitions in the last two weeks if we had jumped at everything. But, we're trying to be very astute dealmakers, and even if it's something we want, we want to make sure that we structure the deal correctly.

I would say that there are some things that we're looking at, like for example, either internationally or in the online area that we're considering that I think would be something that we'd have to craft that into our existing strategy and see how that could. But, anything we do, we want it to be synergistic with the platform that we have right now. So, for example, if we could find a marketing organization that we could use to market direct-to-consumer or help us market CBD, we would look at things like that. So, anyway, I don't know think -- did you want to say anything, Steve, on that or is that...

Steve Shum

No, I think that's good.

Grover Wickersham

Okay. Yeah, that's the way we're looking at. We're being -- if you look at the acquisitions we've done, they've been thought out.

David Bain

All right. Great. No, thank you, guys.

Grover Wickersham

Thank you.

Operator

The next question is from Geoffrey Gwin of Quad Group.

Geoffrey Gwin

Yes. Thanks guys, thanks for taking the question. First of all, I mean, it's amazing transformation we've seen in the past year. My question, the first thing I want to ask is about this Craft acquisition. You gave us the pro forma number for the year, but when we look at it for the fourth quarter and the growth rate, Grover, that you're suggesting here, is that we should see this really accelerate into the first quarter. And, I want to get a sense, is the run rate \$4 million or \$5 million in revenue for the entire business for the first quarter?

Steve Shum

Hey, Geoff. We're probably not prepared to give a projection. But, I would also say, Craft's business historically has been a little bit seasonal, where their really strong periods are the second quarter, third quarter, and into the very early part of the fourth quarter. So, they kind of have their bubble period, so to speak, in Q2 and Q3. So, we're pretty pleased with what they're doing for us on their own right plus some



of the added business they've been able to help us generate in our own fixed facility during Q1. So, we're certainly pleased with how that's shaping up or has shaped up, since we're almost done with Q1. But, we definitely, as Grover mentioned, that'll really also be much more impactful as we go into Q2 and Q3.

Also, I would note that last year Craft pretty much ran at nearly full capacity for the amount of lines that they had in their operation. And, even as we were purchasing them, they were planning to add some additional capacity. Of course, we supported that, and we're actually further adding to that. So, they're adding capacity this year throughout the year. They're going to be adding roughly 60% additional capacity to their operations, which will be coming online over -- throughout the year, starting with some of it starting to hit right now coming online. And, that's a reflection really of the demand that's out there and what we're seeing from customer interest. So, like I said, we're pretty excited. I'm not answering your question specifically about Q1, but needless to say, Craft and the whole co-packaging side of our business is definitely going to be a growth area in Q1 and beyond.

Geoffrey Gwin

Okay, great.

Grover Wickersham

Sorry to tag team here, but Steve did mention the utilization of our existing equipment. That actually -- the impact you're going to see in Q1, I think, our shareholders will say -- hey, they'll like this, they'll like what we did here with Craft.

Steve Shum

Yes.

Geoffrey Gwin

Okay. All right, so to follow-up on David's question to Robert. Robert, you were talking about the mandated distribution. And, could you just clarify to us the accounts -- the distribution points that we're adding now en masse, as I understand it, those are much higher-velocity distribution points. I just wanted you to clarify that. And, the second thing is when we talk about open-for-order in, let's say for example, like a Walmart versus mandated, that's, as in mandated as in the sense that you're in the planogram, how much does that change the velocity as well and the sales as we look at the growth of points of distribution?

Robert Manfredonia

Yes, it's a great question, Geoff. So, let me take the second question first. So, when you look at Walmart, and I'll give you an example, and I'm even laying this out, their initial order is two full cases for every single store, 856 stores. Two cases per store is the opening order. So, the difference between a mandated and an authorization, I'll just clarify that once more. That means that there is no store autonomy on what they want to have on the shelf, it is mandated, pushed down from the top, and it is programmed out from Bentonville, Arkansas. So, the beauty is that we don't have to worry about store by store or the slow methodical way of trying to go store by store and trying to get it on the shelf. We are locked and loaded and ready to go. And, now I program it out with the buyer and then we have consistency across the whole chain nationwide. So, the performance, the case volume that comes with it is exponential versus what we were dealing with last year just to get our foot in the door. So, the nice thing is that there's been a very methodical sort of progression from authorization, proof of concept, mandated positions, programming all locked up through the remainder of 2019.



**Geoffrey Gwin**

Okay.

Robert Manfredonia

To your first question, I believe, is really what we focused on is the grocery sector. Most brands take this approach of phase one is independent liquor stores, phase two is usually your corporate liquor stores, the Total Wine or an ABC, or a BevMo! in the far West. We kind of went past them and went straight to grocery, which is the largest segment of stores with the highest rate of sale, and we focused on them with our relationships and with the pressure that John Rich is creating top-down from everything that he does with the brand. So, we didn't need transactional data validation to get all the way to the grocery sector. We went in and we used the category, we used the brand identity, we used [unintelligible], we used above-the-line marketing that John provides. And, then we used what we believe we have, which is execution discipline on the bottom end of it, and that was enough for everyone to put it into every single store. So, the results will start coming from all of that distribution, Geoff, probably by June-July of 2019.

Geoffrey Gwin

Okay, great, great. And, then lastly, Grover, I saw the rebranding of the Barrel Hitch product. When you go back and look at what Sandstrom has done with Burnside, and we see that in the numbers that you mentioned, Hue-Hue, Barrel Hitch. These rebranded products are above and beyond what they used to be as far as their shelf presence. And, you mentioned that they're going to be -- we've been patiently waiting for these to be rolled out in this massive distribution that Robert has built. So, you talked about rolling the stuff out -- rolling Burnside out into Northern California from L.A. When do we get to see things like Barrel Hitch and Hue-Hue? When can I buy Hue-Hue on the East Coast? When can we see some of these other Sandstrom-rebranded products on a more national scale?

Grover Wickersham

Well, you've touched on a couple of things there. One is, with the Burnside rollout, Gerry Ruvo is a pretty famous guy in the business, is that his formula really is that the really premium high-margin brands tend to go through three stages of being cult, and then cool, and then they become consumer, and then they, in the process of doing that, they get a cachet or become iconic. And, so kind of our -- we're not trying to spill out Burnside at BevMo! and everything else. We, our strategy has been to continue to rack up the medals, like we've been doing, and rack up the reputation. Even make people aware of it nationally, even though it's like Coors, you couldn't get it everywhere for a long time.

And, then Northern California is a logical extension of the Oregon market. Oregon is 4 million, Northern California more like 15 million. And, our products resonate down there, so we're going to, and we're hiring -- extending our Oregon sales force essentially into Oregon with that. So, regarding Burnside, that's our strategy. Regarding Hue-Hue, Robert's chomping at the bit to do more than that, and I think he's got some targeted markets, products like that kind of product did really well in Southern Florida, where he's got some contacts. So, I think you'll be seeing that. I know you love the product; we're going to find a way to get it to New York. So, we will do that.

As far as, I've got everybody -- all the sales guys, they're sort of chomping at the bit to take our products and go out and start pushing them through the national sales force, but my approach is like the Bunker Hill approach, which is you wait until you see the whites of their eyes. I don't want to take just any product out there. The product that we take and we push, it could be -- I don't know what it could be, but it could

be a CBD product, it could be a product that is -- it could very well be a product that's a really hot RTD product that we like that people love in Oregon. We think -- Robert thinks we'll go national, and you know, we can make it by the tanker load with a very high, very high margin. That would be an ideal one to pick up.

But, I will say, I don't think we're losing any time by being careful there because right now we're still kind of in the steep part of the introduction curve with Redneck. And also, we have additional SKUs with Redneck. Okay, we just came out with the Granny Rich, and just this week, we started shipping the half-gallon size and the half-gallon size has a very, very good COGS, it's a better COGS than the 750; it's an ideal product really for a Redneck, you know, that style of light whiskey.

So, we see that as being a great addition, okay, so it's not like the sales force don't have new things, they've got that. We're also going to be re-pricing the 375. We have a depletion allowance on the 750, and the 750 has been very competitively priced. With the depletion allowance it's going to be \$22 on the shelf, different places, you know, making it, you know, competitive with Jack and some of the others. We haven't really done that yet with the 375, which is, I don't know if you've ever seen a 375 of Crown Royal, but it looks like the major bottle, the large bottle that they do, which is like a glass hand grenade, you don't want to put that in your back pocket.

Geoffrey Gwin

Right.

Grover Wickersham

So, anyway, so we think we can be very effective with our 375. I'd like to go into more detail, but it wouldn't be appropriate for this call. But, that we've got the 375, we've got the Granny Rich, we've got the 175, we've got the RTDs, so the sales force is going to be really focused on that and give me a call after this call and I'll give you some color on that. Thanks.

Geoffrey Gwin

Okay. Let me slide in one last question, and then I'll pass it on. The RTD that you're talking about launching for Redneck, when we think about that product, Steve, what is the margin difference between something like that and the whiskey product?

Steve Shum

Well, all of our focus in any new products is to have at or better margins than what we've had on existing products. So, I would say that will always hold true when we're in, as we're introducing some of these RTDs. So, in general, we do see better margins on some of these RTDs in terms of costing and our pricing them and so forth. So, we would expect the same to apply, or we do expect the same to apply to the Redneck Riviera planned RTD.

Geoffrey Gwin

Okay, great, all right. Good luck, guys.

Steve Shum

Thank you.



**Robert Manfredonia**

Thanks, Geoff.

Operator

The next question comes from Ian Gilson of Zacks Investment Research.

Ian Gilson

Yes, good morning, gentlemen, and Mel, if she's there. I've got three questions. I'll give you the three all at the same time. Price per case is down significant on the year-to-year and a sequential quarter basis. Why is that? The tax per gallon is up versus prior quarters, now that's only the quarters this year obviously, because the tax law change, and third is the CBD extract you're using, is that an isolate? Or is that the oil? Thank you.

Grover Wickersham

Ian, good to hear your voice, we'll just on that last question, we're currently using for the mixer product we're using isolate.

Steve Shum

Yes, on average per case rate, Ian, that is purely a function of mix. The growth has been heavy in the Redneck Riviera whiskey product last year as well as our vodka product, which we've highlighted a number of times. Both of those have lower average per-case rates than some of our other products, particularly like the Burnside product and others. So, that all said, I do think that we will see that average per-case rate starts to stabilize around here, it'll probably bounce around a little bit, but I wouldn't anticipate seeing rapid changes like that for 2019.

Yes, so you are correct that the federal excise tax is lower and our average, and we are paying much lower federal excise taxes, or did in 2018. A lot of that was essentially offset by higher customer incentive programs that we've implemented to support the growth in some of the key products like Redneck Riviera. So, if you're looking at line item of excise tax and customer incentive programs, like I said, the federal rate has gone down, our Oregon rate has stayed the same. And, so it'll be higher in the fourth quarter because of our heavier activities in our retail operations where we pay the Oregon excise tax. And, then again, that's all, the Federal rate decline is being offset by higher customer incentive programs.

Ian Gilson

Great, thank you very much.

Steve Shum

Thank you. Thanks Ian.

Operator

The next question will come from Brian Sognefest of ROTH Capital Partners.

Brian Sognefest

Hey guys, just a quick question on, can you give an update on your efforts at Costco and rolling Redneck out there? Thanks.

Robert Manfredonia

Yes, Brian, it's Robert here. I am -- so Brian, I just got an update from Costco. And, we have seven, seven buildings, as they call it. We have four in South Carolina and we have three in Florida. And, the overall performance from their vantage point is the transactional delivery has been good across the board. And, in fact, it's been exceptional in selected buildings. Last week, I received data on just a one-week run, and in East Jacksonville, one of our buildings in Florida, Redneck outpaced Jameson and Bulleit Rye, two mammoth, well-developed, mature brands, and Redneck outsold them. The approach and the ambition of Redneck within Costco is to be a permanent placement nationwide. And, just a very quick backdrop of that, they usually carry roughly 15 items, 11 are permanents, four are rotational, and then they have a few other test items. So, what we're going to probably do is run with this through the end of the trimester. And then, we're going to come back in the fourth quarter with a more nationwide view of it with Redneck and then we're going to march into 2020 as we further develop the brand in the grocery sector. So, we're trying to take parallel paths between the club environment, which is Costco, led by Costco, we're going to start reaching out for Sam's Club and then BJ's in the East as we build the grocery sector, come back in the fourth quarter, and then drive it hard through that class of trade in 2020.

Brian Sognefest

All right, very good. Thanks, guys.

Robert Manfredonia

You're welcome.

Operator

The next question comes from Harold Weber of Aegis Capital.

Harold Weber

Good morning, guys. How you doing? It's nice to see a nice number. I have a good, a question for you in regards to capacity. Based on what you added now and what's currently existing, how much more can we put out with the current capacity capability that we have, double what we're selling until now, triple that we're selling 'til now, how much can we increase actual business with the facilities that we have online presently?

Steve Shum

Yes, thanks Harold, with the addition of Craft, which really gave us a tremendous amount of capabilities. You could actually, we did an analysis and this is before bringing on some additional equipment that we're, that's planned this year. So, before that, we assess that we could do around 500,000 cases of bottled product per year, and over, just over \$2.6 million canned cases per year between the combined facilities. Now, of course, we're using a lot of capacity in our co-packing business for outside customers, but that is basically our current capacity. And, again, we're going to be bringing on additional capacity vis-à-vis through Craft throughout this year.

Grover Wickersham

Yeah, I would just say, Steve, that's correct. However, that does not include the canning capacity of Craft outside of the Milwaukee facility and I'm led to believe they have about 25 million canned capacity outside with the mobile canning units.

Steve Shum

That was included, I was actually including that, because I was giving cases, you're giving individual...

Grover Wickersham

Oh, I'm sorry...

Steve Shum

Yeah, so, it's pretty significant is the bottom line and relative to what you're seeing on our branded side of our production, we have over seven, eight times capacity versus what we sell in our branded product line. But again, we're using that, a lot of that capacity for the co-packing side. But, the way we look at it is that if we see further surges in our branded product side of the business, we will use our own facilities, whether it's the fixed or the Craft to make sure that we support that kind of production need.

Harold Weber

Okay, and how does that apply in regard to the regular spirits? The one let's say, you've just started a new bottle the 1.75 I think it was, right -- production in that?

Grover Wickersham

The 1.75 which is the new bottle – yes, for Redneck.

Harold Weber

Yes. So based on --

Steve Shum

Yes, we have plenty of capacity, we have plenty of production capacity, we have tremendous amount of inventory in bulk spirits and...

Harold Weber

Right.

Steve Shum

And the other supplies necessary. So, again, the way we look at it is that we are locked and loaded and ready to handle the growth. And, even if it exceeds our own internal forecasts, we are more than capable of handling it.

Harold Weber

Okay. Well, I'm glad to hear that. I have one other question you had touched on last time, in regard to the was the rising rate cost on the barrels that you had bought, you had these listed at cost, the last time you said they had gone up by a couple hundred dollars a barrel, where is that, what's the current market on that presently?

Steve Shum

Well, we've actually, so one of the things we did during 2018 is, and this, so prior to 2018, you look all the way back in a '16 and '17. Typically, when we were procuring bulk spirits, we were procuring those bulk spirits as they were essentially aged sufficiently to go into the bottle, and that's a higher cost product. As we improved our working capital and liquidity in late 2017 going into 2018, we started procuring less aged



product and let it basically age on our balance sheet. And so, the importance of that is that it buys down if you, so to speak, our cost of goods as we move forward.

And so, as we start to head into this year, we're going to get the advantage of starting to be able to utilize in our produced products, that, some of that material that we had purchased at lower rates. And, so what, we've obviously developed a pretty extensive portfolio of inventory of bulk spirits. And, so what we did late last year is we identified and we did a couple of things, we identified some earlier purchases that we really didn't have a need for as part of our portfolio of products, and so we moved those out, moved some of that product out in the fourth quarter to other small producers in a sale. We essentially did most of that at cost, so we didn't really make any margin on it.

So, that impacted us in the fourth quarter, but it was an anomaly from our vantage point. And, then we also consumed some of that earlier what I would say the 2016, 2017 stock that had a higher cost on it in the fourth quarter. So, though -- and then lastly, again, we definitely, we further increased our production footprint in our main facility, we added square footage, we're installing the bigger new still there. So, we've added footprint, we've also added some bodies. And, that's actually increased our overall cost per facility, which we didn't get the benefit of higher volumes yet in that, so we had essentially a relatively lower utilization rate in our facilities in the fourth quarter. So, those were the three main buckets of impact in the fourth quarter for margin that we're really not anticipating to continue as we roll into this 2019 period.

Harold Weber

So, would it not be reasonable to say then that our margin should be improving this year?

Steve Shum

Yes, yes, that's our goal. Absolutely.

Harold Weber

Okay.

Grover Wickersham

No, and like they should be approving in Q1. And, then you should see a nice improvement in Q1 back to what's normal for us. And, you should, because our, Harold, because our utilization is going up, we're going from about 20% utilization in Milwaukee to probably 70%, plus we have a new equipment that is very, very in demand that we're putting online, a pasteurizer and a sleever. And, so you should see, you definitely should see significant margin improvement continuing.

Harold Weber

Okay. Well, good. I'm happy to hear that. That's what I'm hoping for, yes. Thank you.

Grover Wickersham

Thank you.

Steve Shum

Thanks, Harold.



Operator

And, this concludes our question-and-answer session. I would now like to turn the conference back over to Grover Wickersham for any closing remarks.

CONCLUSION**Grover Wickersham**

Okay. Yes, I'd just like to thank everyone for their support, and I'd also like to encourage any of our shareholders to take advantage of the fact that we have a, we're a small Company. We've got an open-door policy. Call Steve or myself at any time, and we'll be happy to provide more color. So, also, play your cards right and come over to see us, and there could be a bottle of bourbon in your future too, but -- so, thanks. With that, I'll conclude the call and -- unless Steve has anything?

Steve Shum

No.

Grover Wickersham

Robert? Okay. Thank you very much.

Robert Manfredonia

It was all said. Thank you.

Operator

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect your lines. Have a great day.

