Update Memo

RE: Summit Economics Study of January 2009 titled *Economic Impact of Replacing 3.2 Beer Sales with Full Strength Beer Sales*

Date: March 23, 2011

Submitted by: Tom Binnings, Senior partner

We have reviewed our findings of January 2009 and the summary findings of Colorado Strategies dated February 2009. Based upon these findings we have conducted a little additional research as to the possible timing of the impacts listed in the Summit 2009 study. The comments below relate to the review.

Summit Economics reiterates its findings from two years ago as being reasonable forecasts of what would happen if laws are changed to enable all grocery and convenience stores to sell full-strength beer. The only modification to the forecast might be the length of time it takes for the market to transition to a new equilibrium state after a change in the law.

We are very confident in stating there will be substantial impact on the liquor store industry in Colorado. Our original study forecasted a 40% decrease in the number of liquor stores within three years and 51% within five years. Beer sales at liquor stores will be dramatically and immediately impacted with a 50% reduction within the first year. The lack of similar market transitions in other states and the resulting lack of research providing more accurate documentation of the impacts from a single-owner small store industry to supermarkets and convenience stores should not distort what is a reasonable forecast of what would transpire with widespread beer sales.

Lacking firm research from other states, Summit Economics resorted to four methodologies to estimate the impact on liquor store closures.

- A statistical analysis of the number of liquor stores in each state relative to the population and whether or not beer could be sold in outlets other than liquor stores. This analysis forecasts that selling beer through all outlets will result in the long-term closure of 17% to 52% of all liquor stores. This supplies a range of possible outcomes.
- States that restrict beer sales to liquor stores only have more than twice as many liquor stores per capita than states with beer sales not restricted to liquor stores only. This implies a long-term equilibrium of half the amount of liquor stores. (Note this analysis is based on all 50 states as opposed to selective states and wine sales in the Colorado Strategies analysis.)
- We mapped 4 typical Colorado communities and looked at the distribution of liquor stores compared to the potential competition. If the law were changed, liquor stores would potentially represent only 42% of the potential retail outlets and in many cases the stores would be located in very close proximity to competition. Given the liquor and beer market can assumed to be in

an equilibrium state generating normal profit margins for small businesses, more than doubling the number of outlets in a short time-frame implies that there will be too many outlets. Given that supermarkets and convenience stores are currently surviving without full beer sales, one can reasonably conclude: 1) the convenience stores and supermarket are unlikely to go out of business from the new competition and 2) the market will not support a 144% increase in the number of outlets. If 51% of liquor stores go out of business that would reduce the number of full strength beer outlets to almost two times the current level.

- Using survey results from Colorado liquor stores and business data from Risk Management Associates who provides standard industry ratios by business type for the banking industry, we modeled the impact on liquor stores. Reducing beer sales by 50% results in a 32% decline in all revenues and results in cashflow declining by $84,000 in an average sized Colorado liquor store. Very few small businesses can support cash losses of that magnitude for very long.

We reached our conclusion of the potential store losses based on the above four findings.

To test our findings regarding the length of time it would take for liquor stores to close, we have since reviewed the length of time it took for the grocery and drug store retailing to evolve from small business towards large business market concentration. We reviewed the loss of small businesses under 10 employees since over 90% of liquor stores fit this category. The peak of the market transition in drug store retailing (in terms small business closings) occurred from 1987 to 1996. During this time frame small drugstores in Colorado faced 32% and 17% reductions in the two consecutive five year periods. The peak of small store closings in the grocery industry occurred between 1956 and 1972. In this period, small stores reductions occurred at a rate of 24%, 13% and 26% in the three consecutive five or six year periods. This data alone implies dramatic reductions can occur. Our conclusion regarding 40% to 51% liquor store closures in the first three to five year time frames respectively may look overstated on the surface; however, one must remember that liquor stores will be at a definite competitive disadvantage and the competition will increase very dramatically overnight. From this perspective our forecast is reasonable, although it may take longer than five years.

Once decision-makers accept the potential for liquor store closures, all of the other impacts follow using standard economic multipliers. One might argue that the job losses from liquor store closures would be significantly balanced by job gains in convenience stores and supermarkets. Our analysis did not see much potential in that area and neither did convenience store owners based upon their testimony nor Colorado Strategies when referencing supermarkets in 2009.

Our study, in considering purchasing approaches of supermarkets and franchise convenience stores, concluded that the proposed change would likely impact the Colorado craft beer and wine industries. As the number of liquor store outlets declines, access to the market will be significantly impacted for small producers. Since our study, both the Colorado craft brewers and wine industry affirmed our speculation based on their experience in accessing retail markets for their product.

Not in our original study is the likelihood that licensed beverage industry is already feeling the impact in terms of the market value of their stores. It's highly likely that willing buyers are scarce given the supermarkets and convenience stores keep coming back in an attempt to change the rules of the beer market – rules that protect the independent small businesses. This impact will remain as long as there is uncertainty in the market place.

Thank you for your consideration,

Tom Binnings

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