



MALCOLM BAKER

## The Mighty Squirrel Brewery and Taproom

In the late fall of 2017, Henry Manice and Naveen Pawar huddled in a conference room of Mighty Squirrel Brewing Company on Atlantic Avenue, near Boston Harbor. A year earlier, the two founders had decided to shift their ambitions from creating a national beer brand built on contract manufacturing, to fostering a local and loyal craft beer following in Massachusetts, with a brewery and taproom where customers could view the whole manufacturing process.

Building a brewery and taproom was always a dream of theirs, but Henry and Naveen had decided to focus first on contract manufacturing and national scale, with the hopes of someday building their own brick and mortar. After much consideration, they decided to focus on selling and manufacturing locally, sooner rather than later.

Since that decision, Henry and Naveen had identified more than thirty candidate locations for the brewery, ranging from downtown Boston to suburban cul-de-sacs. That spring, word of Mighty Squirrel's interest in the former home of Downeast Cider on the Mystic River in Charlestown made the local newspaper. After an extensive search, a business park in Waltham on Waverly Oaks Road had risen to the top of that long list. The Waltham location was accessible from Boston and beyond, with ample parking, high ceilings, and a basement with space for dozens of fermenters and tanks. The 300-acre Beaver Brook Reservation was next door with beautiful meadows and hiking and biking trails. Henry and Naveen could already imagine the food trucks assembling outside the new taproom, just as they had envisioned when they developed the Mighty Squirrel concept in San Diego almost eight years earlier.

Henry and Naveen read through the preliminary lease terms that they had negotiated with the Duffy family, the landlords at Waverly Oaks Park. The key question was whether the numbers worked: Did they have the funds to make the taproom dream a reality?

### Mighty Squirrel Brewing Co.

Henry and Naveen first met in San Diego in 2010, when they both worked in product management for Alphatec Spine, a medical device company focused on spinal implants. Born on opposite sides of the world, in India and New York, Naveen had focused on polymer technology at Madras Institute of Technology, graduating in 2001, and then industrial engineering at the University of Arkansas, while Henry had studied human and organizational development and economics at Vanderbilt University,

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graduating in 2009. They shared an entrepreneurial itch. In 2006, Henry had co-founded enjuba, a clothing business that sold handbags, shirts, sandals, belts, skirts, and jewelry made by artisans in Uganda to customers in the U.S. Soon after they met in San Diego, Henry and Naveen knew they wanted to build a business together. After exploring numerous ideas, they settled on craft beer, a scene they loved, with its food trucks and family-friendly environment.

In 2014, Henry and Naveen raised \$2.4 million in a first funding round or “Series A” with the goal of building a national brand and making a small dent in the \$100 billion US beer market. They were inspired by brands like Lagunitas, Green Flash, and Stone Brewing, fast growing craft brewers whose products were available across the country. Their aspiration was to grow rapidly and nationally, with revenues clearing \$100 million or a 0.1% market share, five years from launch. Developing in-house manufacturing capability and capacity to meet this goal was a non-starter. So, Henry and Naveen found contract manufacturers to produce their new beer, first at the von Trapp Brewery in Stowe, Vermont, and later at Peabody Heights Brewery in Baltimore, MD, and then Ipswich Ale in Ipswich, MA.

Mighty Squirrel was still well short of its revenue target in 2016, a year after launching their beer on shelves. The taste of the beer itself was not a problem: in over a hundred events in the fall of 2016 alone, customers had praised the taste. Mighty Squirrel had challenges with both supply and demand. On the supply side, the team had “difficulties keeping all of its brands in stock due to limitations with our contract brewing partners.” It was also hard to experiment with new beer concepts when the team did not control its production. On the demand side, Henry and Naveen felt that “a lack of a taproom was proving to be a significant obstacle in engaging the local community. Not having a brewery in our home state has created a lack of authenticity in the eyes of the end customer, and even more, in the eyes of gatekeepers at bars, restaurants, and retail stores.” Naveen elaborated:

Launching without our own brewery has proven to be expensive, not only because our gross margins and inventories are lower than they would otherwise be for the distribution side of our business, but also because we do not have taproom sales, which have a gross margin of as much as 90%. A focus on Massachusetts with more dedicated local buyers might also mean fresher beer and the potential for still higher distribution margins with higher prices and lower transportation costs.

With this new strategy in mind, the two founders had recently secured an additional \$2.3 million from 25 investors in a follow-on “Series A-1” financing to lengthen the runway and to establish deeper roots with a Massachusetts taproom. (See **Exhibit 1** and **2** for an income statement and a balance sheet following the Series A-1 at the end of 2016.) Expenses were running \$80,000 ahead of Mighty Squirrel’s gross profit each month. Henry and Naveen recognized that this infusion of fresh capital might only last long enough to identify a location, not to develop one.

## The Taproom

Craft breweries had proliferated in Massachusetts by 2016. The large players had their own breweries and taprooms in the state. Jack’s Abby, an early entrant, was producing and selling 34,000 barrels of beer annually from their Framingham location. (See **Exhibit 3** for the top five brewers’ annual production and locations.) A vast majority of the nearly 6,000 craft breweries in the U.S. in 2016 had less than 1,000 barrels of annual production.

Almost as soon as Henry and Naveen decided to pivot Mighty Squirrel, the opportunity to move into the former Downeast Cider taproom in Charlestown fell into their lap. The location had an

established track record of attracting customers, high ceilings, an appealing industrial vibe, almost 8,000 square feet of usable space, and a manageable rent bill. The site was under a bridge, though, off the beaten track. They wondered if they might quickly outgrow the space, as Downeast Cider had. So, the search continued into the spring of 2017, with their general contractor (GC) joining them for tours of their favorite locations to help with due diligence. Henry described a breakthrough in the search:

The GC we had enlisted, the Haynes Group, mentioned a place in Waltham where they were working on an unrelated project. Some empty space was coming online, so the GC connected us, and our team visited the site in May 2017. We loved it immediately. It is a nice big open shell with lots of parking all around, just like the warehouses used for breweries in San Diego that we loved.

The Duffy family, the owners of the 1.2 million square foot Waverly Oaks Business Park, pitched their campus and the Waverly Oaks Athletic Club to tenants and customers as having the finest campus amenities to sweat, shop, and dine with direct access to the Beaver Brook Reservation. (The Waverly Oaks address is mapped in **Exhibit 4** and selected images of the site are shown in **Exhibit 5**.)

Henry and Naveen contemplated subletting 5,000 square feet to Central Rock to build a 100-foot-long rock-climbing wall at the far side of the taproom that would be visible through a giant glass wall. The basement offered plenty of room to expand capacity in coming years. Moreover, the lessors were enthusiastic about the spillover value of Mighty Squirrel as a potential anchor to draw other tenants to their office park. Henry described what they loved about the location:

It is a 10-minute drive from Cambridge and a 20-minute drive from Boston, and it is at the center of many suburbs of Boston at the intersection of the Mass Pike and Route 95. There is a commuter rail stop and a bus stop within walking distance. Also, Waverly Oaks Park has two to three thousand people coming and going every day for a range of businesses and activities, including medical and technology companies, restaurants, a CrossFit and an Athletic Club with thousands of members.

### *Pro Forma Forecast*

The team at Mighty Squirrel started with a simplified forecast for the Waltham site using round numbers described in **Exhibit 6** to get a rough estimate of their peak funding needs. The 15-year lease, with two extension options, would contain a long list of provisions that detailed the rights and obligations of both the tenant and landlord, but the key terms negotiated thus far were as follows:

- **Rent.** Rent would start at \$400,000 per year and rise by 2.25% annually thereafter.<sup>1</sup>
- **Tenant Improvement (TI) Allowance.** The landlord agreed to contribute \$375,000 towards the build-out, including 8 bathrooms and an HVAC system, and to fund the improvement of the façade of the building fully.
- **Security Deposit.** Given the uncertainties of Mighty Squirrel's path to profitability, the landlord required a security deposit of \$350,000, which the Duffy family would hold for Mighty Squirrel in a bank account until the end of the lease. Mighty Squirrel would not earn interest on the security deposit.

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<sup>1</sup> The \$400,000 figure was net of the sublease to Central Rock.

Mighty Squirrel had two financing options to fund the construction of the brewery and taproom:

- **Bank Loan.** Mighty Squirrel had a bank loan commitment from the MassDevelopment Bank, which provided loans to startup breweries with limited revenue. A loan of up to \$900,000 would be secured by the company's assets, notably equipment that could be repurposed, and a personal guarantee from the founders. Interest on the loan would be 5% per annum. Regular commercial loans were not an option until Mighty Squirrel reached profitability.
- **Equity.** Mighty squirrel could return to its investors for a final "Series A-2" funding round.

### *A Cambridge Alternative*

In early summer, a competing option in Cambridge emerged on 135 Fawcett Street, where twin sheet-metal warehouses could house a new taproom. (The Fawcett address is mapped in **Exhibit 4**.) Henry and Naveen described the choice:

Both sites give us about 18,000 square feet and would allow us to produce 20,000 to 30,000 barrels annually. Cambridge feels like a little safer bet, closer to the city with a familiar 'name,' but the Fawcett Street section of Fresh Pond is a little run down and industrial, perhaps too much so for our crowd, compared to the clean Waltham site. There are so many pros and cons, little nuances about each one that make us like both options a lot.

The Waltham discussions had advanced further than Cambridge, but Henry and Naveen wondered if a more generous tenant improvement package from the Cambridge landlord might be a possibility. Having tabled Mighty Squirrel's national ambitions, Henry and Naveen realized the success of a Massachusetts taproom was key to survival, and the numbers had to work.

## **Decision**

The two leaders of Mighty Squirrel had devoted considerable effort to honest and transparent communication with their outside equity investors from day one, giving their success and failure equal attention and sharing detailed quarterly income statements and balance sheets and presenting financial models for key decisions. With the trust they had earned, they felt that one more "Series A-2" financing round of \$2 million was possible but far from assured.

Would that be enough to get the Waltham taproom off the ground? Raising less than they needed in a final financing round and running out of cash was not an option. Raising more than a reasonable buffer, even if they could, was not desirable either. Both Henry and Naveen were convinced that the new taproom would succeed and wanted to avoid diluting their current shareholders more than was necessary.

**Exhibit 1** Mighty Squirrel Income Statement, 2016

January – December 2016	
Revenue	\$190
Cost of Goods Sold	137
Gross Profit	53
Rent	48
SG&A	1,074
Earnings Before Interest, Taxes, and Depreciation	(1,069)
Depreciation	19
Operating Income (Loss)	(1,088)
Interest Expense	0
Taxes	0
Net Income (Loss)	(1,088)

Source: "Mighty Squirrel Sales Report," June 30, 2017.

**Exhibit 2** Mighty Squirrel Balance Sheet, December 2016

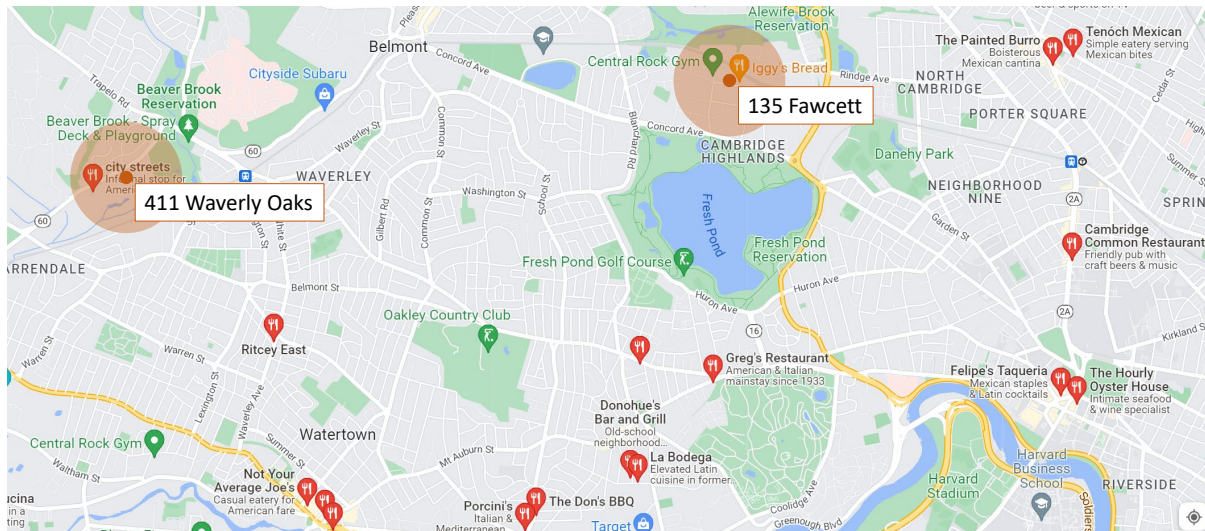
Assets		Liabilities	
Cash and Equivalents	\$2,178	Accounts Payable	\$39
Accounts Receivable	9	Accrued Expenses	20
Inventory	51		
Current Assets	\$2,238	Current Liabilities	\$59
Plant, Property, and Equipment	87	Paid-In Capital	4,731
Net of Depreciation		Retained Earnings	-2,465
		Equity	2,266
Total Assets	\$2,325	Total Liabilities and Equity	\$2,325

Source: "Mighty Squirrel Sales Report," June 30, 2017.

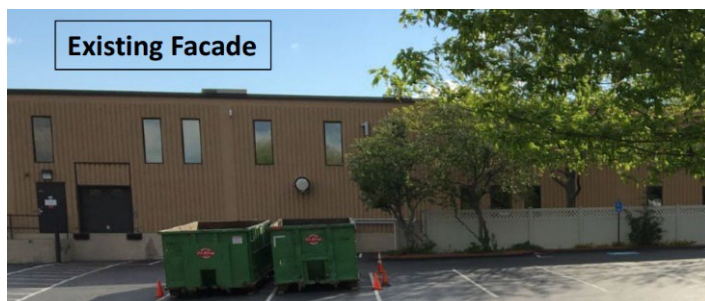
**Exhibit 3** Massachusetts Craft Breweries

Brewery	Founding Year	2016 Sales (Barrels)	Taproom
Jack's Abby	2010	34,000	Framingham
Lord Hobo	2014	15,000	Woburn
Wormtown	2009	15,000	Worcester
Tree House	2010	13,000	Charlton
Trillium	2013	12,000	Boston and Canton
Night Shift	2010	10,000	Boston and Everett

Source: "Letter to the Duffy Family," June 13, 2017.

**Exhibit 4** Candidate Locations for the Taproom

Source: © Google Maps.

**Exhibit 5** Façade and Interior of the Waltham Site

Source: Company documents.

**Exhibit 6** Selected Pro Forma Assumptions for the Waltham Site

**Revenue.** The new taproom was expected to generate \$500,000 in its first partial year of operation in 2018 increasing to \$1.5 million in 2021, as shown below. Meanwhile, distribution sales were expected to accelerate with the new marketing value of the taproom, growing slowly from \$189,000 realized in 2016 to \$225,000 in 2017, \$700,000 in 2018, and to \$6 million in 2021.

**Cost of goods sold.** With the brick and mortar in place, COGS would be 10% of taproom sales and 60% of distribution sales.

**Operating expenses.** Taproom operating expenses would start at \$80,000 in 2018 and grow to \$300,000 in 2021, as shown below. Brewery operating expenses would start at \$200,000 in 2018 and grow to \$350,000 in 2021.

**Selling, general, and administrative.** SG&A expenses were expected to continue as before. In 2016, SG&A had totaled \$1 million and was forecast to rise 10% per year, starting in 2019, as shown below.

**Capital expenditures.** The build-out of the taproom and the brewery would total \$3.7 million, with \$1.2 million in equipment, and an additional \$1 million in 2020 providing enough capacity to reach the 2021 sales targets. The landlord's tenant improvement allowance would reduce 2018 capital expenditures by \$375,000, from \$2.5 million to \$2.125 million, component of plant, property, and equipment that would not be capitalized on Mighty Squirrel's balance sheet. Ongoing capital expenditure in 2019 and 2021 would total \$100,000 per year. The associated depreciation would grow according to tax rules.

**Taxes.** For the purposes of the pro forma model, the team computed the extent to which their forecast assets could be depreciated for tax purposes each year. Mighty Squirrel had \$2.465 million in tax losses through 2016 that would eliminate its tax liability through 2021 and beyond, until it was in a position of accumulated net profits.

**Working capital.** Working capital needs would be modest. Accounts receivable would reflect 30-day payment terms for distribution revenue, inventory was forecast at 10% of the cost of goods sold, the cash and equivalents needed to run the business were 1.5% of total revenue, accounts payable would reflect 30-day payment terms on the cost of goods sold, and accrued expenses was forecast at 6% of operating expenses and SG&A.

		17-Dec	18-Dec	19-Dec	20-Dec	21-Dec
Revenue	Distribution	225	700	3,400	5,000	6,000
	Taproom		500	1,000	1,250	1,500
Operating Expense	Brewery		200	250	300	350
	Taproom		80	200	250	300
Rent		50	400	409	418	427
Selling, General, and Advertising		1,000	1,000	1,100	1,210	1,331
Capital Expenditures		1,200	2,500	100	1,000	100
Depreciation		10	130	330	310	380

Source: Casewriter.

Note: The 2021 sales figures reflected 1,000 barrels consumed in the taproom and 16,500 sold through distribution channels. If demand for Mighty Squirrel's own brands fell short of this target, Henry and Naveen would contract to brew for other breweries in addition to brewing their own brand to generate as much value out of their space as possible. The distribution gross margin was expected to rise, with sales limited to Massachusetts at a higher price point.