



 HPA


**VIRTUAL
HARVEST
2021**

Forward Hop Contracting

Owen Johnson: G'day, I'm Owen Johnston, Head of Sales and Marketing, thanks for being part of this session.

I know forward contracting isn't something that many people are passionate about, but it is enormously important to the success of your brewery and the wellbeing of the broader industry.

The past ten years represent an unprecedented period of change in the hop industry's history. I hardly feel compelled to talk about it, after all, we've all been living through this period, but let's touch on a few highlights.

We have seen the expansion of a new generation of flavour hops. Galaxy, Vic Secret, and others from HPA, hops such as Citra and Mosaic commercialised by John I. Haas from the HBC breeding program in the USA. In the decade to 2019, HPA shifted from 90% of acreage dedicated to alpha production, 10% to aroma, to completely the inverse. More than 90% in modern proprietary flavour hops, less than 10% committed to alpha, supplied into local breweries. Demand for flavour hops was growing more quickly than growers could accommodate, with key varieties remaining tight over many recent years. Perhaps this has been corrected somewhat now with the macro economic shocks driven by the pandemic.

At the same time, open market varieties are experiencing a decline in acreage, with famous hops such as Cascade, Centennial and Willamette all taking a downturn. But just because the consumer has driven hop-forward styles, the fundamentals of the hop market haven't changed. Basically, big growth for one industry still: brewing. Growers are still as sensitive as ever to the impacts of oversupply and the industry needs a solid foundation from which to plan and execute future hops.

Possibly in the past it was somewhat easier for growers and brewers to plan their hop supply when the consumer market was less dynamic. Regardless of whether it's a brewery opening every day, like in the States, or every week, like here in Australia, it's a staggering rate. Compound that with breweries frequently releasing 50 beers a year – also a staggering rate of dynamic marketplace activity. Who knows if the hop contracts will be down, up, or just completely sideways at the end of the year with such a dynamic environment?

In response to these trends, we see an increase in spot buying. This can magnify the effects of an unpredictable harvest or changing consumer sentiment. Let's unpack that statement.

In considering the supply side here, as much as we would like it otherwise, we are an agricultural product. We are subject to yield variations year on year. From the demand side, we can have spot buyers coming in for a wide variety

of reasons, a considered approach to risk management might lead a brewer to consider most, but not all, of their requirement. They'd be back on the spot market for a top up if required. Great.

Or, fingers crossed, there is unforeseen success for a new beer and the hops you have in the cupboard just aren't going to go far enough. That's a good problem to have. These are great reasons to have a proper functioning spot market. Not such a great reason to come in on the spot is because you simply didn't forecast your requirements. This adds in demand-driven pressure into the market that can increase the chance of volatility.

Hop contracts are a necessity if we ever hope to have a hop supply meet hop demand and a market that is in balance, and this includes a proper functioning spot market. Contracts provide growers with valuable insights into market trends, enabling investment in quality and capacity improvements, and to adjust the variety mix on their acreage accordingly.

These factors are clearly mutually beneficial, and they allow growers to successfully support brewers. By entering into a hop contract, you are supporting a broader industry by helping prevent shortages and Long positions and, in a worst-case scenario, the discontinuation of a variety that isn't backed by contracts. Contracts create more certainty and stability in the supply chain.

A hop contract is a legal document where two promises are made. It's potentially an obvious point, but an important one to make: a contract is a two-sided agreement. A brewery promises to take possession of, and pay for, specific varieties and volumes. Suppliers promise to provide those hops available for call off. In HPA's case that means the full gamut of activities, from breeding, cultivating, harvesting, pelletising, to warehousing and logistics.

There is no perfect time to engage with your supplier in contract discussions; conversely any time you are reviewing sales forecasts or recipe changes, for example, that will impact on your hop requirement, this is the right time to pick up the phone and have a chat.

If you have an impression of what the normal range of pricing for what a variety is, and you get good advice about availability, you are immediately in the box seat to decide if it's the right time to contract or not. Best practice is to take a contract for a full 12-month period for your hops that the brewery uses most often, or predictably. We frequently see three- to five-years forward when beer line-ups are mature or stable, allowing accurate forecasting, and use of the spot market is used for one-offs and to cover unexpected demand.

Accurate forecasting is important to prevent brewers assuming more obligation than needed, which can lead to contract reworks or the brewery attempting to sell on a secondary market, both of which are somewhat inefficient.

The information on this slide is loosely based on the information presented by Teri Fahrendorf in the New Brewer back in 2011, nearly 10 years ago now, but still relevant where the ability to forecast your requirements exists. We recommend the following approach where brewers can accurately forecast, and the availability of a particular hop is okay.

If you are being told a hop is tight or under demand pressure and likely to be sold out or waitlisted, take action beyond what is shown here. The Brewers Association published an article by supply chain specialist Chris Swersey in May of 2020 focusing on communicating with your hop suppliers. It's a short read which makes it perfect for me.

In reference to accurate forecasting, he notes that the US hop inventories are at their highest ever recorded levels. He comments that it's absolutely critical that brewers are actively forecasting and communicating adjustments required to their hop suppliers in a timely manner.

This rough planner is for the HPA production cycle with harvest in March each year. The northern harvest is simply offset six months from this. Let's start in March where harvest is underway, and by the end of harvest we are looking to move from projected yields to actual results.

With actuals now available post-harvest, we can begin to allocate volumes to contracts and establish what quantities might be available for the spot market that year. By the end of May the current crop is becoming ready for dispatch. We are already commencing planning for the next harvest. This planning phase is a critical moment for aligning the variety mix with our market intel and the contracts we are holding. What stays, what goes, what gets additional acreage, is all fundamentally informed by the contracts we hold and the capacity constraints on the farm.

From July on, contracts are normally still open for crop 2022 and forward subject to our overall contracted position on any given variety. Typically, on the eve of harvest in February 2022 for this example, we'll cease contracting and have a spell until harvest is in the bale once again and the contracting calendar starts over.

HPA's fulfillment of contractual obligations is absolutely mission critical. We reserve 15% of projected yields uncommitted to sales contracts. This allows for yield variance and ensures we always deliver on our promise. We know that overall demands, brands, and recipes are always changing, so we figure contracts should be reviewed and adjusted regularly.

We've touched on a few situations where changes can be trouble for hop supply, so if you're planning for growth, check in often and top up as required. If you're in the situation where you are experiencing stable demand, consider Teri's planner and maintaining a rolling cycle of base load and top ups progressively. A few too many hops? We've all been there. Get in touch to explore your options. We can often help more than you think, after all it is literally our fulltime job connecting supply with demand.

Find suppliers that work for you and your business. It's normal for breweries to have more than one supplier. Each supplier will offer a mix of price and other contract terms, so find the best fit for you.

There's a final pitch on the virtues of contracting. To not contract is the highest risk strategy in the supply chain and could leave you faced with unpleasant choices if hops aren't available.

Thank you very much for joining me for this session, and we're going to go straight in to live Q&A with Dave Baxter, GM of Direct Procurement for the Asahi Australia Group, including CUB.

G'day, thanks for tuning in. I hope you enjoyed that little preso on forward contracting. I might've said at the top that it's not everyone's favourite topic, but I'll tell you what, some people get pretty passionate about it. To help me explore this important topic, I'm very fortunate to be joined by Dave Baxter, General Manager of Procurement for Asahi Australia.

G'day Dave.

Dave Baxter: G'day OJ, how are you?

OJ: Well, thank you mate. Thanks again for taking the time to join us for a bit of a deep dive on forward contracting. As General Manager of Procurement at Asahi, he's been in the industry for 20 years or so in roles with Foster's, Treasury Wines, CUB, and most recently now here at Asahi. This career path has been quite diverse and has taken you around the world and some very interesting times. Based out of London, and we were talking a little bit before about the times, the really interesting times, with those companies you've worked for, the rate of change and the changes in the procurement space. So, Dave, thank you for joining us today.

DB: It's a pleasure to be here.

OJ: If you're listening live, please feel free to leave questions and comments in the chat box, we can attempt to get to those as we go and, of course, we'll get to them at the end if we don't.

I can tell you about forward contracting from the hop supply point of view, from the ground perspective, but what we really need to round this conversation out is perspective from the brewery. Dave sprang to mind not just because of his expertise and long career in the procurement field, but also because diversity is really important and can be really challenging to manage, and Asahi have not just the big breweries in the group, but also a number of craft brands, so I think Dave's going to have a great perspective on some of the challenges and differences as it relates to planning for big and small, and how to go about procurement.

Although the basic principles are the same, I expect everyone knows how those companies behave in different sizes makes a difference.

What I've got, Dave, is a few questions lined up to get us underway, but let's follow our nose a little and see where the conversation goes.

I guess dovetailing into this long, and what I think's a fascinating career path, tell us a bit about what you've seen change in the world of hops and hop procurement over your journey.

DB: No problems. I think having to manage more varieties. It's been a massive change from what was, literally, even just ten years ago. Understanding your numbers better has been a massive change as well. Working more collaboratively with your supplier base from a sourcing and contracting. I think long gone are the days of set and forget when I used to contract more of the traditional bittering hops, you now need to understand the end-to-end supply chain.

OJ: That diversity piece has its impact on farms as well. I've spoken previously about the same thing: when we were growing select few varieties with a very specific purpose, I think that dovetailed into your comment about buying hops just for bittering, perhaps, it was a little less complex. But now that explosion of varieties is making everyone's life quite complicated.

You and your team manage a vast array of inputs, do you think hops stand out as unique for any reason? And this could be good or bad.

DB: I've always worked with the belief that you don't mess around with ingredients. Hops are definitely unique, especially with the vast variety that's available and the increased interest by the consumer. Is it good or bad? For me it can be a bit of both. You need to ensure you have a good understanding of hops and their risks and opportunities for sourcing.

OJ: You're saying you need to stay connected with how those hops are performing from the consumer's point of view as well?

DB: Most definitely. I think that given that, even ten years ago, you could probably say that only a handful of consumers would even know what a hop variety was. Now they're actually going out, sourcing beers based on hop varieties, which I think is absolutely awesome. It's very unique in terms of how we have to source, now, our hop varieties and get to understand hops a lot better.

OJ: That's absolutely true, the traction or the kudos that a variety named up on a beer can have now is completely different to a decade ago. Having that 360 perspective on the supply chain right out to performance and consumer acceptance really does talk to the complexity of it nowadays.

How do you stay across this sort of complexity? We've got supply and demand, we've got price, of course, priority in the brewery in terms of some recipes are built around this hop and you might be able to swap a few things around down below but this hop has to be there, that sort of priority, given that nowadays each variety might have a different set of those variables?

DB: I think it's super important to have strong stakeholder engagement throughout the business and with external suppliers. We have a fairly good understanding of which products are generally going to exceed expectations, so we hold regular supply meetings to talk through risks, opportunities. I also like to think we engage well with our suppliers, so they're aware of what we have in place for future growth, because it's important to measure up.

OJ: That piece around having, and you mentioned at the start, knowing your numbers, being across your numbers more, and being able to chart the course of a particular product. A particular skew with a hop makeup in its recipe and being able to communicate that to stakeholders internal and in the supply chain to ensure that a hop supplier can go with you.

DB: Yeah, a big piece is planning and comms. Failing to plan is planning to fail. If you can't communicate it properly internally with your sales teams, your planning teams, your production teams, and also with your suppliers, it makes it very hard to grow.

OJ: I guess that the whole system, that whole ecosystem there, gets pressurised by that beer might have a hop named up on the label. Now in that situation, we've spoken about the diversity and moving away from basic bittering. HPA's story's been told quite well, we have pivoted our acreage entirely away from growing bittering hops now. We're 100% focused on our modern flavour of proprietary varieties, that story itself isn't that unique.

We've also seen information out of the US growing base where they used to be 75% alpha, 25% aroma, that's now flipped. Although the number escapes me at the moment, the percentage of that aroma base that is proprietary varieties is also now quite high.

It's probably not the HPA situation, we're a bit different, but I say in this way, where you've got proprietary materials from hop growers plus being more in the consumer's mind and even named up on individual beers, what do you see the future of proprietary hop varieties looking like?

DB: You only need to walk into your local to see how much this has changed and the amount of choice the consumer has. I totally get it when a hop supplier wants to protect their varieties. When you develop something like Galaxy, of course you want to protect it. Would I love to be able to source it everywhere? Yes, however I guess if it was readily available, would it be as popular?

Does it influence the approach to it to a certain degree? Yeah, I think it does. But it should never stop you. I don't see it as bad for brewers. If you look at the wine industry, although not proprietary, they deal with limited supply all the time. You make what you can, you ensure you have good planning programs in place, and also key relationships with your suppliers.

OJ: It's an interesting analogy. I think, I'm probably a little biased, but I think it's understandable a grower would try and protect its IP around a variety, and certainly you see that across agriculture, modern agriculture nowadays.

From the planning perspective, do you think the proprietary hop piece influences the guys tasked with NPD? The way I understand it, a lot of the time on the big end of town, NPD teams are almost working with marketing more and the procurement piece comes in later.

Do you seek to manage the NPD, or temper their pursuit of the next great liquid, with a nod to proprietary varieties and access and price and all those things?

DB: It's a good question. And you're right, it's generally we come further down the track when an NPD's being looked at. That said, what we want to try and do within our organisation is having programs in place to understand what is the next Galaxy. And that would then initiate what could be the next NPD. All that work that we do in the background to help NPD come to life.

OJ: Let's take it a little further. Brewers typically get in trouble in a couple of ways, good and bad, so bad being when they're long, and good when they're unexpectedly short because of the success of a product.

Can you shed some light on how you handle unexpected success? Let's focus on that for a moment.

DB: It's a problem. A good problem to have, but it is a problem. Again, you need to ensure you stay close with internal stakeholders within your business. It shouldn't be a surprise that a particular product has a unique hop and that it has limited supply, however it does happen. It also cements the reason you need to have good stakeholder relationships with your suppliers. When you do have to make that call and see if there is any volume available anywhere, you might get lucky.

However there needs to be more education with our customer base as well. Not consumers, but our customers, so that when you do sell a beer that has a unique hop varietal, they're fully versed on the potential limited supply, which helps make the conversation easier when you're unable to supply after really high growth.

OJ: Important distinction. Your customer differs from the consumer so that they understand that this product's going to roll out to the sales network, whether it's a little differently from a beer that has unfettered access.

DB: We focus a lot of education on consumer, but that middleman, that customer that's purchasing to sell to those consumers, may not have the same education on limited supply or unique hops.

OJ: And I guess the proprietary thing finds its way in here as well. Any brewing company doesn't want to hold up the volume expansion of a brand that's growing and growing rapidly and going to be a very successful thing.

Do you think the ability of bigger breweries is hampered in recipe flexibility? Little brewers, I feel, are more agile and may well be able to tweak their recipes.

DB: Yes, to a certain degree, yes. You are limited if you have a unique or proprietary hop and you can only get x amount, it does limit your capacity to be able to put through those bigger breweries. It basically goes back to planning, you've just got to make sure that you've planned for the growth accordingly.

OJ: Am I just being naïve? Is it different in small breweries? Do you think they are under the same pressure, or less pressure to deliver that hop-forward consistent profile every time?

DB: I think they're still under pressure, it's a different type of pressure and they've got the ability to do a lot more smaller runs, smaller sizes. But if they do have a product that is going well and they only have access to a certain amount of hops, it's the same issue as a big brewer as well that we can do. It's an interesting one for between the larger and the smaller brewers, but it's a concern or it can be an issue for either.

OJ: Yeah, for sure. Moving on to potentially the elephant in the room with hop contracting, and that is, what happens when you're wrong? What happens when you over contract? What strategies do you have in place?

DB: It's never good, however it's something that occurs year on year. It doesn't matter how big you are, you need to have plans in place to understand what you can do if you do have excess hops and you're not wanting to write off. Those smart businesses can use long positions as a way to launch new products to help mitigate any risks. Again, it's not a surprise, and working through the scenarios in your business and with your suppliers is the best way to lessen the impact.

OJ: HPA's a particular case in point about people working back with us as we inherently are the single point of supply. It's both an opportunity and an obligation that we feel very strongly in our contracts to commit to try and help, try and resolve people's long positions. But I tell you what, the role of timing and not being surprised by long position and I think it's the brewery's opportunity, and certainly it increases our chance of success to help rehome long positions when we're well in advance of the actuality arising.

Again, this is asking for everything, isn't it? That people's data is perfect, that beer sales are nice and steady, and I think it's less and less like that.

DB: Totally agree. It's about that other relationship, I think, with the customer and supplier, it's key so you can have those discussions, it's that comms planning. But also bringing the supplier on the journey with that brand and growth. Or, if you are going to be long, having that supplier on the journey with you. Say, in eight months' time we might be in a bit of a long position here with x hop, what can we do?

OJ: And tell me, what's the role of working with multiple suppliers in this complex hop landscape? Do you think breweries of all sizes should work with multiple suppliers? Or is there strength in putting most of your eggs into one basket, so to speak?

DB: Good question. You need to understand the risk. If your supply chain of hops supports your business plan and growth, and you have a good working relationship with your supplier, then why change? However, if there is risk to you achieving your growth projections, or even your current production plans, then it makes sense to mitigate that risk and work with multiple suppliers. I do not see the harm in it, and sometimes it's essential. I'm all for competition, and it can be healthy for the customer and the supplier, however it's also super important ensuring you have the right relationships with the right suppliers, because that's going to help you grow.

OJ: I agree completely. One of the messages we've been out to our customer base here in Australia with, where we service breweries from HPA, is stay in touch. And also, with your hop supplier, find hop suppliers that fit your business and fit your needs, whether that's a level of flexibility including contracting and that sort of thing. Find those suppliers and stay in touch, and I think that goes to the heart of what you've been driving at.

DB: Yeah, most definitely. The supplier relationship is key, and I've engrained it within all my team. It's the mantra of sustainable procurement, where it has to work for both parties. If HPA gets efficiencies, then hopefully it passes through to us. If we can work together, collaboratively. If we're successful, then HPA's successful. That's goes with other suppliers as well, it's a mutual relationship.

OJ: The impetus for HPA to try and encourage full contracting is absolutely about risk management and at our heart we are still a farming business, and we all know the inherent risks around agriculture and we need confidence to

continue to plant up and expand, and contracts are an absolute pillar under our confidence to manage the risk in further expansion. To try to bring more proprietary hops to the market so we don't have to deal with persistent short supply.

So, Dave, we've got this complex landscape of hop varieties now, more than sprinkled in is the proprietary issue around a lack of access across the supplier side. Do you think a brewer of, regardless of size, do you think a brewer should feel pressure to contract every hop?

DB: No, I don't think they should feel pressure, however they should understand what the risk is. Those hops that are unique and critical to your brand may need protection in the form of contracting out. I know for us we contract out our critical hops and certain guardrails on the percentage. I think it also helps when the supplier/grower so they can work out towards ensuring supply and keeping costs down. It can be a bit of pressure there, but it's understanding your risks, ensuring your coms and your strategies are in place, and communicating that with your supplier.

OJ: Absolutely. Dave, two questions from me, questions without notice. What's your favourite beer at the moment?

DB: It has to be Mountain Goat GOAT.

OJ: Fabulous. And through your journey, can you tell me a moment in time, a relationship, a supply piece executed well that you're super proud of that encapsulates what we're talking about here. Where you've had success with planning, with execution, with relationships that are important. Is there any, and it doesn't have to be HPA or even hops, is there any situation there that springs to mind?

DB: I think just recently you might've seen some media coverage on what Asahi's doing with barley and going direct to growers, and I think that's a really important program we've just put in place. It's about sustainability, it's about understanding where our agricultural products come from and working with growers. So, for me, I'm super proud of what we've initiated late last year and into this year and in the future for sourcing barley within Australia. It's something that everyone in my team and withing the Asahi organisation should be proud of.

OJ: I've been keeping up with that in the press. It is a fantastic story, and it does tick a bunch of those boxes: coming closer to the agricultural base and mutual understanding between supplier and farmer and opening of new communication channels to stay aligned for the long run, which is all about what our attitude to farming and working with our customers long run is.

Dave, thank you so much for joining us. We asked a lot of our audience to stay with us for a half hour after a ten-minute presentation, I really value your insights, and thank you for making yourself available to share your experience with our audience. I'm sure this'll become one of our most-watched presentations, it's a pretty hot topic out there in hop land.

DB: It's my pleasure, mate, it's been great to have a chat with you about it.

OJ: Excellent. And with the borders reopening and whatnot post-COVID, I'm sure we'll be able to have a beer soon.

DB: Yes, definitely. Look forward to coming down and having a beer with you, mate, and the HPA team.

OJ: Put it in the diary, come on farm 2022.

DB: Most definitely.

OJ: Alright Dave, thanks for joining me, mate. See you later.

DB: Cheers, thank you.

OJ: A huge thank you to everyone who was part of this session. If you missed some of the action because you couldn't understand our Aussie accent, a recording will be uploaded to hops.com.au/virtual-harvest. For further information, please email info@hops.com.au, and we hope to welcome you all on farm again soon.