

MGP Ingredients, Inc.

| Nasdaq: MGPI |

INVESTMENT RESEARCH REPORT

*"Intoxicated By The Moonshine"*

RECOMMENDATION: *Strong Sell*

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## **Spruce Point Capital is an industry recognized research activist investment firm founded in 2009**

- Founded by Ben Axler, a former investment banker with 16 years experience on Wall Street
- Ranked the #1 Short-Seller in the world by [Sumzero](#) after a comprehensive study of 12,000 analyst recommendations dating back to 2008 (March 2015)
- Ranked the #13 Most Influential FinTweeter on Twitter according to [Sentieo analysis](#) (Dec 2016)
- **Track record of significant changes at Company level post research activism publication:**
  - Two companies have been charged with fraud and delisted from the Nasdaq to the Pink Sheets
  - Three other companies have been forced out of the public markets privatized or acquired
  - Eight CFOs and Eight CEOs have resigned or been replaced post Spruce Point research initiation

### **Recent CEO Resignations Following Spruce Point Report Initiations**

Spruce Point Report Date	Company	Enterprise Value at Release Date	CEO Who Resigned	CEO Announced Departure Date
<a href="#">4/13/16</a>	Sabre Corp.	\$11.0 billion	Tom Klein	<a href="#">6/20/16</a>
<a href="#">8/19/15</a>	Caesarstone	\$1.7 billion	Yos Shiran	<a href="#">5/23/16</a>
<a href="#">11/13/14</a>	AMETEK Inc.	\$14.2 billion	Frank Hermance	<a href="#">5/4/16</a>
<a href="#">12/17/15</a>	The Intertain Group	\$1.1 billion	John Fitzgerald	<a href="#">2/22/16</a>
<a href="#">2/10/15</a>	Greif, Inc.	\$3.1 billion	David Fischer	<a href="#">10/13/15</a>



## *Executive Summary*

## *Quick Highlights:*

1. Rapid Whiskey / Bourbon Sales Growth, A Key Driver of MGPI's Recent Earnings + Share Price Expansion Won't Continue As A Result of Substantial New Capacity Growth
2. Diageo Is A Material Whiskey Customer Accounting For At Least 8% of Revenues, Its New Distillery Comes On-Line In 2017; Best Case It Reduces / Eliminate Its Supply Contract With MGPI; Worst Case It Competes Directly Against It
3. MGPI Also Appears To Be Quietly Covering Up A Large Market Share Loss In the Gin Category Associated With Seagram's. Investors Should Study Both The Gin and Vodka Market As Case Studies For What Can Happen To Whiskey
4. A Multitude of Other Contracts And A Key Ingredient Patent Expires in 2017 Which Significantly Increase MGPI's Business Risk; Investors Are More Focused On The Alcohol Business, And Not Paying Close Attention
5. MGPI Has A History of Operational Disasters (Fires and Chemical Explosions) Which Could Harm Earnings
6. MGPI's Foray Into Branded Liquor Sales Have Shown De Minimis Results, And Are Likely To Disappoint
7. MGPI Is Out of Cash, And Borrowing Heavily On Its Credit Facility, Funding Long-Term Construction With Short-Term Debt. It Must Turnover Its Barreled Whiskey or Face Severe Financial Strain
8. MGPI Quietly Restated 2015 Results of Related-Party Transactions Affecting Its ICP JV With Seacor (Another Public Company) Both Companies Financial Reporting Do Not Reconcile, Which Potentially Puts MGPI In Violation of Its Credit Agreement. MGPI Is Also Quietly Restating Sales Figures Tied To Customer Freight
9. Regulators Are Expanding An Audit Investigation of MGPI, Which May Result In Increased Taxes and Penalty Costs
10. Follow The Money Carefully: MGPI's Largest Shareholder And Founding Family Entered A Stock Sale Program on Dec 21, 2016 – Around The Holiday Period When Things Were “Quiet”
11. Spruce Point Sees Approximately 60% – 70% Downside + Big Hangover Waiting For Investors Intoxicated By The False Hope of Future Gains. MGPI's Valuation Will Revert To 8x-10x EBITDA From 14.5x Currently Once Reality Sets In

# Pay Close Attention To MGPI's Recent Accounting Warnings

**Taking a step back before reading our report, we believe investors should carefully evaluate the unusual changes to MGPI's 2016 10-Q filings it made. We believe the Company is signaling accounting strain and issuing a subtle warning.** Look carefully at Note 1. *Accounting Policies and Basis of Presentation*. MGPI added a stronger cautionary statement suggesting its estimates may require material adjustment, and removed a statement that suggested its financials were fairly presented

Fiscal Year	Basis of Presentation and Principles of Consolidation	Use of Estimates
<a href="#">2016</a>	<p>The condensed consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.</p> <div> <div>Key text omitted in 2016</div> <div>Key text added in 2016</div> </div>	<p>The financial reporting policies of the Company conform to accounting principles generally accepted in the United States of America ("GAAP"). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. <b>The application of certain of these policies places significant demands on management's judgment, with financial reporting results relying on estimation about the effects of matters that are inherently uncertain. For all of these policies, management cautions that future events rarely develop as forecast, and estimates routinely require adjustment and may require material adjustment.</b></p>
<a href="#">2015</a>	<p>The accompanying <b>unaudited</b> condensed consolidated financial statements of the Company <b>reflect all adjustments (consisting only of normal adjustments) which, in the opinion of the Company's management, are necessary to fairly present the financial position, results of operations and cash flows of the Company.</b> All intercompany balances and transactions have been eliminated in consolidation.</p>	<p>The preparation of the condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.</p>

# *Spruce Point Believes MGPI Is A “Strong Sell” For The Following Reasons:*

## **MGP Ingredients (“MGPI” or “the Company”) Is A Commodity Ingredient and Alcohol Producer Now Being Spun As A Sexy Transformation Story Into A Premium Producer of Branded Whiskey and Bourbon**

- MGPI is a simple story to understand. It operates two businesses: an ingredients business run from Kansas and an alcohol distillery in Indiana. [Both of these facilities are old assets](#) and [prone to substantial operational hazards](#). Most recently, MGPI has experienced fires, work outages, and chemical disasters requiring the hospitalization of innocent people
- [MGPI's shares have appreciated 1,000% since 2014](#) as investors have cheered the Company's decision to hire new management, reprioritize its businesses away from commodity ingredients, and focus on “higher margin” premium alcohol beverages. MGPI has also recently benefited from a temporary, yet unsustainable, increase in earnings from its 30% joint venture with Seacor (NYSE: CKH) called Illinois Corn Processing (ICP)
- On the surface, the Company's transformation strategy appears wildly successful. Its EPS has risen from a loss of (\$0.29) in 2013 to positive earnings of \$1.50 per share in the LTM 9/30/16 period. Over the same period, sales have essentially been flat, but gross margins have expanded from 6.4% to 18.1%

## **Spruce Point Believes Investors Should Be Cautioned Not To Extrapolate Recent Earnings Performance. We Believe There Are Numerous Business Risks And Cracks In The Growth Story That Are Not Being Adequately Discounted**

- The biggest aspect of the “bull case” surrounding MGPI is that it is a play on the explosive growth in consumer taste for whiskey and bourbon, and can transition to a branded producer. Investors fail to realize that MGPI is primarily a white-label producer that sells to other brands. One of its largest customers (which MGPI doesn't adequately disclose) is Diageo, which owns the Bulleit brand. [Diageo is close to completing its own Kentucky whiskey distillery that is expected to be completed in 2017](#). At best, Diageo reduces or completely eliminates [up to 8% of MGPI's sales](#), and at worst they start to directly compete in the bulk wholesale market
- [There are now over 1,000 craft distillers for whiskey / bourbon in the United States. Just like Diageo, many of these distillers are constructing their own distilleries, which would reduce / eliminate their need to buy from MGPI.](#) The rapid proliferation of new distilleries and brands in the market makes MGPI's ability to brand itself all-the-more challenging. [Based on our research](#), its recent tiny acquisition of George Remus whiskey and introduction of Metze's Select (Metze being MGPI's master distiller who [recently departed](#)) have had limited traction, and are nothing more than way out-of-the money call options. [Many high profile liquor brands endorsed by celebrities and billionaires have failed in the past](#). There's no reason to assume MGPI will have any success
- Because investors are so enamored with MGPI's alcohol business, [they are not paying attention to other material risks that loom large in 2017](#) such as: 1) key ingredient patent expiration, 2) collective bargaining agreement, 3) supplier agreements, and 4) added fines / penalties from a) recently expanded audit investigation by the TTB, and b) from the chemical explosion in 2016

# *Spruce Point Believes MGPI Is A “Strong Sell” For The Following Reasons:*

## **MGPI’s Barreled Whiskey Inventory Is Rapidly Rising, While Sales Are Declining, And Inventory Turnover Plunges**

- MGPI’s [whiskey inventories](#) have risen from \$11.1m in 2013 to \$45.0m as of 9/30/16. During the same time period, its [inventory turnover has plunged](#) from 8.6x to 3.7x and its [food grade alcohol sales are declining](#). MGPI says everything is fine and that it is spending \$29m to expand warehouse storage. It started to disclose “premium beverage alcohol” sales in its [press release](#) in an attempt to show strength in this segment, but won’t stand behind the numbers and include them in the recent [10-Q](#)
- [MGPI’s free cash flow is sharply negative and it is borrowing heavily on its credit facility](#) (funding a long-term asset with short-term debt). MGPI also has no cash on its balance sheet and its credit facility is now 46% utilized. As a result, its financial profile is precariously stretched in what amounts to a levered bet that it can sell its existing whiskey inventory either under its own brand (a speculative bet we argue is likely to fail absent enormous investment in distribution/marketing) or in the open market
- [The Company tells investors it has the “potential” to sell its whiskey at 3x the current cost](#). It lists its whiskey as a current asset, but must age the product for three years. We believe it should be viewed as a long-term asset, and as a result believe [MGPI’s current ratio \(a measure of its liquidity\) is significantly worse than it appears](#)
- [MGPI must turn its inventory and hope that it doesn’t decline in value because its credit facility and borrowing base depend on inventory valuation](#). We don’t believe investors should assume that management is correct, and its whiskey will magically appreciate 3x in value. Based on our recent channel checks, we believe there is an abundance of wholesale whiskey / bourbon available. [We contacted Ultra Pure](#) the #1 bulk wholesaler in the market. We found that prices have been largely stagnant since 2014. Additionally, [we sourced price quotes from J.B. Thome](#), another reputable broker and found no price differential between aged MGPI rye. As substantial new supply comes into the market, we would not be surprised to see prices begin to decline

## **Look To Struggles In the Vodka and Gin Market For An Indicator of What Can Happen in Whiskey / Bourbon**

- Consumer alcohol preferences are inherently fickle and constantly changing. A few years ago, the craft vodka market exploded leaving established brands such as Smirnoff and Absolut to compete with new brands such as Kettle One, Grey Goose, Ciroc, and dozens of others. MGPI claims 25% vodka market share, but [industry executives recently called the vodka market “saturated”](#) and overall vodka organic growth is stagnant at just 1% as reported by industry bellwether [Diageo](#)
- [MGPI also produces flavored and natural gin](#). The Company does not disclose revenues by product type, but [from its recent investor presentation, the Company changed its market share from 65% to 35% share](#). This illustrates what can happen when a customer decides to shift production and reduce dependence on MGPI. [Based on our research](#), we believe that MGPI has produced Seagram’s gin, and its owner Pernod Ricard has been shifting production to Arkansas away from MGPI

## *We See 60% - 70% Downside Risk*

### **Warning: Related-Party Transactions and Revenues From Customer Freight Shipping Are Not Adding Up**

- Spruce Point always takes extra precaution to identify and evaluate related-party transactions when they occur at public companies. In the case of MGPI, we think investors should question its relationship with [ICP](#), an entity which it owns 30% and produces ethanol related products with Seacor, another publicly traded company
- [To our dismay, starting in Q2'16 we find that MGPI has been quietly restating purchase amounts from the JV in fiscal year 2015.](#) These restatements, coincide with the period that both MGPI's CFO abruptly resigned in [May 2015](#) (he had been CFO since 2009) as well as its Randy Schrick who had been with the Company 42yrs in [June 2015](#) (most recently served as VP of Production and Engineering). [MGPI's reported purchases from ICP are explicitly contradicted by Seacor.](#) Seacor has generally reported less sales to MGPI than MGPI claims. We can understand why MGPI might report slightly higher purchases than Seacor (e.g. shipping costs), but don't understand why in any case they would be reported lower as in 2014
- [We also observe that sales figures related to customer freight costs are not adding up YTD, and being retroactively restated higher in 2015.](#) Our concern about the validity of MGPI's numbers [could cause issues with its credit facility covenants](#)

### **MGPI's Shares Are Priced For Perfection And Now Its Largest Shareholder Is Liquidating**

- [In our view, it is easy to refute the bull case. Investors are valuing its shares as if it already were the best branded alcohol producer in the world \(greater than Diageo, Constellation and Brown-Forman\)](#) even though it has no firmly established brands. MGPI trades at a rich 2.5x, 14.5x and 29.0x 2017 street estimates of sales, EBITDA, and EPS, respectively. Optically, Its leverage appears conservative at just 0.8x Debt to EBITDA. But, in reality once its EBITDA and EPS start to decline, investors will focus heavily on the fact it has zero cash and is utilizing 46% of its credit revolver
- MGPI has just two small sell-side analysts that tout its stock has 17% upside to \$55/sh and seem confident it can compound its sales and earnings by at least 5% over the next two years, while expanding EBITDA margins by 170bps. Based on our price target of 60% - 70% downside, there's a terrible risk / reward of owning shares at the moment
- [MGPI's valuation multiple is stretched and trading near an all-time high.](#) We believe that once it becomes clear that the whiskey market is saturated, MGPI is stuck with excess inventory, and its tiny brands fail to gain traction, investors will once again realize they own a mediocre commodity alcohol and ingredient Company, which would ordinarily be valued at 1x sales and 8x – 9x EBITDA. As a result, we see approximately 60% - 70% downside risk in MGPI's share price to a range of \$16 – \$21 per share
- [Insiders always know best so follow the money.](#) It's no surprise to us that the Seaberg family which owns ~28% of the Company's common stock and 84% of the preferred shares (giving them Board control) recently entered into a stock sale program in late December to start liquidating a portion of its holdings

# Capital Structure Overview

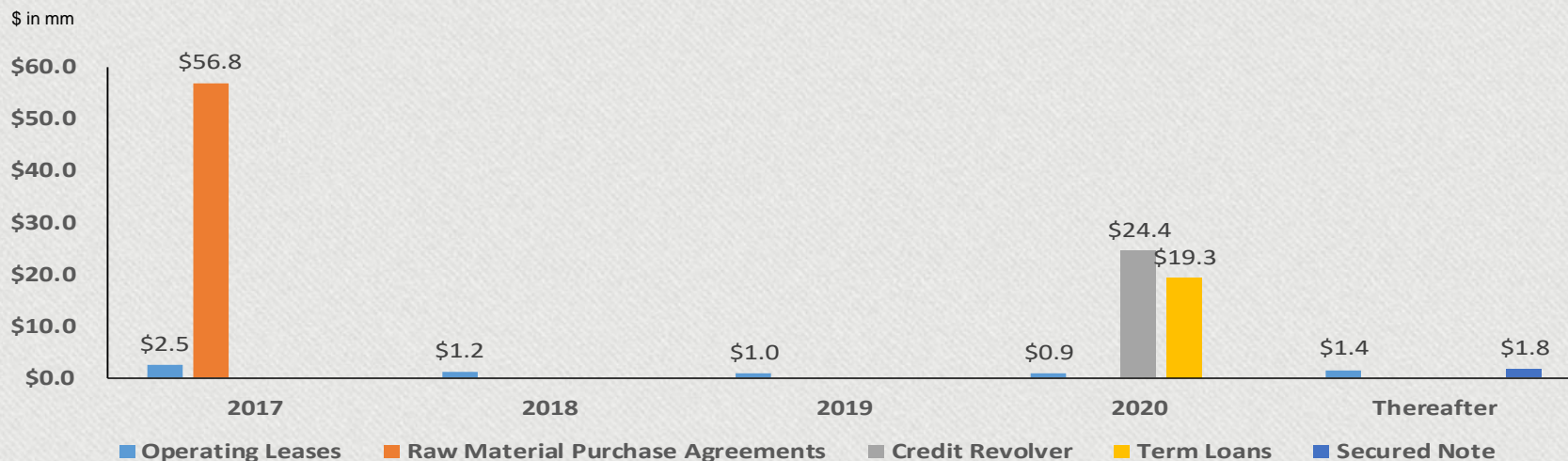
**MGPI's valuation is rich and its financial condition is fragile with no cash and significant leverage on earnings and EBITDA expectations that are likely to sorely disappoint**

\$ in mm except per share figures

		<b>Street Valuation</b>	<b>LTM 9/30/16</b>	<b>2016E</b>	<b>2017E</b>	<b>2018E</b>
Stock Price	\$47.20					
Fully Diluted Shares	16.6	EV / Sales	2.5x	2.6x	2.5x	2.3x
<b>Market Capitalization</b>	<b>\$783.5</b>	EV / Adj. EBITDA	16.3x	15.8x	14.5x	13.1x
Revolving Credit Facility	\$24.4	Price / Reported EPS	27.6x	27.4x	28.6x	24.9x
Revolving Term Loan Borrowing	\$19.3	Debt / Adj. EBITDA	0.9x	0.9x	0.8x	0.7x
Other Debt	\$1.8	<b>Spruce Point Adjusted</b>				
<b>Total Debt Outstanding</b>	<b>\$45.5</b>	EV / Sales	2.5x	2.6x	2.8x	2.9x
Less: Equity Investment In ICP	\$17.5	EV / Adj. EBITDA	16.3x	15.8x	19.9x	21.8x
Less: Cash and Equivalents	<b>\$0.0</b>	Price / Adj. EPS	31.5x	31.3x	39.2x	45.9x
<b>Total Enterprise Value</b>	<b>\$811.5</b>	Debt / Adj. EBITDA	0.9x	0.9x	1.1x	1.2x

Based on Wall St. Sell-side analyst and Spruce Point adjusted estimates

## Debt Maturities In The Near Term Relate Mostly To Material Purchases



# MGPI's Meteoric Stock Increase Deserves Significant Investor Scrutiny





## *The Bear Case on MGPI*

## Bull vs. Bear Case

### What The Stock Cheerleaders' Say

#### **Apis Capital Dec 2015**

*"Margins will expand in coming years, driven by mix shift towards premium alcohol and ingredients products..."*

#### **Apis Capital Dec 2015**

*"The company benefits from secular tailwinds in favor of whiskey – rye whiskey in particular" and "Existing Business Growth with Significant Market Share and Sustainable Barriers."*

#### **Apis Capital Dec 2015**

*"The real strategic win, however, appears on the balance sheet as "barreled distillate". These barrels are filled with distillate, booked at cost, and owned by MGP for the aging process. In a sense, this is MGP's "reserve" which they can access at any point after aging for 4 years. Aged barrels of distillate can sell for 3x the cost after ~4 years of aging."*

### Spruce Point's View

We believe a majority of the margin benefits have already been realized, well in advance of plan

- Mix of premium ingredients has already reached ~**86%** and shift is being driven as much by deterioration of industrial revenues as growth
- MGPI doesn't disclose how much high margin old-aged product is supporting current results
- Further expansion highly dependent on success with its own brand launch, which we believe is likely to fail

No barriers to entry that capital investment cannot displace. Premium alcohol white label volume growth to temper or reverse as deep pocketed customers seek to [distill their own product](#); the most notable is [Diageo's \\$110m KY distillery](#) which [could potentially jeopardize 8% or more of MGPI's current revenue](#), and put more secondary supply into wholesale market.

What may have been true in the past, should not be assumed in the future. With substantial new distillate and storage capacity coming on line, we do not believe that it's safe to assume whiskey prices will rise in the future. What if they decline? What if they have [storage losses](#) or more [plant explosions](#)? Our [price checks](#) suggest no premium for their aged product

## Bull vs. Bear Case (cont'd)

### What The Stock Cheerleaders' Say

#### **Apis Capital Dec 2015**

*"..additional upside exists if the company is able to successfully launch its own, branded whiskey."*

#### **Craig Hallum Dec 2016**

*"The company announced the acquisition of the George Remus Whiskey brand in an all cash transaction (terms not disclosed)... this acquisition is the first of potentially more as it develops of its own portfolio of premium spirits brands. ."*

#### **Seeking Alpha Blogger "Cleshock" (MF Analyst)**

*"This story has a clean balance sheet, good free cash flow..."*

#### **Apis Capital Dec 2015**

*Comparable companies in the space are hard to find given the "whiskey pure-play" nature of MGP. However, a quick glance at gross margins at Brown-Forman, Diageo, Suntory, Pernod Ricard, Remy, among others, shows gross margins anywhere from 50-70%.*

### Spruce Point's View

- The success of proprietary brands to date has [shown little traction](#)
- MGPI hasn't even disclosed how much market and distribution expenses are required to become a credible, national branded liquor co.
- [Many well-funded and celebrity-backed alcohol spirits have failed](#)
- MGPI's foray into branded liquor products is at best a way out-of-the-money call option

[MGI has zero cash on its balance sheet, borrowing heavily on its short-term credit facility to fund a long-term warehouse facility, and is free cash flow negative.](#)

Have you looked at [Castle Brands](#) (AMEX: ROX)? MGPI will never be a Diageo, Brown-Forman, or Suntory (Jim Beam). The comparisons are meaningless in our opinion

## Bull vs. Bear Case (cont'd)

### What The Stock Cheerleaders' Say

#### **Apis Capital Dec 2015**

*"Additionally, strong earnings growth combined with modest rerating towards its branded alcohol peer group offers substantial upside"*

#### **Craig Hallum Dec 2016**

*"Our \$50 price target for MGPI is based on 15.0x CY18 EV/EBITDA on our estimate of \$58.5M, in-line with Consumer Alcohol peers trading at 15.2x."*

#### **SunTrust Dec 2016**

*"We are raising our price target to \$60 from \$50 which equates to 14x our 2018 EBITDA estimate, at the low end of the mid-to-high teens EBITDA multiples of other beverage companies...our EV calculation assumes \$150M in barreled whiskey inventory (given it is a tangible product with an intrinsic value) which is subtracted from the company's equity value."*

#### **Seeking Alpha Blogger "Cleshock" (MF Analyst)**

*"...Good visibility, and limited downside (say earnings top out here at \$1.50/yr and market gives them 20x, so a \$30 downside? "*

### Spruce Point's View

The stratospheric rise in MGPI's share price has resulted in it already trading at a premium to aspirational beverage peers. The appropriate valuation multiple is as a commodity ingredient provider, not a branded beverage company

Once the whiskey bubble bursts, and MGPI's branded liquor strategy clearly fails, investors will realize they own a mediocre ingredient Company, which [would be valued](#) at 1x sales and 8x – 9x EBITDA

*It doesn't give us confidence that the analyst admits modeling errors in the same note. How can one ascribe 3x current value to whiskey inventory on the balance sheet at just \$45m. Clearly, just taking management's word of its future value not considering [large supply increases coming](#), or the fact that [bulk whiskey prices have not been increasing](#). Also MGPI has to reserve some of the whiskey for its own white label clients*

There is no visibility in MGPI's commodity businesses. Also, many [key contracts may be canceled and a patent expiry looms large in 2017](#). We see substantial downside especially if barreled whiskey inventory doesn't turn over, it spoils, or prices declines shrink its credit facility borrowing base, and in an extreme case, trigger mandatory debt repayment

# Profit Driver Analysis Suggests A Difficult Road Ahead For MGPI's Earnings Growth

Profit Driver	Assessment	Implication for Future MGPI Profit
Distillery Sales	Revenue drivers are: 1) Premium Spirits, 2) Industrial Alcohol, 3) Feed and co-products, and 4) warehouse / storage revenues. <b>Premium spirits</b> will fail to hit expectations as acquired brands such as George Remus are slow to ramp, existing whiskey sales stagnate / disappear due to large supply increase. <b>Warehouse revenue</b> also disappoints as fewer customers require the service. <b>Industrial alcohol</b> : pricing conditions in the industrial alcohol industry have been difficult all year as this market is oversupplied. <b>Distillers Feed</b> : an overabundant co-product tied to corn prices may continue to decline in sales	Negative
Ingredients	Pricing headwinds expected to continue. Material starch ingredient Fibersym® comes off patent in 2017 and could lower margins	Negative
Input Costs	Principal distillery inputs are corn, rye, barley, wheat and ingredients flour. MGPI is very dependent on 2 suppliers for grain. If its financial condition deteriorate credit conditions could tighten. Most <a href="#">grain commodities remain oversupplied</a> leaving a low risk of substantial near term price inflation	Neutral
ICP JV	Profits peaked at \$10.1m in 2014 and have been in steady decline. Recent contraction of industry wide fuel ethanol margins weighing on performance	Negative
Operating Expenses	Recent one-time, non-recurring benefits includes a legal settlement and a gain on sale of an asset – both totaling \$3.4m. Chemical release likely to result in fines and increases in safety and operational improvement costs	Negative
Taxes	Effective tax rate declined from 34% to 31% due to an accounting change. This change is likely to hold constant next year and won't drop the rate further	Neutral

# Overview of MGPI's Old and Aging Assets

Both of MGPI's assets are old and prone to operational disasters. In particular, MGPI is promoting its ability to leverage its Lawrenceburg distillery to gain share in the premium spirits market with a focus on whiskey and bourbon. The facility has a long history and was established in 1857 as the Rossville Union Distillery. Seagram and Sons acquired it in 1933. When Seagram's folded in 2000, Diageo and Pernod Ricard split the beverage division, with Pernod taking the Lawrenceburg facility. Pernod sold it to CL Financial in 2007 to form LDI. MGPI acquired LDI in [October 2011](#) for the announced sum of \$15m, although the actual payment was just \$10.9m according to the [10-K](#). New and modern distillery capacity is rapidly entering the market while MGPI's old assets are currently trading at a historic valuation multiple near 6x book value!

Lawrenceburg, Indiana  
Founded in 1847

Products: Premium spirits distilled



Atchinson, Kansas  
Opened in 1941

Products: Distilled Alcohol and Food Ingredients



# MGP's Track Record of Operational Hazards

It's hard to get excited to pay a premium multiple to own a Company with a history of operational disasters which include explosions, and hospitalizations of workers and innocent community members. Fortunately, no one has died yet from accidents at MGPI's plant. Current and prospective investors should price in the risk that a potentially larger disaster completely incapacitates operations and has a material hit to earnings.

Date / Source	MGPI Accident Headline
<a href="#">Oct 2016</a>	"Chemical spill reported at MGP Ingredients, multiple people being treated for respiratory discomfort"
<a href="#">Feb 2016</a>	"Explosion reported at MGP Ingredients warehouse"
<a href="#">Oct 2014</a>	"A fire in the Atchison distillery in October 2014 shut down production of distillery products and ingredient solutions for seven days, resulting in higher production costs"
<a href="#">Jan 2014</a>	"Experienced a fire at our Lawrenceburg facility. The fire damaged certain equipment in the feed dryer house and caused a temporary loss of production in late January"
<a href="#">Sept 2002</a>	"Two Employees Are Burned In Distillery Explosion"



Source: [KSHB](#)

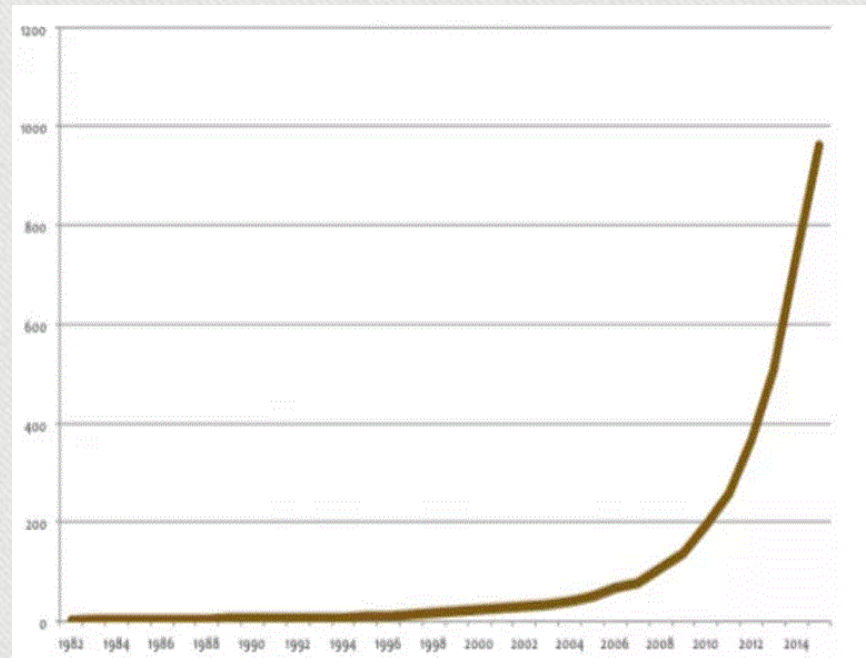
# Craft Whiskey Market Becoming Saturated; Pop Out The Bubbly....

In Spruce Point's opinion, the "explosive growth" in the craft whiskey market has now reached the saturation point. Thanks to the help of an ambitious whiskey blogger who has tracked the market, it's easy to see there are now in excess of 1,000 brands/distillers domestically (1). According to a recent industry white-paper, *"The Craft Distilling market is no longer in its infancy. The pioneers of the 90's and 00's yielded to the explosion in new entrants over the past few years. And now we are seeing some of those entrants departing. The next phase of the market will see increasing numbers of exits, even as the number of new entrants continues to grow."* This bodes poorly for MGPI's fledgling new brands. Without substantial marketing effort and brand awareness, MGPI's goals to establish a branded product faces substantial challenges.

## Recent Liquor Store Visit: Dozens of Domestic Whiskey / Bourbons Competing For Shelf Space



## Bubble-Like Increase of In-Production US Craft Distilleries



(1) [The Complete List of American Whiskey Distilleries & Brands](#), Updated Jan 6, 2007

# White Oak Barrel Shortage Will Self Correct

A bottleneck that restricted the supply of domestic whiskey and bourbon has been a shortage of white oak barrels used for aging. In May 2015, a [Wall Street Journal article](#) highlighted the issue. However, like all supply/demand imbalances they eventually get corrected. In response to the shortage, current manufacturers are expanding production

**From industry heavyweight Brown-Forman:** *“The reduction in underlying net (other) sales was due primarily to declines in used barrel sales reflecting lower prices and volumes as a result of weaker demand from blended Scotch industry buyers and pricing pressures due to increased supply of used barrels in the market. (Source: [10-Q](#) p. 24, filed 12/7/16)*

## Demand Creates New Supply

### Independent Stave Company Purchases Land in Western Kentucky Slated to Become the Company’s Sixth American Oak Stave Mill, Paving the Way for Future Expansion to ISC’s Barrel-Making Operations

MOREHEAD, Ky. (April 4, 2016) – American Stave Company, a division of Independent Stave Company (ISC), is pleased to announce the acceptance of its offer to purchase 48 acres of land in Marshall County, Ky., where the company plans to build a state of the art stave mill. Once operational, the new facility will become the sixth American oak stave mill in the family-owned company’s portfolio and the seventh overall, as ISC also owns a large stave mill in France. The new mill is expected to create approximately 40 new jobs in the Marshall County community.

Source: [Independent Stave Co](#)

### Laurel County Barrel Maker Planning \$20m Expansion

To make bourbon, you have to have barrels, and Kentucky distillers need a lot of them. To accommodate that demand, East Bernstadt Cooperage in Laurel County is considering a \$20 million expansion. The Kentucky Economic Development Finance Authority on Thursday gave preliminary approval for up to \$2.1m in tax incentives for the \$20.2m project. According to the economic development report, the expansion would include the construction of a new facility to increase barrel production. The project would create 75 new jobs with average hourly wages (including employee benefits) of \$15.05.

Source: [Kentucky.com](#)

### Speyside Bourbon Cooperage

In mid-July, just eight weeks into operations, Speyside plant management and employees reached a production goal by crafting 500 high-quality, oak barrels in one shift. With a 200,000-barrel-a-year capacity, the new plant is poised to meet the growing demand of distillers and looks ahead at possible plant expansion in the future.

Source: [Portsmouth Daily Times](#)

# Rapid Aging Technologies Changing the Whiskey Industry

Spruce Point has always favored looking for non-consensus short ideas where investors are under-appreciating the risk of technology disruption. In the case of the whiskey and aged liquor business, there are new entrants offering the same craft spirit experience, but produced in significantly less time than the traditional three year aging process.

Others such as [Time & Oak](#), are offering a new technology kit to allow for home aging. Anything that reduces the aging time to bring new whiskey to market is bearish for supply.

## Technology That Produces More Whiskey Faster – [CNBC August 2015](#)

*“With more modern technology than what’s used in the traditional whiskey-making process, Cleveland, Ohio-based distiller Cleveland Whiskey has refined a proprietary scientific method. But thanks to his experimentation, his current process takes about a week from the beginning of production to bottling and shipping, compared with the years it takes using traditionally methods”*

## Everything You Need To Know About Rapidly Aged Whiskeys – [Esquire, June 2015](#)

Fast whiskey: Distillers use technology to shorten aging process -- [Mlive.com June 2015](#)

Cleveland Whiskey: 6 Days



[Source](#)

Hudson Bay Bourbon Whiskey: 4 Months



[Source](#)

Virginia's Cooper Fox Distillery



[Source](#)

## *Case Study: Whiskey Will Follow The US Vodka Market, Which Became Saturated From Hundreds of Entrants*

MGPI investors would be wise to learn from the recent history of the Vodka market for insights into what may happen in the whiskey market. The explosion of premium brands such as Grey Goose, Ciroc, Belvedere, Tito's and countless others led to a saturation and maturation of sales in the vodka category. Consumer alcohol preferences are inherently fickle and constantly evolving, so while whiskey preference may be strong today, when tastes change it will leave a glut of brands and supply with few buyers.

**Over-saturation in the US vodka market is blurring category boundaries and damaging sales of established premium and super-premium brands.**

According to Pierre Pringuet, CEO of Pernod Ricard, the influx of “hundreds” of new vodka brands over the past few years has negatively impacted sales of the group’s premium vodka Absolut.

Depletions in the US during the 2013/14 financial year came in at -2%, causing overall volume sales of the brand to decline 4%.

“Let’s be honest, we are not pleased with the performance of Absolut in the US,” Pringuet said during a presentation of the French drinks group’s end-of-year financial presentation. “The reality is that there are several hundred new entrants in the market. Basically 99% or more of these brands will not survive, but the problem is that they do take market share.”

Diageo meanwhile has witnessed a similar effect on Smirnoff and Ciroc, both of which recorded volume declines in the US of 4% and 3% during 2013/14.

Ivan Menezes, CEO of Diageo, said earlier this summer: “In the US what did happen is you’ve had a lot of competitive entry; I think there are over 200 brands or items that came into the market in the last two years”



## *Diageo Is A Material Customer That Could Disappear Fast*

Completion of Diageo's new distillery in Shelbyville, KY is expected soon. Diageo has stated its facility has capacity for 1.8m proof gallon (750,000 9-liter cases). (1) Compare this with MGPI's estimated 2.3m case production of rye whiskey and bourbon in 2015, and you can see why Diageo may no longer need MGPI's distilling capacity. (2)  
A contract termination or modification by Diageo could have a material adverse effect on MGPI.



**Warning:** MGPI does not include a risk factor related to the loss of Diageo's business in its recent 10-K. However, a note in its credit agreement (below) suggests it is a "Material Contract" with an aggregate amount of more than \$25m or approximately 7.8% of LTM sales.

Date	Warning From MGPI's Credit Agreement
<a href="#">2<sup>nd</sup> Credit Amendment Amendment</a>  Feb 27, 2015	<p>"Material Contract" means, collectively, (i) any contract or other agreement (other than the Loan Documents), whether written or oral, to which any Loan Party is a party <b><u>that involves payments in an aggregate amount of more than \$25,000,000 or as to which the breach, nonperformance, cancellation or failure to renew by any party thereto would have a Material Adverse Effect</u></b>, (ii) each Existing Supply Agreement and <b><u>(iii) that certain Distillate Supply Agreement dated as of July 1, 2013 between Diageo Americas Supply, Inc. and MGPI Indiana.</u></b></p>

(1) [Diageo announcement](#), May 2014

(2) [MGPI Investor Presentation](#), Nov 2016 (slide 5); total cases multiplied by market share

# MGPI May Lose Customers As They Increase Their Own Distilling Capacity

Industry sources suggest that MGPI's key customers are Diageo, High West, Sagamore Spirit and Templeton Rye. (1) Each of these customers (as well as Terresentia) are adding their own production capacity and storage which suggests they may no longer need to do business with MGPI.

Customer	Here's What They Are Doing
Diageo	<a href="#">October 2015</a> : Crews broke ground on the \$115 million project in August 2014. Located on an approximately 300 acre site, the 1.8 million proof gallon distillery is on track to be up and running by the end of 2016. Along with Bulleit® Bourbon, the facility will produce a number of current and future Diageo bourbon and North American whiskey brands. Bulleit Distillery is midway through completion. The first completed warehouse is already holding barrels of bourbon. The warehouse is expected to be full by mid-October. A second warehouse is nearing completion, and ground was broken on a third warehouse in September. Each has a capacity of 55,000 barrels.
High West	<a href="#">October 2016</a> : Acquired recently by Constellation Brands. The High West portfolio sells approximately 70,000 cases annually.
Templeton Rye	<a href="#">October 2016</a> : Templeton Rye to add distillery at Iowa facility. Video states, " <u>the company actually contracted the distilling portion to a separate company in Indiana (aka MGPI).</u> " The Iowa Economic Development Authority approved last week what's reported to be \$1.6 million in tax credits to help facilitate a \$26 million expansion and renovation of Templeton's existing operations. ( <a href="#">source</a> )
Sagamore Spirit	<a href="#">July 2015</a> : <i>"While Sagamore's ultimate plan is to produce its rye entirely at the Port Covington facility, its first batch was made at LDI (now known as MGP Ingredients), an industrial-sized distillery in Indiana. It has been aging for years there and in Kentucky."</i> <a href="#">April 2016</a> : Under Armour Founder and billionaire Kevin Plank gets into the whiskey business. The hope is to open the 22,000-square-foot facility by the first quarter of next year. <i>"We're going to be build a world-class facility and you're eventually going to see the size and the scope of it. We will be able to compete at the highest levels when we, as a team, are ready to get there."</i>
Luxco	<a href="#">May 2016</a> : Invests \$30m in a Bardstown distillery for whiskey/bourbon. The campus will include an 18,000-square-foot distillery and visitors' center with a tasting room and event space. Additionally, Luxco will construct up to six barrel warehouses on its 70-acre site off State Highway 245. Construction will begin in the coming weeks with completion planned by late 2017. <b>Luxco currently contract distills its bourbon brands – Rebel Yell, Ezra Brooks and Blood Oath – through relationships with other distilleries (aka MGPI)</b>
Terresentia	<a href="#">June 2016</a> : Bourbon distillery will begin producing bourbon next month. A grain handling system installation project is wrapping up. Crews have been working on it since January. Once that's complete, the bourbon will start flowing. <b><u>We're told bourbon that was distilled in Indiana ( MGPI?)</u></b> and aged in rickhouses at the O.Z. Tyler Distillery is already being sold at most Owensboro liquor stores. TerrePURE Kentucky Distillers has spent around \$25m buying and renovating the 130 year old distillery.

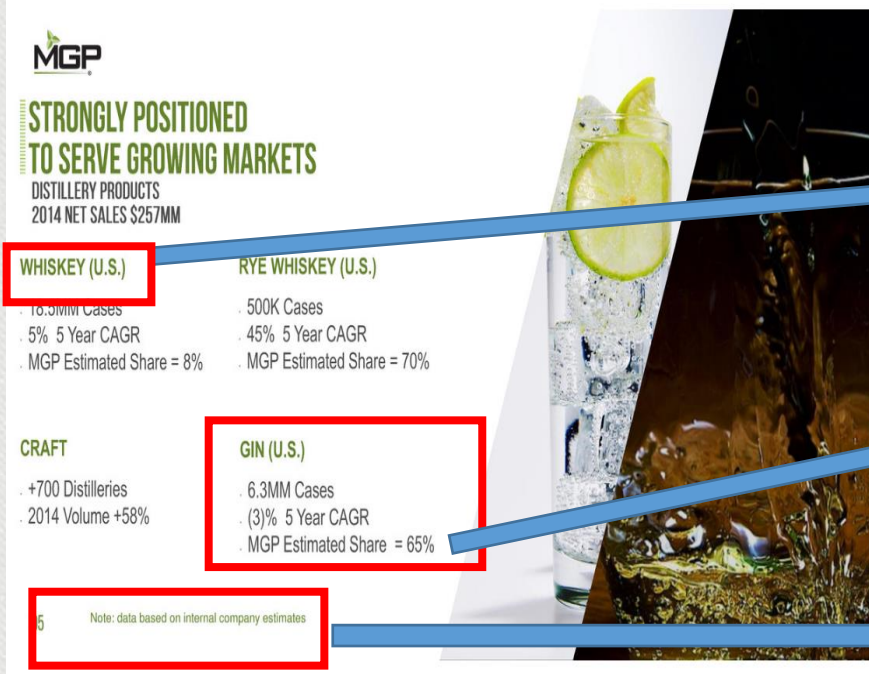
# Substantial New Whiskey Bourbon Capacity Coming To Market

Competitor	Here's What They Are Doing
Bardstown Bourbon	<a href="#">September 2016</a> : New distillery located on 100 acres in Kentucky. The facility is 37,000 sqft and cost \$25m. The distillery has a 1.5m gallon capacity at the moment, but it can and likely will be expanded to 6m without disturbing the current design. <a href="#">October 2016</a> : Constellation brands takes a minority stake in Bardstown. Commercial production started in September and it recently announced that it was preparing to expand its current 1.5m proof gallon capacity
Heaven Hill	<a href="#">Feb 2016</a> : The bourbon and whiskey producer expects to start construction on a \$15.5 million distillery expansion in Louisville and a \$13.2 million warehouse expansion in Nelson County this spring. Both projects should be completed by 2017. In Nelson County, Heaven Hill is also constructing two new warehouses that will hold about 55,000 barrels each — taking the company's storage capacity up to more than 1.2 million barrels total.
New Riff Distilling	<a href="#">June 2016</a> : Plans \$12.5m expansion. New Riff currently is aging 4,000 barrels in brick warehouses near the Licking River. The expansion will add capacity for 28,000 barrels and build a restaurant and taproom adjacent to the storage facility, according to documents submitted to the Kentucky Economic Development Finance Authority
Maker's Mark	<a href="#">Feb 2014</a> : Maker's Mark announced a \$67 million expansion on Thursday to meet booming demand for the Kentucky bourbon known for its iconic red wax top. The distillery will add a third still — an exact replica of its existing mirror-finish copper stills — to its historic still house in Loretto, increasing capacity by 50 percent, and build new warehouses to age the bourbon.
Wild Turkey	<a href="#">Sept 2013</a> : Celebrated the grand opening of its \$43m Packaging Facility at its KY Distillery. Since purchasing the brand in 2009, Gruppo Campari investment has surpassed more than \$100m. In 2011, the Company unveiled a US\$50 million expansion at the distillery, more than doubling the plant's production capabilities.
Jack Daniels	<a href="#">Feb 2016</a> : Tennessee whiskey giant Jack Daniel's is set to make a \$140 million expansion to its distillery in Lynchburg, according to Gov. Bill Haslam and state economic officials.
Four Hills	<a href="#">June 2015</a> : \$55m expansion plan: \$34m for a duplicate column still and more fermenters at the Lawrenceburg distillery and \$21m for four new warehouses at Coks Creek outside Bardstown. With the second column still, capacity is scheduled to increase to about 8 million proof-gallons (about 11.2 million regular gallons), enough to fill more than 211,000 barrels a year
Sazerac	<a href="#">April 2014</a> : Sazerac is to spend \$71m expanding its Buffalo Trace, The Glenmore and Barton 1792 distilleries in an attempt to meet demand for bourbon
Chattanooga Whiskey Co	<a href="#">July 2016</a> : 46,00 sqft facility with room to house 4,000 aging barrels of bourbon whiskey. Plans also include over 10,000 square feet of production space, over 2,000 square feet of office space where Chattanooga Whiskey will be headquartered, and over 4,000 square feet of future event space.

## Case Study: MGPI Quietly Lost Significant Market Share In The Gin Category

Pay close attention to MGPI's recent investor presentation. In the past year, MGPI changed the layout of the key slide that promotes its market share in key distillery products. In particular, we find that MGPI's share of Gin plunged from 65% to 35% in one year. The Company has not disclosed the impact of this loss in any of its SEC filings. MGPI also reclassified its "US Whiskey" category as "Bourbon" – which now includes three items (Bourbon, Tennessee Whiskey and Rye) and allowed them to portray their market share growing by 1%.

### MGPI Gin Market Share At 65%....



Source: [MGPI Investor Presentation](#), Nov 2015

### A Year Later It's At 35%.....



Source: [MGPI Investor Presentation](#), Nov 2016



## Gin Market Share Loss (Cont'd)

Seagram's is the #1 Gin by market share in the U.S. according to [Statistica](#) and owned by Pernod Ricard. If you look carefully at the label, you will notice bottles list Fort Smith, Arkansas. It is very likely that Pernod shifted production away from MGPI's Lawrenceburg, Indiana distillery to Arkansas.



# MGPI Has Significant Business Risks Into 2017 Not Being Discounted

**Spruce Point believes investors are underpricing the risks faced by MGPI in 2017, some of which could have a material adverse effect on its financial condition**


Key Risk	Discussion	Potential Impact and Spruce Point Risk Assessment
Diageo Americas Supply, Inc.	Distillate supply agreement signed July 1, 2013. MGPI obscures the importance of this agreement by not disclosing it in its 10K/Q as a material contract, but we found evidence that suggest it accounts for upwards of 8% of revenues	<b>Very High:</b> With Diageo nearly complete its new \$110m Bulleit distillery in Kentucky, it may no longer need to purchase any distillate from MGPI. This could be a material loss to the Company. Diageo has stated its facility will have capacity for 1.8m proof gallon (750,000 9-liter cases). Compare this with MGPI's 671,000 case production of rye whiskey in 2015 and observe that Diageo would no longer need MGPI's distilling capacity. A contract termination or modification by Diageo could have a material adverse effect on MGPI.
Fibersym® Patent	MGPI's key patent rights to Fibersym® <b>expire in 2017</b> . The company markets one of its specialty wheat starches under the Fibersym® Resistant Starch series	<b>High:</b> MGPI faces competition in this market which could lead to diminished returns and lower margins. It describes Fibersym as " <i>one of our more popular specialty starches</i> ." MGPI would face increased costs to defend the patent which could result in a material adverse effect on its business post 2017
Grain Supply Contracts	Most of MGPI's grain requirements are purchased from two suppliers, Bunge Milling and Consolidated Grain and Barge (CGB) – <b>both contracts expire on December 31, 2017</b> . These contracts permit MGPI to purchase grain for delivery up to 12 months into the future at negotiated prices, based on a formula using several factors	<b>High:</b> Potentially disruptive impact if MGPI's financial condition were to deteriorate further in 2017. The Company has \$56.8m of purchase order commitments related to raw material and packaging as of 9/30/16. Grain supply counterparties could potentially tighten credit to MGPI and/or require cash collateral or shorten contract duration. MGPI is currently utilizing 46% of its revolver and has \$0 cash on hand as of 9/30/16 placing it in a fragile financial condition
Collective Bargaining Agreement	A collective bargaining agreement covering 56 employees at MGPI's Lawrenceburg facility <b>expires on December 31, 2017</b> .	<b>Medium:</b> ~20% of its workforce is covered by this agreement. A work stoppage/disruption could have a material adverse effect on MGPI. MGPI has recently had operational issues and work hazards. These problems could potentially give its unionized workers cause for concern and want greater safety protections
TTB Audit	In 2016, MGPI disclosed that the regulators at the TTB have expanded their audit of MGPI and there have been "clerical errors" and "storage losses"	<b>Medium:</b> MGPI has suggested it will have to pay penalties and taxes but claims it won't be 'material' – investors should exercise caution and skepticism

# MGPI Is Baiting Investors With Hope of Big Profits Selling Aged Whiskey

MGPI is investing \$29m to construct new warehouse capacity to allow clients to store and age its whiskey products. It also believes its \$45m of inventory can be sold in a few years at prices in excess 3x book value.

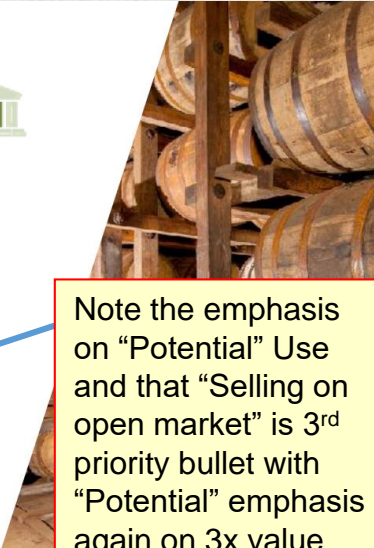
The problem with this argument is: 1) Substantial new whiskey capacity is coming online, 2) New technologies are emerging that allow distillers to age whiskey in under 1 week, and 3) The 'great barrel shortage' which restricted supply is likely to taper as supply/demand rebalance

MGPI hypes ability to store whiskey and sell for 3x value



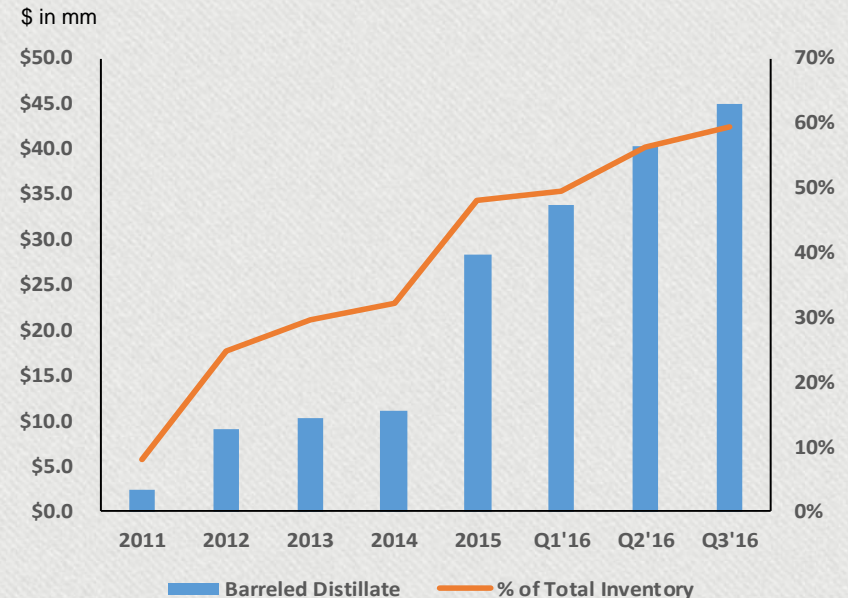
**INVESTING TO GROW**

- Expanding barrel warehouse capacity - \$29MM investment
- Building our barreled whiskey inventory
  - Investment up \$4.7MM in Q3 to \$45MM
  - Potential uses:
    - Support own brands
    - Strategic partnerships
    - Sell on open market – potential value 3X
- Attracting, developing and retaining talent



Note the emphasis on “Potential” Use and that “Selling on open market” is 3<sup>rd</sup> priority bullet with “Potential” emphasis again on 3x value

Whiskey Sitting Within Inventory Is Surging....





# Don't Bet On Appreciation of Aged MGPI Rye Whiskey.....



**J.B. THOME & CO., INC.**  
BULK SPIRITS

USD\$1,250.00 per barrel, 53 original liquid gallons, including wood  
Ships @ about 120 proof, 70% Rye, 30% Corn  
EXW: Owensboro, KY

**Tennessee Rye Whiskey (70% Rye, January 2016 Entry)**  
USD\$1,200.00 per barrel, 53 original liquid gallons, including wood  
Ships @ about 120 proof, 70% Rye, 30% Corn  
EXW: Owensboro, KY

**Rye Whiskey (95% Rye, Indiana, 2011 Entry)**  
USD\$3,000 per barrel, 53 original liquid gallons, including wood  
Ships @ about 120 proof  
EXW: Lawrenceburg, IN

**Rye Whiskey (95% Rye, Indiana, 2013 Entry)**  
USD\$3,000 per barrel, 53 original liquid gallons, including wood  
Ships @ about 120 proof  
EXW: Lawrenceburg, IN

**3-Year-Old Corn Whiskey**  
USD\$1,350.00 per 55-gallon drum, drum price inclusive  
Ships @ about 125 proof  
EXW: Auburndale, FL

**Corn Distillate (Unaged)**  
USD\$25.00 per liquid gallon in 55 gallon drums or 275 gallon totes, container inclusive  
Ships @ about 160 proof  
EXW: Riviera Beach, Florida

**3-Year-Old Canadian Whisky**  
USD\$5.89 per L/A in 23,000 liquid liter tank containers  
Ships @ about 125 proof  
EXW: Calgary, Alberta Canada

—  
USD\$1,500 per 55-gallon drum, drum price inclusive  
Ships @ about 125 proof  
EXW: Auburndale, FL

—  
USD\$5,500 per 1,000-liter tote, tote price inclusive  
Ships @ about 130 proof  
EXW: Temperance, MI

## GNS

**American 100% Corn based**  
USD\$1.49 per proof gallon in bulk 6,200-gallon tank trucks or 29,000 liquid gallon rail cars  
Ships @ about 190-192 proof  
EXW: Muscatine, Iowa or Washington, IN

—  
USD\$4.75 per liquid gallon in 1,000 liter totes or 55 gallon drums, container price inclusive

J.B. Thome & Co is a well regarded bulk spirits brokerage in the distilled spirits industry founded in 1977. Their current price list contains two 95% Rye Whiskies listed from Lawrenceburg, IN which we can safely assume is MGPI's product. We observe no price difference between the 2011 and 2013 vintage product.

# MGPI Has Virtually No Pricing Power

Most of MGPI's whiskey and bourbon sales are white-label, and go through the bulk wholesale market. We contacted Ultra Pure the #1 U.S. based bulk alcohol supplier which we believe acts as a broker that purchases supply from distillers such as MGPI, and resells to other industry participants.

What we found via our research is that prices are virtually unchanged in over two years.

## Recent Ultra Pure Prices – Jan 2017

## Ultra Pure Prices – July 2014



Signature Spirits USA is the beverage division of Ultra Pure, LLC, a global supplier of alcohol products.

### Why consider Signature Spirits as a supplier?

- Special order, or non-stock products, are custom quoted in price as well as delivery time.
- All products are tested against published specification sheets.
- Sales are "Transfer in Bond" transactions. TTB paperwork and shipping are handled by Ultra Pure, LLC.

### Signature Spirits

c/o Ultra Pure, LLC  
50 Old Kings Highway North  
Darien, CT 06820

Phone: 877-778-5872  
Fax: 877-948-5872  
www.ultrapure-usa.com

Beverage Division Contacts:  
nielsv@ultrapure-usa.com  
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robert@ultrapure-usa.com  
jennifer@ultrapure-usa.com

## SIGNATURE SPIRITS DISTILLATE PROGRAM

	<a href="#">High Corn Bourbon Distillate</a>	<a href="#">High Rye Bourbon Distillate</a>	<a href="#">100% Bourbon Distillate</a>	<a href="#">Rye Distillate</a>	<a href="#">Neutral Whiskey Distillate</a>
<b>Mash Bill/Formula</b>	75% Corn, 21% Rye, 4% Malted Barley	60% Corn, 36% Rye, 4% Malted Barley	99% Corn, 1% Malted Barley	95% Rye, 5% Malted Barley	100% Corn
<b>TTB Designations</b>	Unaged Whiskey, Whiskey	Unaged Whiskey, Whiskey	Unaged Whiskey, Whiskey, Corn Whiskey	Unaged Rye Whiskey, Whiskey, Rye Whiskey	Unaged Whiskey, Whiskey
<b>Container</b>	Stock-265 gal tote	Special Order	Stock-265 gal tote	Stock-265 gal tote	Special Order
<b>Proof</b>	135	135	135	135	189
<b>Cost Per Tote/Drum</b>	\$3,230	\$3,420	\$3,498	\$3,925	\$3,509
<b>Cost Per PG</b>	\$8.95	\$9.56	\$9.78	\$10.97	\$7.01
<b>Cost Per WG</b>	\$12.19	\$12.91	\$13.20	\$14.81	\$13.24
<b>Cost Per 750mL at 80 Proof</b>	\$1.43	\$1.52	\$1.55	\$1.74	\$1.11

### Why use Distillates?

- Combine with your own distillates to either increase your yield or create a unique blend of mash bills
- Barrel Signature Spirits distillates to age at your facility.
- Bottle Distillates as a "white dog" or white whiskey product

Some more information that has come my way. This is obviously MGP's whiskey, but the offering came from a broker, Ultra Pure. The pricing is in gallons, but there's a 500-gallon (one tote) minimum.

- Rye Distillate (95% Rye, 5% Malted Barley): 135 Proof, \$14.25/gallon
- 100% Corn Distillate: 150 Proof, \$13.79/gallon
- Bourbon Distillate (75% Corn, 21% Rye and 4% Malted Barley): 135 Proof, \$11.68/gallon

Source: [Straightbourbon.com](http://Straightbourbon.com)

# MGPI's Foray Into Branded Whiskey A Long-Shot To Succeed, With Limited Traction

MGPI tells investors that it will be able to transform itself into a purveyor of premium spirits. To date, it has introduced three brands, but Spruce Point sees limited traction or success, and MGPI hasn't provided investors with more information to evaluate its performance (sales/marketing spend), or articulate the costs of establishing a national distribution plan.

MGPI Brand	Observations On Why It Has Limited Traction
<a href="#">Till Vodka</a> (introduced March 2016)	Craft vodka category already a crowded market. Described as " <a href="#">super premium</a> " yet sells for just \$25/bottle. Limited availability in Iowa, Indiana, Kentucky and Missouri. The brand has just <a href="#">140 Twitter followers</a> , which suggests lack of traction or limited marketing effort
<a href="#">Metze's Select</a> (introduced July 2015)	George Metze, MGPI's master distiller, <a href="#">mysteriously resigned in May 2016</a> less than 1yr after the brand was launched. According to the website, only 6,000 bottles were made and sold at \$75/bottle = max sales of \$450,000. As a <a href="#">review</a> states, "At nearly \$75 a pop, this bourbon will have to prove it's worth the price tag."
<a href="#">George Remus</a> (acquired Nov 2016)	Undisclosed purchase price. Sold to MGPI by three co-founders who created the product as a part-time endeavor while working full time jobs at E.W. Scripps and Proctor & Gamble. Available in Ohio, Kentucky and Indiana. The brand has Just <a href="#">a few hundred Twitter followers</a> which suggests limited traction or marketing effort. Available for <a href="#">\$45/bottle</a> . It's <a href="#">stated</a> that MGPI was supplying the whiskey and aging the barrels, so MGPI is really just acquiring the brand

# Deep-Pocketed Investors and Celebrity Endorsement Don't Guarantee Success In The Branded Alcohol Business

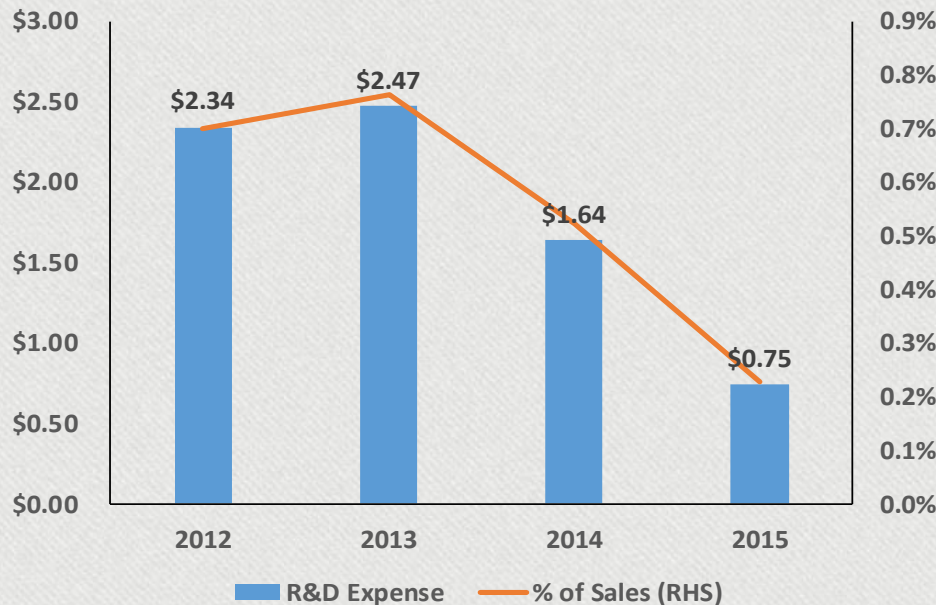
Building a nationally recognized and successful liquor brand is no small endeavor. There are plenty of examples of failures across all liquor categories. In particular, having a liquor brand backed by a deep-pocketed billionaire, future president, or celebrity musician does not guarantee success. In the table below, we illustrate examples of failed forays into branded spirits. We don't believe MGPI has fully articulated to investors how much it has spent, and will commit to spending, to market and grow its three brands.

Date / Source	Liquor	Celebrity Backer	Outcome
<a href="#">2006-2011</a>	Vodka	Donald Trump	Trump Vodka was discontinued in 2011, and the brand isn't included in a list of assets the businessman submitted with election officials after declaring his candidacy
<a href="#">1994-2007</a>	Virgin Vodka	Richard Branson	Virgin Vodka failed to take off and was removed from the market
<a href="#">2011-2012</a>	Cream Liqueur	Pharrell Williams/Diageo	in July 2012, Diageo abruptly told Williams that it would discontinue Qream distribution after two years of marketing the brand.
<a href="#">2002</a>	Whiskey	Willie Nelson	Still available on second-hand liquor sites for as low as <a href="#">\$17/bottle</a> for 6yr old aged bourbon. Appears to have limited commercial success

## Limited R&D and Patent Expiration Risk

As a producer of commodity products and ingredients, MGPI has to constantly innovate to maintain a competitive advantage against its larger peers that have substantially more resources and can easily out-spend it. MGPI holds very few patents, but as we highlighted earlier, its key patent rights to Fibersym® is set to expire in 2017 and could have a material adverse effect on margins.

### R&D Expenses Plunging....



### R&D Expense To Peers



Source: MGPI Annual Reports. Note: MGPI doesn't disclose quarterly R&D expenses

(1) As of last public report in 2012 (2) As of last public report in 2014

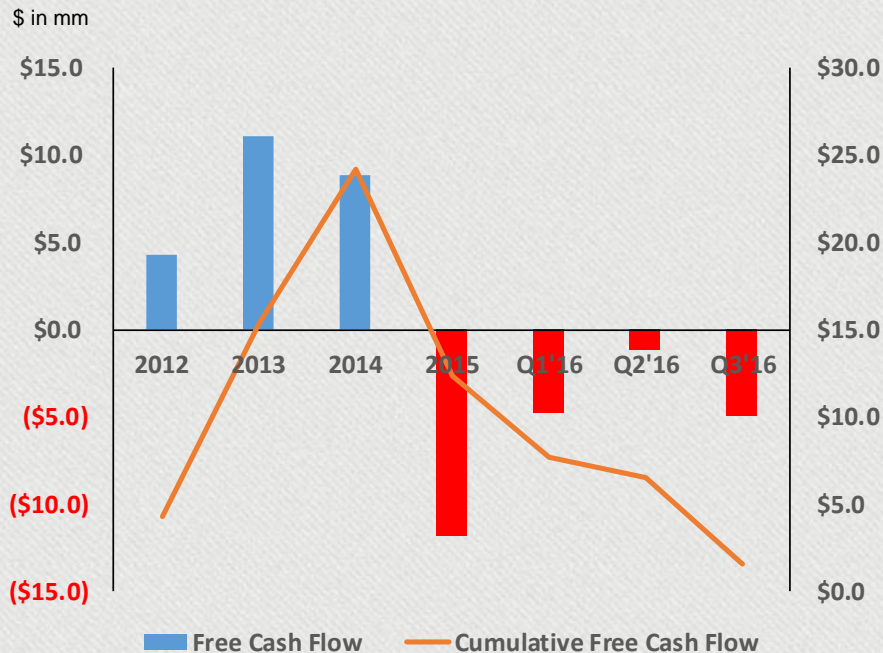


## *Liquidity Risk, Credit Concerns and Questionable Related Party Accounting*

# A Terrible Business With No Margin For Error In the Whiskey Expansion Plan...

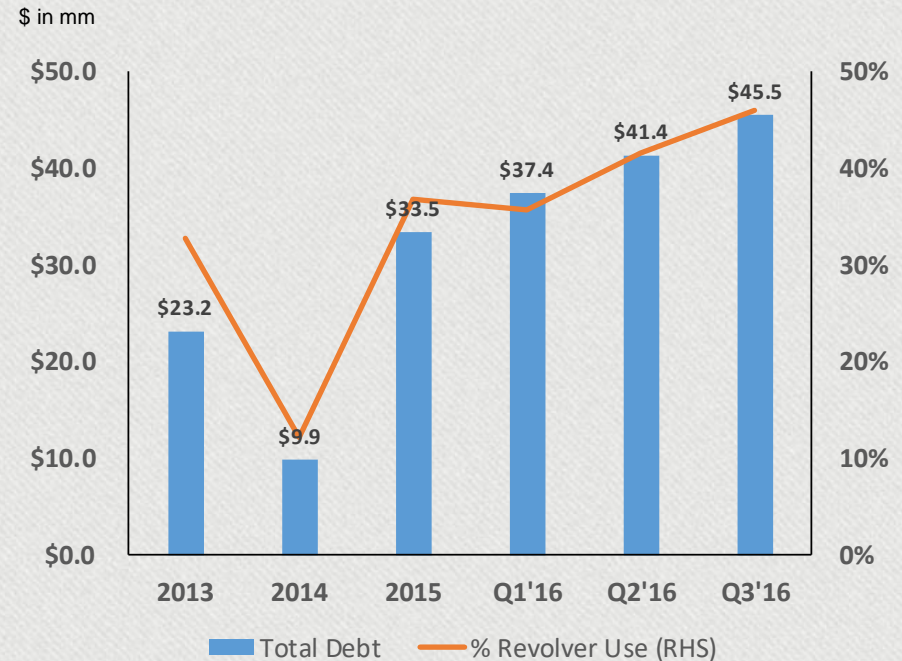
MGPI has a weak financial profile that cannot fund its own growth. Its cumulative free cash flow since 2012 is just \$1.5 million! As a result, MGPI is becoming more dependent on short-term revolving credit borrowings. It has made a bold bet that expanding its warehouse capacity to grow its whiskey business will pay off. If it fails to achieve its goals, the Company will be burdened with a record debt load and no cash on hand.

**Cumulative Free Cash Flow of Just \$1.5m Since 2012**



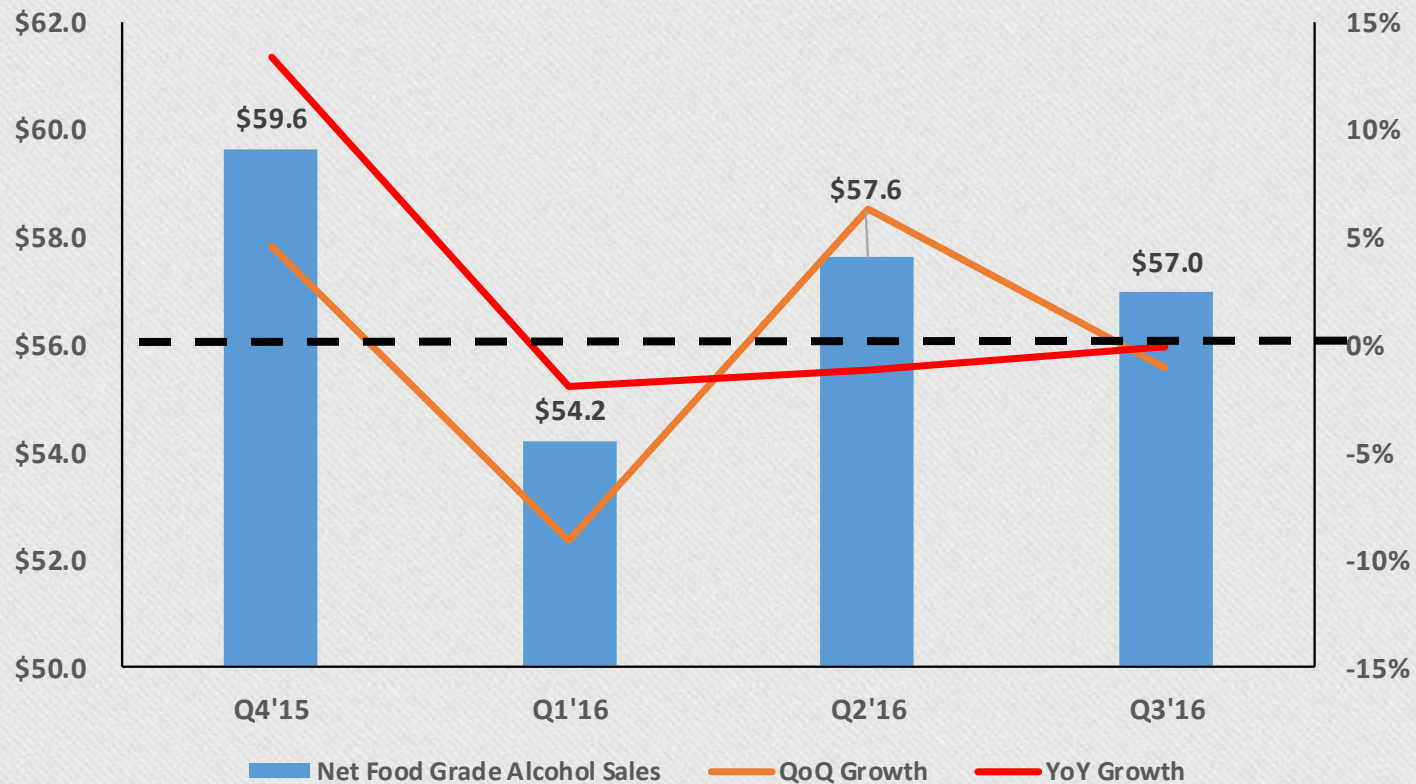
Source: MGPI SEC filings

**Worrisome Rise in Credit Revolver Dependency**



## Warning: Food Alcohol Sales Are Not Growing

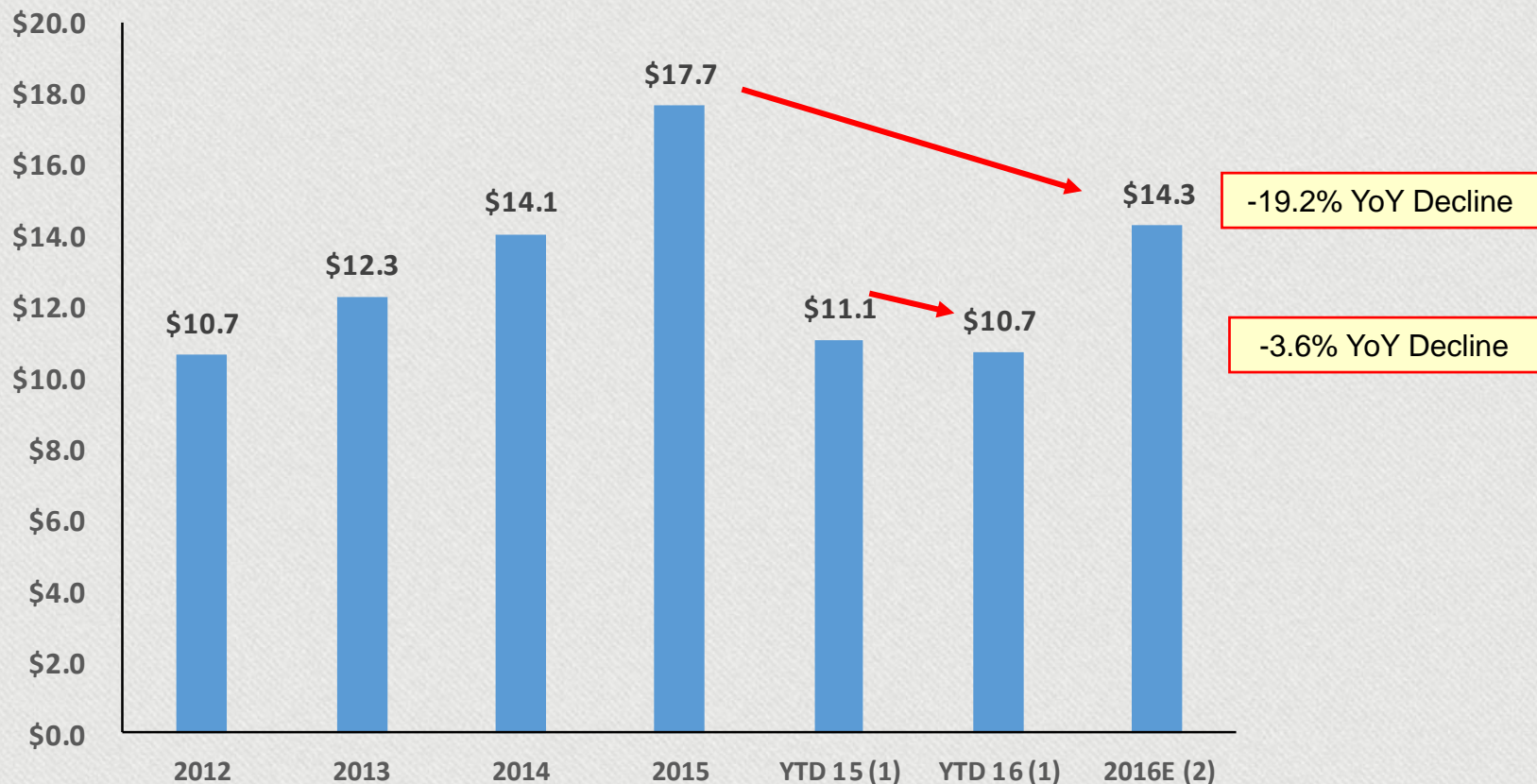
Despite all the excessive optimism that MGPI is a booming whiskey/bourbon producer, we point out that its net food grade alcohol sales growth has been recently declining.



Source: MGP Financials

## Warning: Slowdown Signaled By Freight Costs

Taking a step back, using customer paid freight costs as a directional indicator of business activity, we observe they are in YoY decline. Based on YTD 2016 annualized results, we estimate 2016 full year results are close to 2014 levels. This does not appear to be the sign of a healthy, growing company.



Source: MGP Financials

(1): YTD 15/16 based on recently disclosed figures in Q3'16

(2) Annualized based on YTD 16 results

## Warning: Inconsistencies Suggesting Potential Revenue Overstatement

As another subtle indicator of potential financial issues, we suggest investors look closely at MGPI's revenue recognition disclosures of customer paid freight costs included in sales. The YTD 2016 results are not adding up, and 2015 results are retroactively being revised higher.

### 2016 Disclosures of Customer Paid Freight Costs Included In Sales

Sales include customer paid freight costs billed to customers for the quarters ended March 31, 2016 and 2015 of **\$4,137** and \$3,399, respectively Q1'16 [10-Q](#), p. 8

Sales include customer paid freight costs billed to customers for the quarters ended June 30, 2016 and 2015 of **\$3,939** and **\$4,577**, respectively, and \$8,076 and \$8,878 for the year to date periods ended June 30, 2016 and 2015, respectively. Q2'16 [10-Q](#), p. 8

Sales include customer paid freight costs billed to customers for the quarters ended September 30, 2016 and 2015 of **\$3,599** and **\$3,614**, respectively, **and \$10,272 and \$11,068** for the year to date periods ended September 30, 2016 and 2015, respectively. Q3'16 [10-Q](#), p. 8

Notice the YTD 2015/2016 numbers don't add up to the quarterly results. YTD '16 should equal \$11.68m and YTD '15 should equal \$11.59m

### 2015 Disclosures of Customer Paid Freight Costs Included In Sales

Customer-paid freight costs are included in Sales and were **\$3,552** and \$3,672 for the quarters ended June 30, 2015 and 2014, respectively, and \$6,951 and \$7,162 for the year to date periods ended June 30, 2015 and 2014, respectively. Q2'15 [10-Q](#), p. 9

Customer-paid freight costs are included in Sales and were **\$3,138** and \$3,237 for the quarters ended September 30, 2015 and 2014, respectively, and \$10,088 and \$10,400 for the year to date periods ended September 30, 2015 and 2014, respectively. Q3'15 [10-Q](#), p. 8



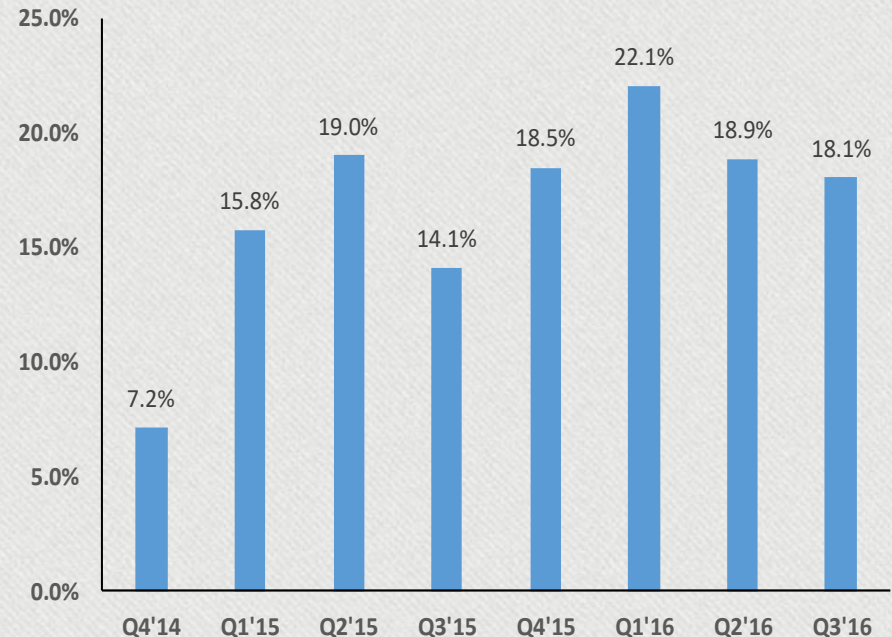
## Warning: Inventory Turnover In Rapid Decline

With stagnant sales, MGPI's inventory turnover has been falling for many quarters, and yet its gross margins are near record highs. The Company does not disclose how much older and higher margin whiskey may be sold off to support current margins. MGPI has also attributed recent gross margin increases to "*plant efficiencies*," but then had a chemical hazard, which sent innocent people to the hospital a month later.

### Quarterly Inventory Turnover Plunging...



### Yet....Gross Margins Near Historic Highs



Source: MGPI Financial Filings  
Defined as LTM Cost of Goods Sold / Average LTM Total Inventory

# MGPI's Liquidity Is Worse Than It Appears

MGPI states in its Annual Report the following in its discussion of inventory accounting: *"Bourbon and whiskeys are normally aged in barrels for several years, following industry practice; all barreled bourbon and whiskey is classified as a current asset."* But wait a second, how can an asset that is intended to be held for more than a year be classified as current? A current asset is generally defined as an item that can be converted to cash with one year. (1) By adjusting MGPI's balance sheet to remove the effect of long-term whiskey holdings, and include off-balance sheet purchase order commitments, we observe that its liquidity (as measured by its current ratio) to be significantly worse than it appears on the surface.

\$ in mm	2014	2015	Q1'16	Q2'16	Q3'16
Current Assets	\$82.2	\$91.2	\$100.9	\$107.9	\$114.1
Less: Whiskey Distillate	(\$11.1)	(\$28.3)	(\$33.8)	(\$40.3)	(\$45.0)
Adjusted Current Assets	\$71.1	\$62.9	\$67.1	\$67.6	\$69.1
Less: Current Liabilities	(\$30.7)	(\$37.7)	(\$37.2)	(\$35.7)	(\$32.8)
Less: Contractual Purchase Obligations (2)	(\$61.9)	(\$75.8)	(\$66.9)	(\$64.9)	(\$66.9)
Adjusted Current Ratio	0.8x	0.8x	0.6x	0.6x	0.7x
Stated Current Ratio	2.7x	2.4x	2.7x	3.0x	3.5x

Source: MGPI Financials

(1) Definition of ["Current Asset"](#)

(2) Disclosed in Note 3 "Commitments and Contingencies" as open purchase order commitments generally extending out 1 year



## Something Doesn't Make Sense To Us

Spruce Point doesn't understand how MGPI's distillery margins increased 310 bps YTD when its segment sales declined by 2.1%. The Company says the increase is from: *"the continuing shift in sales mix within food grade alcohol from lower margin industrial alcohol products to higher margin premium beverage alcohol products, a decline in input costs, and an increase in warehouse revenue."* Looking carefully, we find a speculative explanation in the press release, but MGPI cannot commit to put it in its 10-Q SEC filing.....why?

PRODUCT GROUP NET SALES					
	Year to date Ended September 30,		Period-versus-Period Net Sales Change Increase / (Decrease)		Period-versus-Period Volume Increase / (Decrease)
	2016	2015			
	Amount	Amount	\$ Change	% Change	% Change
Food grade alcohol <sup>(a)</sup>	\$ 168,769	\$ 170,640	\$ (1,871)	(1.1)%	
Fuel grade alcohol <sup>(a)</sup>	5,345	5,927	(582)	(9.8)	
Distillers feed and related co-products	17,000	20,411	(3,411)	(16.7)	
Warehouse revenue	6,131	4,564	1,567	34.3	
Total distillery products	\$ 197,245	\$ 201,542	\$ (4,297)	(2.1)%	(10.1)% <sup>(a)</sup>

Other Financial Information				
	Year to date Ended September 30,		Period-versus-Period Increase / (Decrease)	
	2016	2015	\$ Change	% Change
Gross profit	\$ 40,879	\$ 35,506	\$ 5,373	15.1 %
Gross margin %	20.7%	17.6%		3.1 pp <sup>(b)</sup>

**Warning:** Carefully notice that MGPI doesn't put the break-out of "Premium Beverage Alcohol" in its 10-Q SEC Filing. Yet, in its [Q3'16 press release](#) it boasts that industrial alcohol fell -22.9% YTD while premium beverage increased +16.7%

Given the significant increase in margin, management should give more disclosure here.

<sup>(a)</sup> Volume change for alcohol products.

<sup>(b)</sup> Percentage points ("pp").




# Related-Party Purchases Not Adding Up, Quietly Being Restated Higher in 2016



There are serious discrepancies in reporting and prior year restatements of related party purchases between MGPI and ICP. The income statement disclosures and footnote disclosures of the ICP equity investment should match, but they often don't

Quarter	Source	Current Year 2016 SEC Filings	Prior Year 2015 SEC Filings
Q1 Ended March 31 <sup>st</sup>	Footnote to Income Statement	Includes related party purchases of \$6,700 and <b>\$11,372</b> for the quarters ended September 30, 2016 and 2015, respectively. Includes related party purchases of \$19,639 and <b>\$33,503</b> for the year to date periods ended September 30, 2016 and 2015, respectively. ( <a href="#">10-Q, p. 3</a> )	Includes related party purchases of <b>\$8,929 and \$10,079</b> for the quarters ended September 30, 2015 and 2014, respectively. Includes related party purchases of <b>\$28,366</b> and \$26,220 for the year to date periods ended September 30, 2015 and 2014 ( <a href="#">10-Q, p. 4</a> )
	Footnote to Summary of ICP Financials	Includes related party sales to MGPI of \$6,700 and <b>\$11,123</b> for the quarters ended September 30, 2016 and 2015, respectively. Includes related party sales to MGPI of \$19,639 and <b>\$32,332</b> for the year to date periods ended September 30, 2016 and 2015, respectively. ( <a href="#">10-Q, Note 2, p. 13</a> )	Includes related party sales to MGPI of <b>\$8,680 and \$9,287</b> for the quarters ended September 30, 2015 and 2014, respectively, and \$27,195 and \$23,905 for the year to date periods ended September 30, 2015 and 2014, respectively. ( <a href="#">10-Q, Note 2, p. 13</a> )
Q2 Ended June 30 <sup>th</sup>	Footnote to Income Statement	Includes related party purchases of \$6,698 and <b>\$12,187</b> for the quarters ended June 30, 2016 and 2015, respectively. Includes related party purchases of \$12,939 and <b>\$23,364</b> for the year to date periods ended June 30, 2016 and 2015, respectively. ( <a href="#">10-Q, p. 3</a> )	Includes related party purchases of <b>\$10,145 and \$9,008</b> for the quarters ended June 30, 2015 and 2014, respectively. Includes related party purchases of <b>\$19,437</b> and \$16,140 for the year to date periods ended June 30, 2015 and 2014. ( <a href="#">10-Q, p. 3</a> )
	Footnote to Summary of ICP Financials	Includes related party sales to MGPI of \$6,698 and <b>\$11,803</b> for the quarters ended June 30, 2016 and 2015, respectively. Includes related party sales to MGPI of \$12,939 and <b>\$22,442</b> for the year to date periods ended June 30, 2016 and 2015, respectively. ( <a href="#">10-Q, Note 2, p. 10</a> )	Includes related party sales to MGPI of <b>\$9,761 and \$8,273</b> for the quarters ended June 30, 2015 and 2014, respectively, and \$18,515 and \$14,618 for the year to date periods ended June 30, 2015 and 2014, respectively ( <a href="#">10-Q, Note 2, p. 13</a> )
Q1 Ended March 31 <sup>st</sup>	Footnote to Income Statement	Includes related party purchases of \$6,241 and <b>\$9,292</b> for the quarter and year-to-date periods ended March 31, 2016 and 2015, respectively. ( <a href="#">10-Q, p. 3</a> )	Includes related party purchases of <b>\$9,292 and \$7,132</b> for the quarters ended March 31, 2015 and 2014, respectively. ( <a href="#">10-Q, p. 4</a> )
	Footnote to Summary of ICP Financials	Includes related party sales to MGPI of \$6,241 and <b>\$8,754</b> for the quarters ended March 31, 2016 and 2015, respectively. ( <a href="#">10-Q, Note 2, p. 11</a> )	Includes related party sales to MGPI of <b>\$8,754 and \$6,345</b> for the quarters ended March 31, 2015 and 2014, respectively ( <a href="#">10-Q, p. 13</a> )

# Two Books Being Kept Between Related Parties?

 MGPI's reported purchases from ICP (its related-party JV where it owns 30%) are explicitly contradicted by the majority owner, Seacor (NYSE: CKH). Seacor has generally reported less sales to MGPI than MGPI claims. We can understand why MGPI might report slightly higher purchases than Seacor (e.g. shipping costs), but don't understand why in any case they would be reported lower as in 2014.

Annual Report	Here's What MGPI Says	Here's What Seacor Holdings Says
2015	ICP's net sales includes related party sales to MGPI of <b>\$40,787, \$35,613, and \$7,736</b> for 2015, 2014, and 2013, respectively. ( <a href="#">10-K, p. 51</a> )	During the years ended December 31, 2015, 2014 and 2013, the Company sold <b>\$38.9 million, \$36.3 million and \$6.6 million</b> , respectively to the noncontrolling interest partner. As of December 31, 2015 and 2014, ICP had accounts receivable of \$2.4 million and \$3.3 million from the noncontrolling interest partner. ( <a href="#">10-K, p. 131</a> )
2014	Includes related party sales to MGPI of <b>\$34,615</b> and \$7,736 for the years ended December 31, 2014 and 2013, respectively.	During the years ended December 31, 2014, 2013 and 2012, the Company sold <b>\$36.3 million, \$6.6 million</b> and \$44.8 million, respectively to the noncontrolling interest partner. As of December 31, 2014 and 2013, ICP had accounts receivable of \$3.3 million and \$1.8 million from the noncontrolling interest partner. ( <a href="#">10-K, p. 73</a> )



## *Has MGPI Violated Its Credit Agreement?*



The quiet restatement of figures without explanation for both a) MGPI's related-party purchases from ICP, and b) Customer paid freight costs included in sales has Spruce Point worried about the potential that MGPI could be: 1) Misstating purchase figures from ICP at off-market prices to boost margins, 2) overstating revenues, or 3) Making an undisclosed change in accounting method. Either scenario would be bad and is expressly listed as a Negative Covenant according to its Credit Agreement

Date	Negative Covenant
<a href="#">2nd Amendment</a> Feb 27, 2015	<p><b>6.8 Accounting Methods. Parent will not, and will not permit any of its Subsidiaries to, modify or change its fiscal year or its method of accounting (other than as may be required to conform to GAAP).</b></p> <p><b>6.10 Transactions with Affiliates: Each Borrower will not, and will not permit any of its Subsidiaries or Parent to, directly or indirectly, enter into or permit to exist any transaction with any Affiliate of Parent or any of its Subsidiaries except for:</b></p> <p><b>(e) purchases of Inventory by any Borrower from the Illinois Joint Venture so long as such purchases are no less favorable, taken as a whole, to such Borrower than would be obtained in an arm's length transaction with a non-Affiliate, and</b></p>

## Other Credit Implications



Investors should pay careful attention to MGPI's credit agreement. It has a fixed charge covenant and requires mandatory pre-payments if the revolver usage exceeds the borrowing base. The covenant ratio would be impacted heavily if MGPI's EBITDA declines (from possible customer losses we highlighted) or tax penalties increase (from the TTB audit). The borrowing base is increasingly being driven by MGPI's barreled whiskey distillate. To the extent its whiskey value declines or 'storage losses' result in lost inventory, MGPI's borrowing base would shrink and mandatory prepayment risk increases

Key Credit Issue	Terms and Conditions
Fixed Charges	<p><b>"Fixed Charges"</b> means, with respect to any fiscal period and with respect to Parent determined on a consolidated basis in accordance with GAAP, the sum, without duplication, of (a) Interest Expense accrued (other than interest paid-in-kind, amortization of financing fees, and other non-cash Interest Expense) during such period, (b) principal payments in respect of Indebtedness that are required to be paid during such period, including without limitation required all reductions of the Fixed Asset Sub-Line Amount, and (c) <u>all federal, state, and local income taxes accrued during such period</u>, and (d) all Restricted Payments paid (whether in cash or other property, other than common Equity Interests) during such period; provided, however, that solely for purposes of calculating the Fixed Charge Coverage Ratio for determining compliance with Section 7.1 hereof, the amount of the September 2015 Stock Repurchase shall not constitute a Fixed Charge.</p> <p><b>"Fixed Charge Coverage Ratio"</b> means, with respect to any fiscal period and with respect to Parent determined on a consolidated basis in accordance with GAAP, the ratio of (i) EBITDA for such period minus unfinanced Capital Expenditures made (to the extent not already incurred in a prior period) or incurred during such period, to (ii) Fixed Charges for such period.</p>
Borrowing Base	<p>(e) <b>Mandatory Prepayments.</b></p> <p>(v) <u>Borrowing Base. If, at any time, (A) the Revolver Usage on such date exceeds (B) the Borrowing Base reflected in the Borrowing Base Certificate most recently delivered by Borrowers to Agent, then Borrowers shall immediately prepay the Obligations in accordance with Section 2.3(f)(i) in an aggregate amount equal to the amount of such excess.</u></p>

# Newly Disclosed TTB Audit Investigation Also Looks Negative



MGPI started to disclose an audit by the Alcohol and Tobacco Tax Trade Bureau (TTB) in 2015, and its recent 2016 disclosure suggests that the scope of the audit has increased to additional time periods. Furthermore, MGPI has acknowledged that “**clerical errors**” and support for “**storage loss**” will result in additional taxes and penalties. Are investors comfortable that these added costs won’t be material as management tries to suggest?

Date of Disclosure	Expanded Disclosure Statements
<a href="#">10-K</a> Mar 10, 2016	<p><i>“The Alcohol and Tobacco Tax Trade Bureau (“TTB”) performed a federal excise tax audit of the Company’s subsidiaries, MGPI of Indiana, LLC and MGPI Processing, Inc., <b><u>for the periods January 1, 2012 through July 31, 2015 and January 1, 2013 through July 31, 2015, respectively.</u></b> <b><u>The Company is in the process of addressing the preliminary findings of the TTB audit regarding clerical errors and support for storage losses.</u></b> <b><u>The Company is unable to determine the probability that additional excise tax and penalties will be owed and cannot reasonably estimate the amount thereof.</u></b> However, the Company believes it is probable that a penalty may be imposed by the TTB as a result of certain TTB audit findings but it is unable to reasonably estimate the amount thereof. Management expects that the aggregate liabilities, if any, arising from such legal and regulatory proceedings, including the TTB audit, would not have a material adverse effect on the consolidated financial position or results of operations of the Company.”</i></p>
<a href="#">10-K</a> Mar 12, 2015	<p><i>“<b><u>We are currently being audited by the TTB for the period from December 27, 2011 to November 30, 2014.</u></b> The outcome of this audit is unknown at this time.”</i></p>



## *Valuation and Price Target*

# Bulls Have Aspirational Dreams MGPI Can Be Valued Like a Beverage Company

The bulls aspirational hopes are that MGPI will successfully transition from a commodity ingredient producer to a fully branded spirits company, and achieve a significantly higher multiple. As a result, they try to justify the current \$50 price target on a multiple that MGPI doesn't deserve. We believe its transition will fail miserably, and that investors will re-value it back in line with commodity ingredients peers at approximately 1x sales and 2x book value. The bulls also ignore the fact that MGPI's common stock is subordinate to the preferred stock, which is controlled by the Seaberg family, and has special voting rights and controls a majority of the Board votes.

\$ in millions except per share amounts

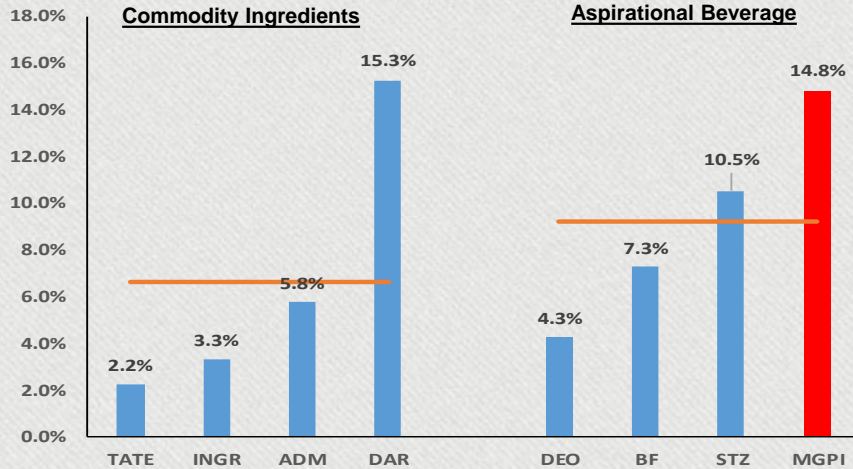
	Stock Price	% of		'17E-'18E		Price /		Enterprise Value						
		52-wk	Enterprise	Revenue	EPS	Consensus EPS		EBITDA		Sales		Price /	Debt /	Dividend
Company Name (Ticker)	1/11/2017	High	Value	Growth	Growth	2017E	2018E	2017E	2018E	2017E	2018E	Book	Capital	Yield
<u>Commodity Ingredients</u>														
Archer Daniels (ADM)	\$44.01	92%	\$32,214	1.2%	5.8%	14.9x	14.1x	9.3x	9.0x	0.5x	0.5x	1.5x	29%	2.7%
Ingredion (INGR)	\$125.77	90%	\$10,435	2.7%	3.3%	16.7x	16.2x	9.6x	9.3x	1.8x	1.7x	3.6x	42%	1.6%
Tate and Lyle (TATE.LON)	\$8.55	81%	\$4,557	1.7%	2.2%	15.7x	15.3x	10.3x	9.9x	1.3x	1.3x	2.8x	39%	4.7%
Darling Ingredients (DAR)	\$12.78	80%	\$4,069	5.9%	15.3%	17.8x	15.4x	8.6x	8.1x	1.2x	1.1x	1.0x	47%	0.0%
SunOpta (STKL)	\$7.50	97%	\$1,187	8.7%	41.0%	19.2x	13.6x	9.9x	8.7x	0.8x	0.7x	1.6x	57%	0.0%
			Max	8.7%	41.0%	19.2x	16.2x	10.3x	9.9x	1.8x	1.7x	3.6x	57%	4.7%
			Average	4.0%	13.5%	16.9x	14.9x	9.5x	9.0x	1.1x	1.1x	2.1x	43%	1.8%
			Min	1.2%	2.2%	14.9x	13.6x	8.6x	8.1x	0.5x	0.5x	1.0x	29%	0.0%
<u>Aspirational Beverage</u>														
Diageo (DEO)	\$106.90	91%	\$78,370	4.9%	4.3%	20.4x	19.5x	15.4x	14.5x	5.3x	5.0x	4.9x	49%	3.5%
Constellation (STZ)	\$149.00	86%	\$37,246	5.5%	10.5%	20.6x	18.7x	14.1x	13.0x	4.9x	4.6x	4.3x	55%	1.1%
Brown-Forman (BF)	\$45.85	81%	\$18,766	4.6%	7.3%	25.0x	23.3x	17.1x	16.0x	6.1x	5.8x	11.2x	49%	1.6%
Castle Brands (ROX)	\$0.76	60%	\$139	12.2%	NM	NM	NM	34.8x	27.3x	1.8x	1.6x	5.2x	37%	0.0%
			Max	12.2%	10.5%	25.0x	23.3x	34.8x	27.3x	6.1x	5.8x	11.2x	55%	3.5%
			Average	6.8%	7.4%	22.0x	20.5x	20.3x	17.7x	4.5x	4.3x	6.4x	48%	1.5%
			Min	4.6%	4.3%	20.4x	18.7x	14.1x	13.0x	1.8x	1.6x	4.3x	37%	0.0%
MGP Ingredients (MGPI)	\$47.20	89%	\$829	6.1%	14.8%	28.6x	24.9x	14.8x	13.3x	2.5x	2.4x	5.7x	25%	0.2%
Spruce Point Non-GAAP Adjusted		89%	\$829	-4.5%	-14.5%	39.2x	45.9x	20.4x	22.2x	2.8x	3.0x	5.7x	25%	0.2%

Source: Company financials, Wall St. and Spruce Point estimates

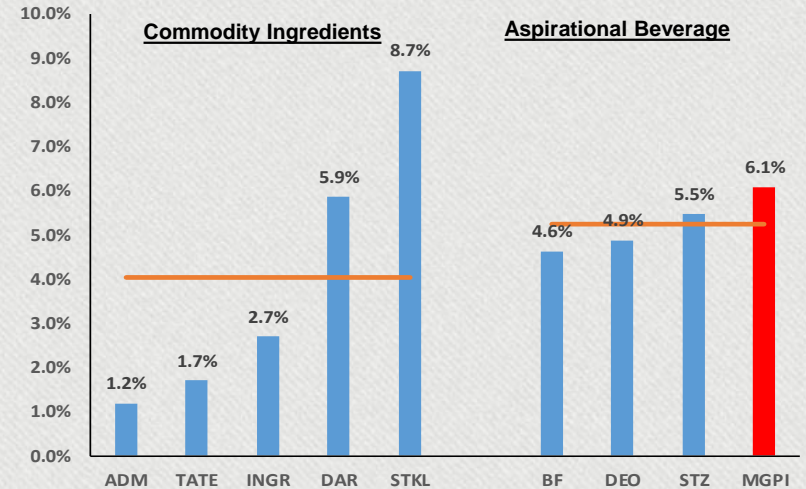


# MGPI's Valuation In Perspective...

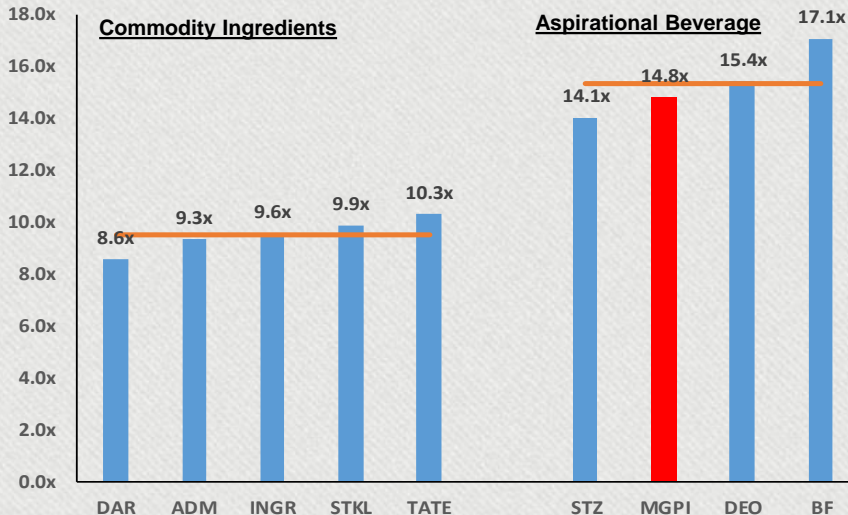
## 2017/18 Revenue Growth



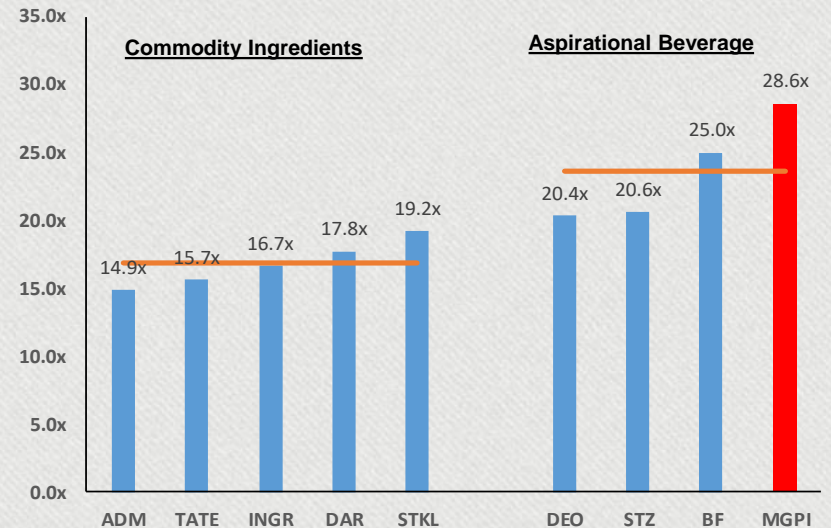
## 2017/18 EPS Growth



## Enterprise Value / 2017E EBITDA



## Price / 2017E EPS



# If You Want Whiskey/Bourbon Exposure Look At Castle Brands As A Comp....

MGPI's valuation is more expensive than Diageo, Constellation, and Brown Forman, yet it has no proven and firmly established brands! Also, investors that want to make a pure-play investment in the whiskey/bourbon markets (without any manufacturing risks) could look at Castle Brands (AMEX: ROX).

While we are not recommending an investment in Castle Brands, it's instructive to see that it trades at just 1.5x revenues and has over \$65m of sales growing mid single digits.

Compare this valuation to MGPI which is trading at 2.5x sales and has de Minimis branded sales but claims "premium beverage alcohol" sales are growing 16% but won't certify it with figures in its 10-Q.

## Premium Brand Portfolio



**CASTLE  
BRANDS**



**KNAPPOGUE  
CASTLE**  
SINGLE MALT IRISH WHISKEY



**JEFFERSON'S**  
VERY SMALL BATCH BOURBON



**PALLINI**  
*Limoncello*



**Clontarf**  
IRISH WHISKEY



**Goslings**  
Since 1806



**BRADY'S**  
IRISH CREAM

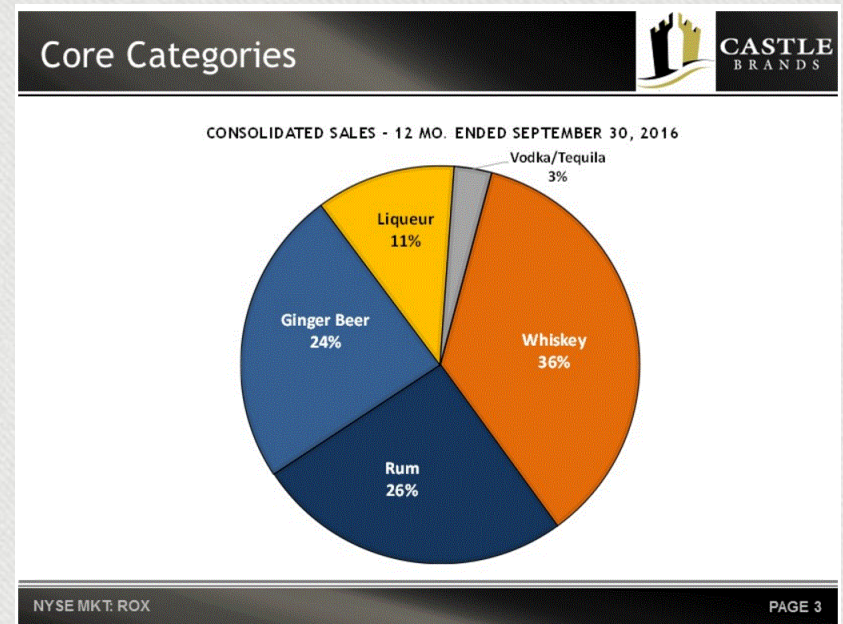


**BORU**  
IRISH VODKA



**CELTIC  
HONEY**  
IRISH HONEY LIQUEUR

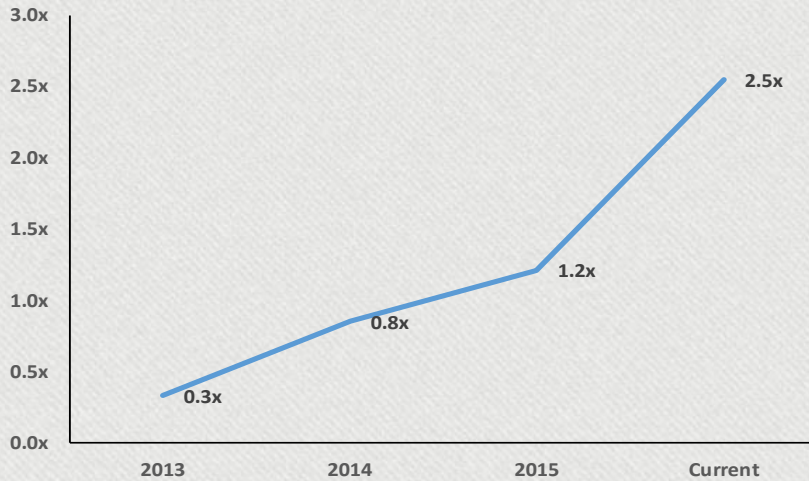
NYSE MKT: ROX
PAGE 8



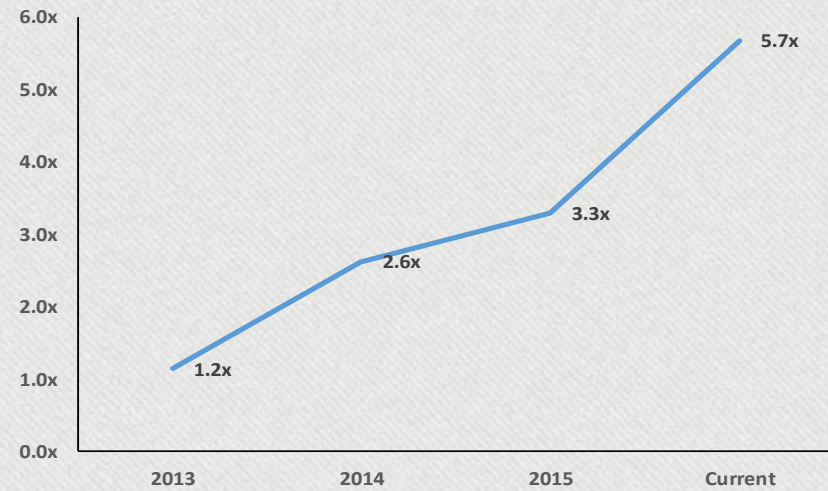


# MGPI Trading At Historic Valuation Multiples On Illusion Results Will Continue

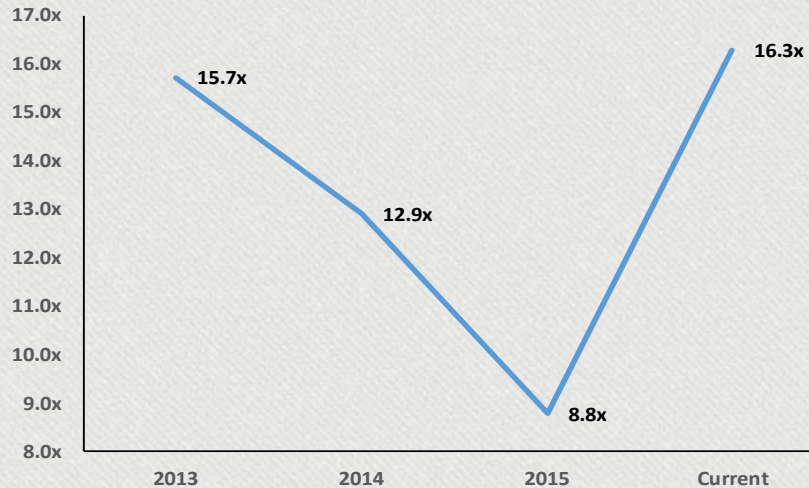
**Enterprise Value / LTM Revenues**



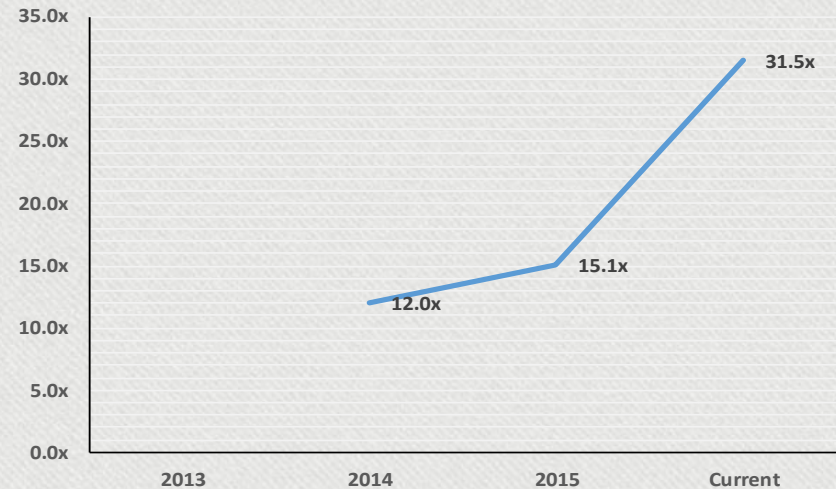
**Price / Book Value**



**Enterprise Value / LTM EBITDA**



**Price / LTM EPS**



# Spruce Point Estimates 60% – 70% Downside

Spruce Point believes that 2017/18 could be a major re-set year for MGPI's earnings and valuation. We believe the biggest catalyst will be loss of revenues associated with Diageo and a normalizing expectation of profits associated with selling whiskey and bourbon. Additional headwinds on the horizon include the loss of sales associated with Fibersym® whose patent expires in 2017.

## Spruce Point Intermediate View vs. 2017/18 Street View

\$ in millions, except per share amounts

Metric	17/18 Street	Spruce Point	Note
<b>Sales</b> % Growth	\$327 / \$347 3.0% / 6.1%	\$295– \$286 -7.0% to -10.0%	Driven by loss of Diageo contract
<b>Adj EBITDA</b> % margin	\$56 / \$62 17.1% / 17.9%	\$39 – \$43 13.5% – 14.4%	Assumes 40% contribution margin on these sales
<b>Adj EPS</b> % Growth	\$1.65 / \$1.90 -4.1% / 14.8%	\$1.12 – \$1.28 -35% to -25%	31% tax rate and 16.7m shares

## Spruce Point Intermediate Term Price Reference Ranges

\$ in millions, except per share amounts

Metric	Low	High	Note
<b>2017 Adj. EPS</b> <b>P/E Mult.</b> <b>Price Tgt.</b> <b>% Downside</b>	\$1.12 14x \$15.75 <b>-70%</b>	\$1.28 16x \$20.50 <b>-60%</b>	Loss of Diageo + failure to grow branded spirits will result in investors realizing that MGPI is nothing more than a commodity ingredient producer which should be valued at a 14x-16x P/E and 8x-9x EBITDA multiple
<b>EBITDA Mult.</b> <b>2017 EBITDA</b> <b>Plus: Cash</b> <b>Plus: ICP stake</b> <b>Less: Debt</b> <b>Dil. Shares</b> <b>Price Tgt.</b> <b>% Downside</b>	8.0x \$39 \$0.0 \$17.5 \$45.5 16.7 \$16.90 <b>-64%</b>	9.0x \$43 \$0.0 \$17.5 \$45.5 16.7 \$21.30 <b>-55%</b>	