

TO: Senate Law and Justice Committee
BY: Louis J. Cerone, Ph.D.
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Good morning Chairman McIlhinney, Chairman Ferlo and members of the Senate Law and Justice Committee. Thank you for your time and the opportunity to present testimony regarding the proposed privatization of Pennsylvania's existing liquor system.

I am Louis Cerone, President of XTL, which is a Pennsylvania-based third party logistics company and a wholesale distributor for the Pennsylvania Liquor Control Board.

The Liquor Control Board has three (3) distribution centers that it uses to store and supply wine and spirits to more than six hundred (600) retail stores across the state. XTL is the current contracted operator for the Liquor Control Board's Southeastern Pennsylvania regional distribution center. At this distribution center, XTL operates an order fulfillment operation that provides wine and spirits delivery to approximately one hundred seventy (170) of the Liquor Control Board's retail stores in Philadelphia and the surrounding four (4) counties of Bucks, Chester, Delaware, and Montgomery. XTL has been serving the Liquor Control Board in this capacity since 2000. In total, XTL has more than twenty-two (22) years of service for the Liquor Control Board, and is a partner that is dedicated to the success of the Liquor Control Board.

At this regional distribution center, XTL employs more than one hundred twenty (120) employees in family sustaining jobs, who work in various roles such as warehouse workers, store delivery drivers, administrative personnel, and company management. In 2012, XTL delivered more than five million nine hundred thousand (5,900,000) cases of wine and spirits to the retail stores.

From a day-to-day perspective, the warehouse operates five (5) days per week, Monday through Friday. During our daily operations, XTL will schedule and receive wine and spirits that are planned by the supplier or the PLCB, so as to ensure that there is adequate supply in the warehouse to meet the projected demand. The PLCB will electronically transmit retail store orders to XTL that are processed by XTL on line item by line item basis. XTL's responsibility is to select the correct orders from the stock on hand, properly load our delivery vehicles, and process all required inventory control documentation. XTL will also coordinate and dispatch its team of delivery drivers so that the drivers will perform store deliveries on the following morning according to the scheduled determined by the PLCB, with some stores receiving deliveries as early as 5:00 AM. The delivery to stores occurs five (5) days per week. Our long-standing business partnership with the Liquor Control Board has created a predictable process and predictable service level so that both partners can run efficiently with a minimal disruption to the daily store operations.

In our opinion, XTL believes that the current wholesale and retail systems used by the Liquor Control Board to manage, control, distribute, and sell wines and spirits is the "right approach" for the citizens of Pennsylvania. In fiscal year 2011-2012, the current system transferred more

than five hundred two million dollars (\$502,000,000) to the State Treasury, while simultaneously infusing nearly seventy-nine million dollars (\$79,000,000) in the local economy through retail store leases from private landlords, as well as outsourced warehousing services through its three (3) distribution centers.

The current process is a known and predictable source of revenue that has a long history of benefiting the citizens of Pennsylvania. Privatization would disrupt this recurring revenue source, and put the long-term financial benefits to the General Fund, as well as risk the controls that are in place to protect the consumers and citizens of Pennsylvania

It is XTL's opinion that modernization of the current wholesale system is more advantageous than privatization.

From a wholesale perspective, there seems to be a few ways to change the system while maintaining the integrity and controls of the wholesale operations. For example, if the Commonwealth determines that wine and/or spirits should be made available at locations other than the current retail stores (e.g., sell wine through beer distributors), the Liquor Control Board's current wholesale system and XTL's infrastructure is established and prepared to meet that challenge. XTL's fleet of delivery equipment, team of experienced order selectors, and years of management expertise will allow this process to occur smoothly. It is XTL's opinion that the most advantageous way for the Liquor Control Board to retain control of an expanded retail operation is to control the wholesale. If the retail store only receives its product from the warehouse, then all aspects of product tracking and financial accountability are maintained.

By controlling the supply chain, one can maintain the integrity of the process, which is especially important when working with a "controlled substance." Wholesale control allows for the quick and efficient removal of product from the marketplace during a product recall. Wholesale control allows for the Commonwealth to ensure compliance to policies, procedures, and state regulation by suppliers. If the Commonwealth can "turn off the supply chain," which, in effect, turns off the supplies revenue stream, then the suppliers would be hesitant to violate state policy. In other words, if you control the wholesale, then you control the "purse strings."

If the Commonwealth decides to remain in the wholesale business of wine and spirits, it is XTL's opinion that the Liquor Control Board has an opportunity to optimize the full potential of the wholesale system. By doing so, the Liquor Control Board can maximize the long-term financial benefit. By being a "market leader," the Liquor Control Board can capitalize on "buying power" and its supply chain infrastructure to generate additional revenue for the General Fund. For example, as being the largest purchaser of wine and spirits in the US, the Liquor Control Board could assist the Port of Philadelphia to position itself as the "Port of Choice" for alcohol beverage importation for the Mid-Atlantic States. The City of Philadelphia has the logistics infrastructure of rail, water, air, and highway and, along with XTL's suggested automated warehouse, can support such a business initiative while maintaining wholesale control.

From a wholesale perspective into possible retail changes, modernization might include having longer retail hours on the days prior to certain holidays, such as the day before Thanksgiving,

which tends to be a very busy time for all involved in meeting consumer demand. Additionally, retail store modernization might include having more stores open on Sunday with longer Sunday hours, and for select stores to be open for business on certain holidays.

In addition, the Liquor Control Board could work with suppliers to offer more promotional discounts and more wine tastings to introduce customers to new products. The Liquor Control Board is and can continue to work with supplier to delist products that are not selling. While having a very large selection of products can be seen as an enhancement to the consumer experience, the reality is that many people purchase products they are familiar with. This results in most new products failing to sell enough quantity to remain viable. This is often referred to as the “80/20 rule” in which eighty percent (80%) of the volume is twenty percent (20%) of the items, which is an effect that we see in the warehouse operation. Putting products on the shelf that the consumer does not buy is not practical.

In conclusion, it is XTL’s opinion that modernization of the current wholesale operation is more advantageous than privatization because it allows the Liquor Control Board to maintain its regulations and controls while optimizing the long-term, financial benefits for the Commonwealth of Pennsylvania.

Thank you very much for your time. I welcome any questions.