

FINANCIAL FUNDING IMPLICATIONS

Investment Plan and Funding Strategy for
Modernization of Critical Systems

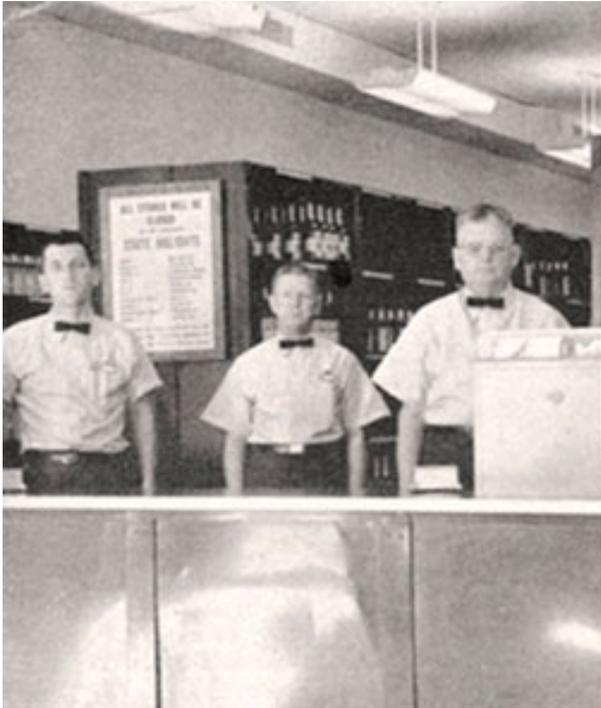
January 22, 2015



OBJECTIVES

- Agency and Financial Highlights
- Financial Concepts Unique to ABC
- Business Challenges and Governor's Budget
- Project Improvements
- Agency Investment Strategy
- Appendix - Facts and Figures

80th anniversary in 2014



Retail stores featured over-the-counter sales until a conversion to self-service stores began in 1969.

Virginia Beach ABC store in Hilltop North Shopping Center reopens in December 2014 after extensive remodel as state's third premier location – others premium stores located in Leesburg and Williamsburg



AGENCY HIGHLIGHTS

Highlights

- Appointment of Board: Jeffrey L. Painter, Judy G. Napier, and Henry L. Marsh
- Ryant Washington, former Fluvanna County Sheriff, named ABC's Special Policy Advisor for Law Enforcement in April
- Travis G. Hill named Chief Operating Officer in October
- Paul Van Lenten named Chief Financial Officer in December

Facilities

- Central Office and Warehouse located in Richmond
- 350 Retail Stores and 9 Regional Offices
- Plans to open 20 new stores and modernize 50 stores over next three years

Operating Budget

- FY 2014: \$551,902,197 (merchandise for resale is approximately 71% of expenses)
- FY 2015: \$577,917,496

Employees

- 1,031 Full Time, 2,286 Part Time (approximately a 556 increase from 2013, due to the implementation of the 29 hour cap)
- 20 contractors

Mission Critical Statistics

- Retail store customer transactions: 28 million
- Retail Licenses: 17,700
- One-day banquet and special-event licenses: 18,400
- Total Cases shipped to ABC stores: 4,392,471

Agency contributions to the Commonwealth in the last five years: \$1.8 billion

FY 2014 AGENCY ACCOMPLISHMENTS

- Record Sales of \$801M and profits of \$140M
- Total Agency Contributions of almost \$387M
 - an \$18M increase over FY2013
- 7 New Stores
- 19 Store Renovations or Modernizations
- Launch of Website Redesign and Point of Sale Upgrade
- Licensee Survey
- Creation of Portfolio Steering Committee
- Industry Stakeholder Engagement
- *Virginia's Finest* partnership
- Reorganization of Communications Division
- Greater Focus on Marketing

FY 2015 AGENCY PRIORITIES

- Enforcement
 - Full Accreditation
 - Improvements to Licensing System and Processes
- Retail
 - Increase Store Openings and Modernizations
 - Strengthen Marketing Focus and Initiatives
 - Develop E-commerce Presence
 - Enhance Security of Consumer Transactions
- Business Technology
 - Begin Acquisition of New Financial Management System
 - Address APA Audit Points

FY 2015 AND FY 2016 FINANCIAL OUTLOOK

- FY 2015 sales and profits are tracking according to our Forecast
 - Retail business is still the primary sales driver, slight increase in restaurant sales
 - Growth Categories: Bourbon, Cordials, Vodka, Moonshine
 - Growth Brands: Fireball, New Amsterdam, Tito's Vodka, and Hennessy
- Outlook for FY 2016
 - Projecting slight growth (3 percent) in volume in line with national averages
 - Expect moderate growth in profits for FY 16
 - Potential risks include unknowns such as unforeseen changes in demand, weak holiday sales, and costs associated with potential system failures.

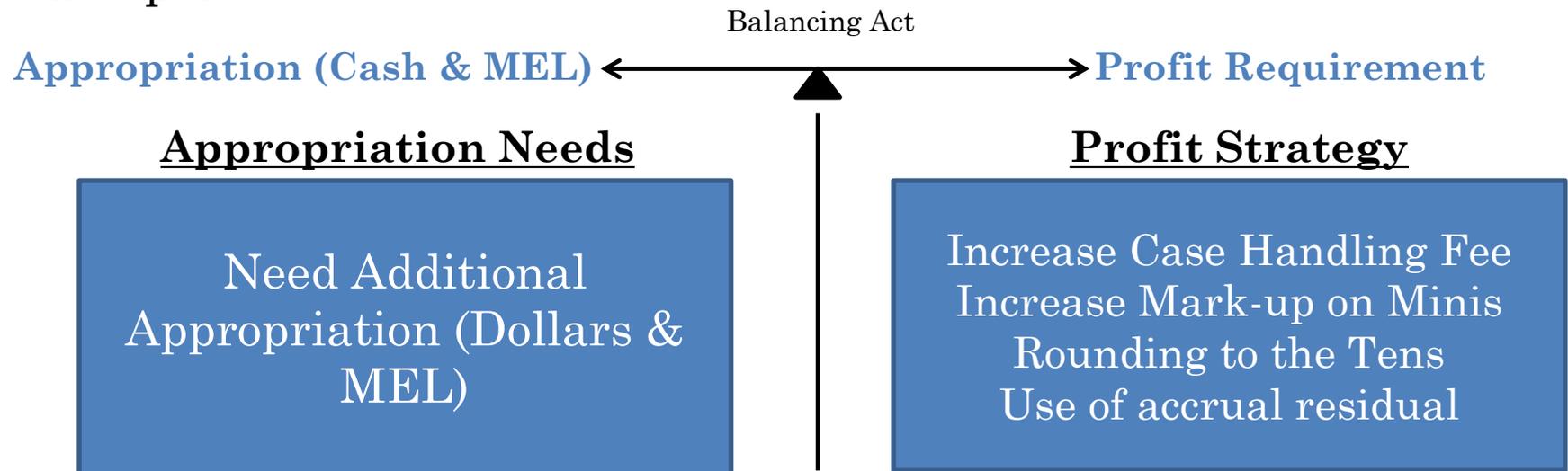
FINANCIAL CONCEPTS UNIQUE TO ABC

ABC COMPARED TO PRIVATE SECTOR

	ABC	Corporations
Similarities		
Profits	Profit turned over to the General Fund	Profit turned over to the Shareholders
Investment Funding Source	Appropriation	Bank Loans
GAAP Accounting	Yes	Yes
Financial Statements	Yes	Yes
Required Annual Audits	Yes	Yes
Differences (Cost as a Percentage of Revenue)		
Profit	17.5%	8.3% (PA Liquor Board)
Average IT Spend	2.37%	3.50% (U.S.)
Average Finance Spend	0.27%	1.17% (U.S.)
Average Marketing Spend	0.05%	2.00% (U.S.)
Average HR Spend	\$1,641 (per employee)	\$2,243 (per employee)

ABC BALANCES APPROPRIATIONS AND FUNDING

- ABC does not receive general fund appropriations. ABC operates as an enterprise fund – meaning appropriation provides authority to spend, but no actual funding
 - Funding generated by operations (sales, licenses, penalties, etc.)
- In order to achieve success, ABC must balance both appropriation and profit



NOTE: There is no correlation between a business's cashflow and the profits and losses on its financial statements

DEPRECIATION OF ASSETS LIMITS PROFIT IMPACTS



Example: New Integrated Financial System

Asset worth \$17 million, but does not impact expenses in first year for two reasons:

1. § 4.1-115, Code of Virginia requires ABC to maintain an accounting structure in compliance with generally accepted accounting principles (GAAP)
2. GAAP requires that expenses for an asset be recognized over the life of the asset (5yrs)

	Year 1	Year 2	Year 3	Year 4	Year 5
Asset - New Financial System (\$17M)	\$17.0M	\$13.6M	\$10.2M	\$6.8M	\$3.4M
Recognize Depreciation Expense	(\$3.4M)	(\$3.4M)	(\$3.4M)	(\$3.4M)	(\$3.4M)
Value of Asset	\$13.6M	\$10.2M	\$6.8M	\$3.4M	\$0M

When does ABC Recognize Asset Expense?

-Asset Expense is spread over the life of the asset
(Depreciation expense)

PROJECTS IN BUDGET AND PROJECT INFORMATION

ABC BUSINESS CHALLENGES

Minimal investments in core Agency systems for the past 15 years

- Only one current system is less than 15 years old
 - Wine Tax and Beer Tax Collection System – 16 years old
 - Financial Management System (Performance) – 15 years old
 - Enforcement Licensing System – 15 years old
 - Inventory Forecasting and Receiving System – 15 years old
 - Management Information and Product System – 12 years old
- APA Audit criticized ABC because of the risks associated with its aging information systems

Other opportunities for improvement

- Website does not permit online ordering capabilities or online licensee renewals
- Upgrade broadband capability in ABC stores
- Improve electrical circuitry in ABC warehouse and central office

GOVERNOR'S INTRODUCED BUDGET

Appropriations Provided for FY 2015 and FY 2016

(Largest to Smallest)

Item	FY 2015	FY 2016	Total
Cost of Goods Sold	\$7.8 million	\$12.9 million	\$20.7 million
New Financial System	\$1.1 million	\$13.0 million	\$14.1 million
Inventory System	\$0	\$4.9 million	\$4.9 million
Forecasting and Receiving System	\$0	\$2.8 million	\$2.8 million
Retail Strategies	\$482,500	\$1.9 million	\$2.4 million
Tax Collection System	\$0	\$2.0 million	\$2.0 million
Licensing System	\$0	\$1.7 million	\$1.7 million
Website Capabilities	\$300,000	\$800,000	\$1.1 million
Broadband for Stores	\$400,000	\$200,000	\$600,000
Electrical System	\$0	\$462,800	\$462,800
Total	\$10.1 million	\$40.6 million	\$50.7 million

PROJECTS NEEDED TO CORRECT PROBLEMS

- New Financial System - \$14.1 million
 - Records \$1.8 billion in financial transactions
 - Vendor has been resold 5 times in 5 years
 - If system fails, ABC's financial data would likely be lost
 - Current system is the basis for profit transfers to general fund
- New Licensing Management System - \$1.7 million
 - Paper-based system serves as official record for 18,000 licensees, 20,000 one-day special licenses, 10,000 inspections, and corporate reports
 - Electronic system only captures "high points" of records
 - Electronic system built on outdated Windows 7, Oracle 7, and Delphi
 - Little internal support for system due to fragility
- Retail & Marketing Strategies - \$2.4 million
 - Increases rate of new store expansion to 12 new stores per year
 - Currently, 7-8 new stores are opened each year
 - New stores generate an average of \$140,000 in profit each year after 16 months
 - Doubles rate of store modernizations to 15 per year
 - Currently modernize 7 stores per year
 - Modernization typically produces a 9.4 % increase in sales growth

New Stores and Remodeled Stores



Marketing Display Improvements



PROJECTS NEEDED TO CORRECT PROBLEMS

- Increase Agency Website Capabilities - \$1.1 million
 - ABC currently has no e-commerce abilities
 - Licensees would be able to renew and pay on-line; develop product lists and store preferences
 - Saves ABC \$58,000 in annual mailing cost
- Procure New Tax Collection System - \$2.0 million
 - Current system is 16 years old and built using PowerBuilder
 - Part-time employee supports PowerBuilder applications
 - Collects \$80 million in wine and beer excise taxes
 - Requires 147 man-hours per week for 5 staff to manually process 27,000 lines of data monthly
 - No on-line payment capability exists; staff calculates tax for industry
- Procure Real-Time Inventory System - \$4.9 million
 - Current system is a custom built 12-year old
 - Provides vendors visibility into ABC store inventories
 - Requires 5 staff to maintain current system
 - Often requires upgrades affecting its availability
 - If it failed could disrupt inventory and product delivery to ABC stores

PROJECTS NEEDED TO CORRECT PROBLEMS

- Inventory Forecasting & Receiving System - \$2.8 million
 - Current systems are 15-years old
 - Forecasting system is inefficient for forecasting and validating ABC store orders – requires more staff time and results in some inappropriate product deliveries
 - Vendor product delivery system no longer supported by vendor and subject of APA audit finding
 - If system failed vendor product supplies might not be available for ABC stores
- Broadband Technology for ABC Stores - \$600,000
 - Currently ABC stores use low band-width 128 kilobit per second connections
 - Will increase speeds to 2 MB, 4 MB, or 10 MB per second as available
 - Provides better connections for debit and credit card transactions
 - Permits ABC to distribute software, anti-virus, and data updates to stores that cannot be processed at all times due to low band-width
- Upgrade Electrical Circuitry in Agency Facilities - \$462,800
 - Electrical system for Central Warehouse and Central Office installed in 1950 and 1960
 - Power system components at end-of-life and replacement parts hard to find
 - No service records exist for current electrical system

FUNDING STRATEGY

1. Revenue Enhancements enacted by the ABC Board

ABC Strategy	FY 2015	FY 2016
Rounding to Dime	\$1.5 million	\$2.7 million
\$2 Case Handling Fee	\$3.0 million	\$5.2 million
Mini-Bottle Mark-up	\$855,060	\$1.6 million
Total	\$5.3 million	\$9.5 million

- Strategies developed after consultation with stakeholders
- ## 2. Depletion of small accrual residual to meet cash transfer requirements
- Accrual residual built over time due to difference between cash and accrual accounting
 - Reduces residual from \$8.6 million in FY 2015 to \$59,321 in FY 2021
 - Used to continue profit transfers to general fund while projects ongoing

This is a reasonable funding strategy that results in:

- Satisfying future required cash transfers to general fund
- Modernization of ABC's existing infrastructure
- ABC continues to provide high levels of customer service and continues to be a strong source of revenue for the Commonwealth

How Accrual Residual Usage Works

	FY 2014	FY 2015
Required Profit Transfer	\$138.7	\$144.8
CASH BASIS		
Prior Year—4 th Qtr Carryover	\$6.5	\$7.1
1 st Quarter	\$32.9	
2 nd Quarter	\$42.9	
3 rd Quarter	\$29.7	
4 th Qtr Estimated	\$27.4	
4 th Qtr Accrual Residual	7.1	
Actual Profit Transfer	\$139.4	

Deplete 4th Qtr Accrual Residual to enable ABC to meet Cash Transfer Requirements

POTENTIAL FUTURE PROJECTS

Fiscal Year 2017 & Beyond

- POS Replacement ERP - \$16.0M
- Legacy System Upgrade (Sales Audit, Sales Custom, SEIS and Lottery) - \$2.0M
- Budget System (Hyperion) - \$0.8M
- Human Resources ERP - \$3.0M

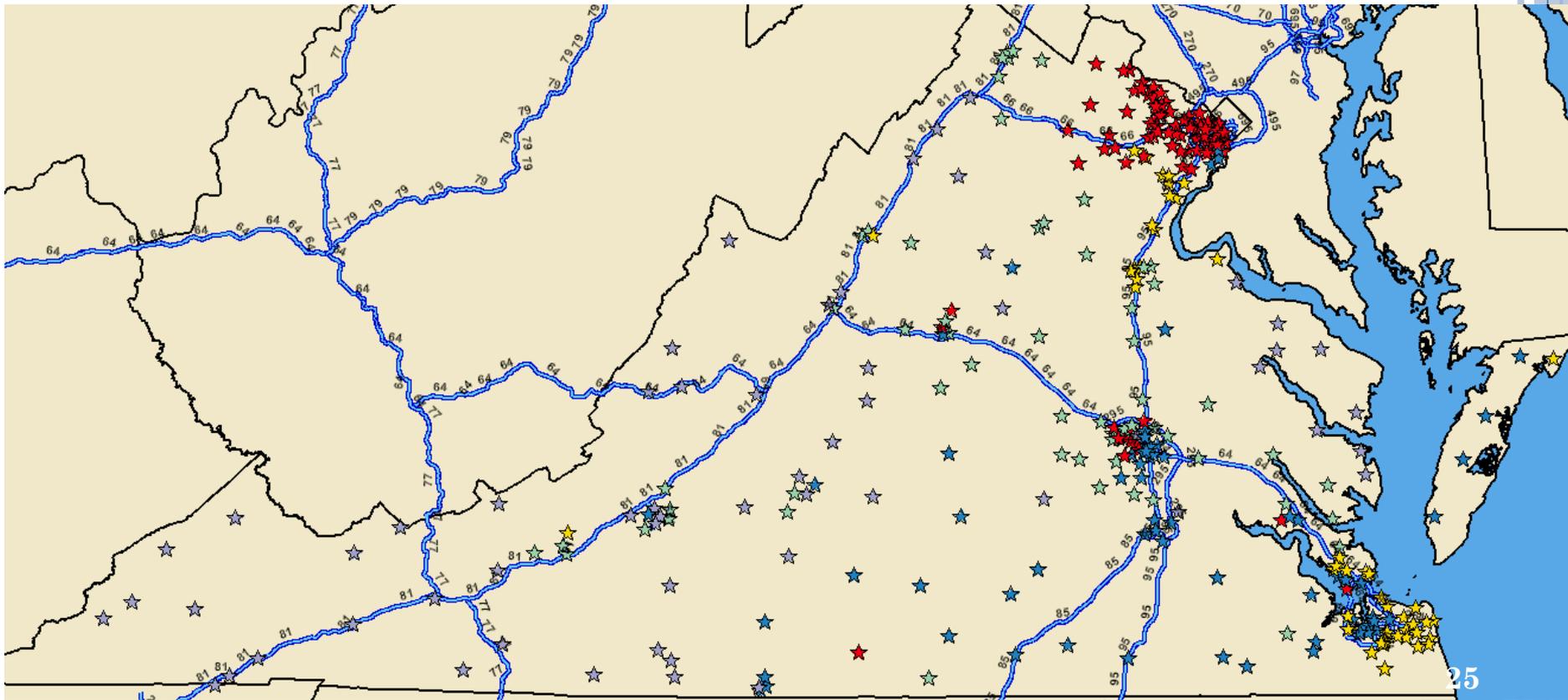
APPENDIX

New Regional Alignment



Store Clusters

- Group stores based on similar **consumer buying patterns** overlaid with **demographics**
- Drive assortment, space allocation and other initiatives to **better fit shopper preferences**



AGENCY CONTRIBUTIONS TO COMMONWEALTH BY SOURCE

Financial Results in Brief – FY 2010 to FY 2014

Revenue Source	FY 2014	FY 2013	FY 2012	FY 2011	FY 2010
ABC profit transfers	\$139,987,344	\$134,576,751	\$132,021,784	\$121,013,600	\$120,509,682
State taxes	\$132,043,584	\$126,802,220	\$120,988,748	\$114,201,593	\$111,293,220
General sales tax	\$36,879,111	\$31,263,867	\$29,617,739	\$27,889,207	\$26,906,495
Wine liter tax	\$34,608,741	\$34,400,161	\$33,457,628	\$32,171,151	\$30,580,004
Malt beverage tax	\$43,341,595	\$42,846,308	\$43,660,370	\$43,915,010	\$44,454,535
Total	\$386,860,375	\$369,889,307	\$359,746,269	\$339,190,561	\$333,743,936

2014 REVIEW OF AGENCY EXPENSES

Category	(In Millions)
Merchandise for Resale (Alcohol, Virginia Wine, Mixers)	\$388.7
Personnel	\$95.8
Continuous Charges (Rents and Utilities)	\$26.2
Contractual Services (VITA/Freight)	\$19.5
Credit Card Fees	\$7.8
Supplies and Equipment	\$3.4
Miscellaneous (Largely Depreciation)	\$3.3
Grand Total	\$544.7

2014 – TOP 25 BRANDS

Rank	Brand	Gross Sales
1	Jack Daniel's 7 Black	\$25,658,300
2	Smirnoff 80	\$19,066,109
3	Jim Beam	\$17,802,469
4	Grey Goose	\$17,104,944
5	Fireball Cinnamon	\$16,124,716
6	Crown Royal	\$15,900,902
7	Hennessy VS	\$15,139,972
8	Absolut	\$14,838,477
9	Aristocrat	\$12,974,264
10	Bacardi Superior	\$12,194,703
11	Patron Silver	\$11,911,743
12	Captain Morgan's Spiced	\$11,610,420
13	Maker's Mark	\$11,570,538
14	Jose Cuervo Especial Gold	\$9,477,546
15	Jagermeister	\$9,409,119
16	Pinnacle	\$9,384,939
17	Jameson	\$8,391,923
18	Seagram's Extra Dry Domestic Gin	\$7,184,418
19	Ketel One Imported Vodka	\$6,826,003
20	Bowman's Virginia Domestic Vodka	\$6,707,100
21	Tito's Handmade Domestic Vodka	\$6,647,407
22	Skyy	\$6,429,614
23	Burnett's	\$6,426,821
24	Tanqueray	\$6,348,116
25	Canadian Mist	\$5,300,361

2014 - CATEGORY PERFORMANCE

Category	FY 14 Dollars	% Change from FY 13
Statewide Total	\$799,466,384	4.1
Whiskey	\$241,535,472	6.1
Vodka	\$215,776,883	1.9
Cordials -Liqueurs-Specialties	\$99,178,346	9.5
Rum	\$73,055,910	-0.6
Tequila	\$56,512,715	3.7
Gin	\$39,332,179	0.2
Cognac\Armagnac	\$28,558,868	9.6
Brandy	\$20,981,240	2.8
Specialty Bottles	\$9,181,402	24.6
Cocktails	\$6,682,962	-19.5
Non-Alcoholic Mixers	\$4,196,952	-2.4
Virginia Wine	\$1,548,012	-4.5
Egg Nog	\$1,444,950	12
Vermouth	\$1,413,567	4.6
Non Beverage Item	\$58,384	-8.8

TOP 25 STORES

Rank	ABC Stores/Address	Locality	Gross Dollars	Spirit&Wine Taxes
1	256 1612 Laskin Road	Virginia Beach City	\$8,630,556	\$1,424,799
2	225 405 30th St	Virginia Beach City	\$7,312,737	\$1,194,033
3	278 3333 Virginia Beach Blvd	Virginia Beach City	\$6,652,089	\$1,088,389
4	219 8338 Leesburg Pike	Fairfax County	\$6,490,317	\$1,061,542
5	169 10 North Thompson St	Richmond City	\$6,107,183	\$984,355
6	280 1103 South Military Highway	Chesapeake City	\$6,016,930	\$995,599
7	327 1332 South Main St	Montgomery County	\$5,991,007	\$992,257
8	282 2400 Cunningham Drive	Hampton City	\$5,964,447	\$984,973
9	202 1902 Emmet Street	Charlottesville City	\$5,911,307	\$965,944
10	358 4312 Wheeler Avenue	Arlington County	\$5,645,107	\$932,149
11	226 7862 Tidewater Drive	Norfolk City	\$5,573,911	\$924,641
12	374 2955-A South Glebe Road	Arlington County	\$5,533,890	\$965,557
13	107 141 W Virginia Beach Blvd	Norfolk City	\$5,508,100	\$912,961
14	314 4320 S. Laburnum Ave	Henrico County	\$5,376,201	\$884,368
15	184 2035 East Market Street	Rockingham County	\$5,320,237	\$879,063
16	360 2901 Hermitage Road	Richmond City	\$5,300,776	\$866,827
17	331 3406 Pump Road	Henrico County	\$5,285,384	\$869,061
18	353 4255 Cheshire Plaza	Prince William County	\$5,151,285	\$847,289
19	341 621 Stoney Creek Lane	Newport News City	\$5,149,720	\$850,110
20	119 901 North St. Asaph St	Alexandria City	\$4,967,549	\$819,154
21	294 3556-E S. Jefferson St.	Fairfax County	\$4,854,445	\$799,644
22	350 11108 Midlothian Tnpk.	Chesterfield County	\$4,767,248	\$786,092
23	295 8095 Sudley Road	Prince William County	\$4,765,981	\$785,959
24	263 5900 Virginia Beach Blvd	Norfolk City	\$4,740,188	\$785,638
25	267 1446 Chain Bridge Road	Fairfax County	\$4,658,526	\$765,620

LICENSING & ENFORCEMENT

Licenses and Licensing

ABC retail licenses (1)	18,171
New retail, wholesale and special-permit licenses	2,063
Licensed retail establishments	16,933
Private or corporate owners	13,105
Alcohol compliance rates for retail licensees (%) (2)	85.09
Average processing time for new retail applications (in days) (3)	73
One-day banquet and special-event licenses	19,525

(1) Inclusive of licenses for sale and consumption of beer and wine, mixed beverages, on- or off-premises.

(2) FY 13 rate: 85.7 percent

(3) FY 13: 78 days. ABC targets a 60-day average.

Law Enforcement Activity

Criminal investigations	8,675
Arrests	1,670
Illegal still investigations	56
Inspections of licensed establishments	8,884
Underage Buyer (UAB) compliance checks	3,600
ABC special agents	100
Written warning reports	1,154
Written violation reports	730
Wine, beer and mixed-beverage application and state license fees collected	\$12,991,941.82



ABC's WORKFORCE

Employees and Hiring

Total employees (as of June 30, 2014)	3,312
Total classified employees	1,026
Total part-time employees	2,286
Classified employees hired in FY 14	101
Part-time employees hired in FY 14	556

ABC employs a diverse workforce. The agency's 3,312 employees work throughout the Commonwealth operating 349 retail stores and eight regional offices. Approximately 418 ABC employees and 26 contractual workers (444 total) are physically located in Richmond at the central office and warehouse facility.

Employee Demographics

Average age (years) (1)	47.0
Average years of service, classified employees (2)	11.2
Gender: male (%) (3)	58.0
Gender: female (%) (3)	42.0
Minority (%) (4)	29.9

The demographics of ABC's workforce are generally consistent with the overall state workforce. Nearly 71 percent of state classified employees are over the age of 40, 54.1 percent are female and 34.8 percent are minorities. The average age of an ABC classified employee is 47 years, with an average length of service of 11.2 years. ABC has a high number of retirement-eligible classified employees: 145 employees (13.2 percent of FTE positions) are eligible to retire currently, an additional 69 employees (6.3 percent FTE positions) within the next five years, and an additional 66 employees (6.0 percent FTE positions) eligible within 10 years. A total of 280 ABC classified employees, or 25.6% of ABC's classified workforce will be eligible to retire within the next 10 years (2024).

- (1) Average age (all state employees): 46.7 years
- (2) Average years of service (all state employees): 12.1 years
- (3) Gender (all state employees): male, 46.0 percent; female, 54.1 percent
- (4) Minority (all state employees): 34.8 percent

HEARINGS

Cases Referred for Hearings

Case Activity	Count
Violation/disciplinary reports	780
Contested applications	52
• Approved	15
• Denied	12
• Withdrawn before hearing	25
Contested banquet applications	12
• Approved	5
• Denied	4
• Withdrawn before hearing	3
Wine and beer franchise cases	5
Total hearings requested	849



EDUCATION

Publications and Conferences

"Do Not Sell" stickers packets distributed to licensees	18,743
Licensee newsletters distributed	50,000
YADAPP 2013 adult and student participants (1)	529
AAAG PSA campaign reach (2)	38,083
AAAG training participants (3)	240
Educational brochures disbursed	61,414
SAVVY Expos (4)	1
SAVVY Expo attendees	190
SAVVY Schools & Communities Recognition Program awardees (4)	14
VaCALC professionals trained (5)	143
Miss Virginia School Tour stops (6)	13
Miss Virginia School Tour student participants	4,233
College Tour stops (7)	2
College Tour participants	134

- (1) Youth Alcohol and Drug Abuse Prevention Project (YADAPP) annual summer conference held at Longwood University, July 15–19, 2013. Ninety-three youth teams represented schools and communities across Virginia.
- (2) Alcohol and Aging Awareness Group (AAAG) was interviewed and featured on Hampton Roads this Morning in November 2013.
- (3) AAAG sponsored Screening, Brief Intervention, and Referral to Treatment (SBIRT) trainings in Williamsburg (December 5-6, 2013), Lynchburg (March 26, 2014), Fairfax (March 26, 2014) and Newport News (April 24, 2014).
- (4) The fourth and final regional Substance Abuse Awareness Vital for Virginia Youth (SAVVY) Expo was held September 18, 2013, in Abingdon.
- (5) Virginia College Alcohol Leadership Council (VaCALC) trains professionals through their bi-annual Drive-In Workshops and annual Summer Retreat.
- (6) Miss Virginia 2013, Desiree Williams, toured elementary and middle schools across the Commonwealth with her prevention message.
- (7) College Tour stopped at Tidewater Community College on March 22, 2014, and at Northern Virginia Community College on April 4, 2014.



Licensee Training

RSVP classes conducted by ABC special agents (1)	105
RSVP participants (statewide)	1,739
MART classes conducted by ABC special agents (2)	26
MART participants (statewide)	389

- (1) Responsible Sellers & Servers: Virginia's Program (RSVP) classes are conducted by ABC Law Enforcement Special Agents across the Commonwealth.
- (2) Managers' Alcohol Responsibility Training (MART) classes are conducted by ABC Law Enforcement Special Agents across the Commonwealth.