CRAFT SPIRITS DATA PROJECT

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Annual Craft Spirits Economic Briefing

October 2017

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Contents

Key Messages

Key Messages

- For purposes of this research, U.S. craft spirits are distilled spirits that are produced in the U.S. by licensed producers that have not removed more than 750,000 proof gallons (or 394,317 9L cases) from bond, market themselves as craft, are not openly controlled by a large supplier, and have no proven violation of the ACSA Code of Ethics.
- The number of active craft distillers in the U.S. grew by 20.8% over the last year to 1,589 in August 2017.
- The U.S. craft spirits market volume (cases) reached 5.8m cases in retail sales in 2016, growing at an annual growth rate of 18.5%. In value terms, the market reached $3.0 billion in sales, growing at an annual growth rate of 25.0%. The market share of U.S. craft spirits reached 2.6% in volume and 3.8% in value in 2016, up from 1.0% (volume)/1.2% (value) in 2011 and 2.2% (volume)/3.0% (value) in 2015.
- Exports of U.S. craft spirits reached 566,000 cases in 2016, adding more than 8.8% of additional volume to U.S. craft distillers' total sales. Exports grew by 8.2% versus last year.

Key Messages (Continued)

- The U.S. craft distilling market is fairly concentrated with nearly 2% of the larger producers (between 100,000 and 750,000 proof gallons removed from bond) being responsible for 57.0% of the cases sold. 92.0% of U.S. craft producers are classified as small producers (between 0 and 10,000 proof gallons removed from bond). They are responsible for just 12.8% of the cases sold annually.
- Direct sales at the site of the distilled spirits producer (DSP) are important for all craft distillers but especially important for small producers where these sales make up 34% of total sales. Out of state business is particularly important for large producers, accounting for more than 58% of the total business.
- Many surveyed retailers and wholesalers see the potential for craft spirits to perform in line or better than craft beer over time. With craft beer market share currently over 12% in the U.S., the craft spirits market is expected to continue to grow rapidly.
- Employment in the U.S. craft industry has been on the rise: in 2017 industry employment grew 47.8% (over 6,000 FTEs) to almost 19,600 FTEs. Investments by the U.S. craft industry have reached close to $600 million in 2017.

Craft Spirits Research Definition

Craft Defined for Purposes of the Research

Size:
Not more than 750,000 proof gallons (or 394,317 9L cases) removed from bond by licensed producer (DSP)

Self-proclamation of licensed craft distiller, not openly controlled by a larger supplier:
Distiller claims to be a U.S. craft spirits producer with a valid DSP license and is not openly controlled by a larger supplier

ACSA Code of Ethics:
"We operate in an honest, transparent and non-deceptive fashion. We inform consumers truthfully and accurately about the sources and methods used to make our spirits through our labels, materials and communications. We expect fair dealing and respect amongst members. We obey all federal, state, and local laws."

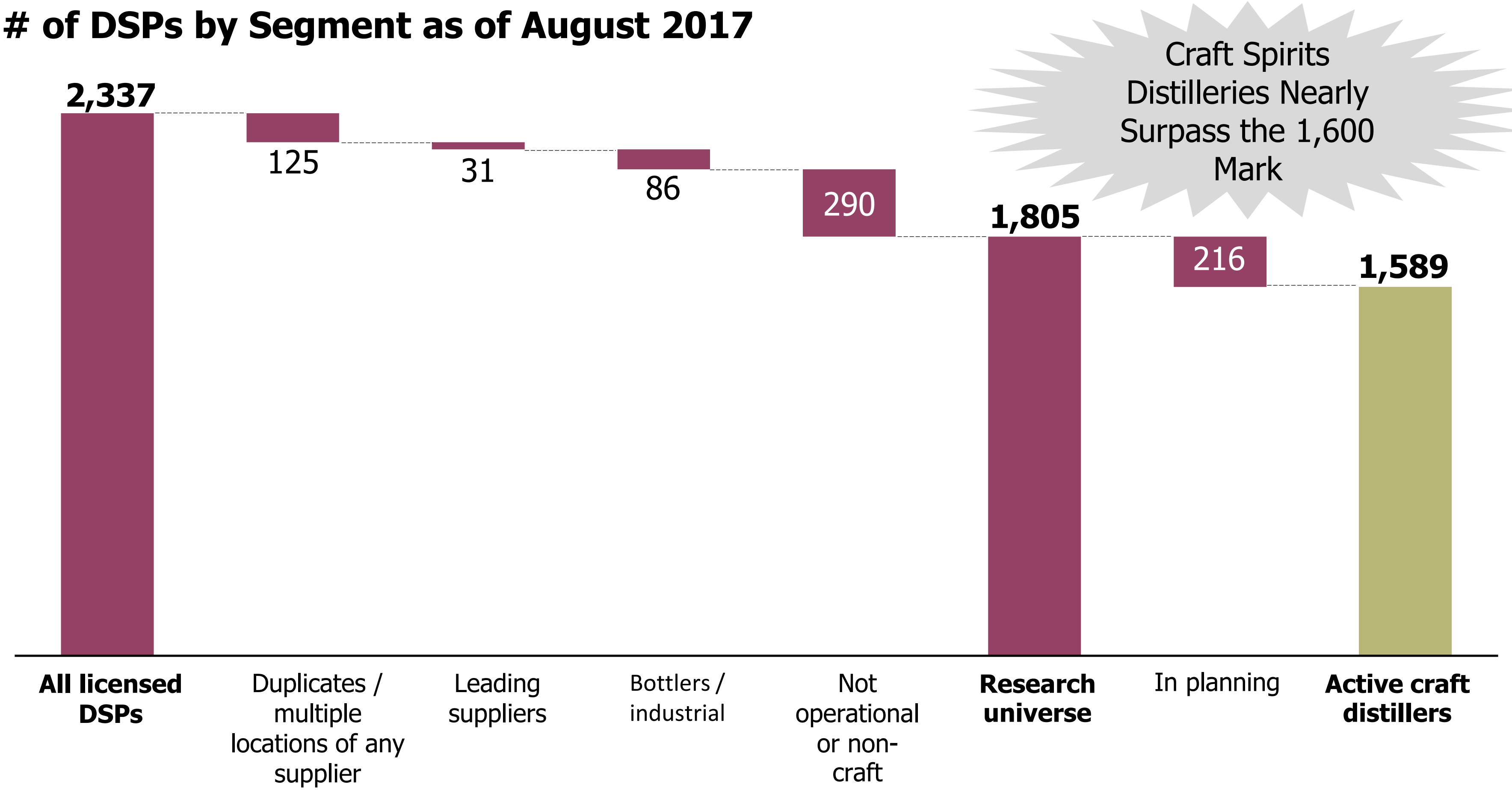
U.S. Craft spirits (for the purposes of this research)

U.S. Craft spirits are distilled spirits that are produced in the U.S. by licensed producers that have not more than 750,000 proof gallons (or 394,317 9L cases) removed from bond, market themselves as craft, are not openly controlled by a large supplier, and have no proven violation of the ACSA Code of Ethics

Craft Spirits Market Data

From DSPs to Active Craft Distillers

of DSPs by Segment as of August 2017



- The list of DSPs is broken down into segments in order to distinguish the amount of distillers that are not considered craft: duplicates, leading suppliers, bottlers, and/or non-craft/non-operational
- The list of active craft distillers is generated bottoms-up through individual assessment

Sources: TTB, ACSA, ADI, State ABC Boards, State Guilds, Team Analyses

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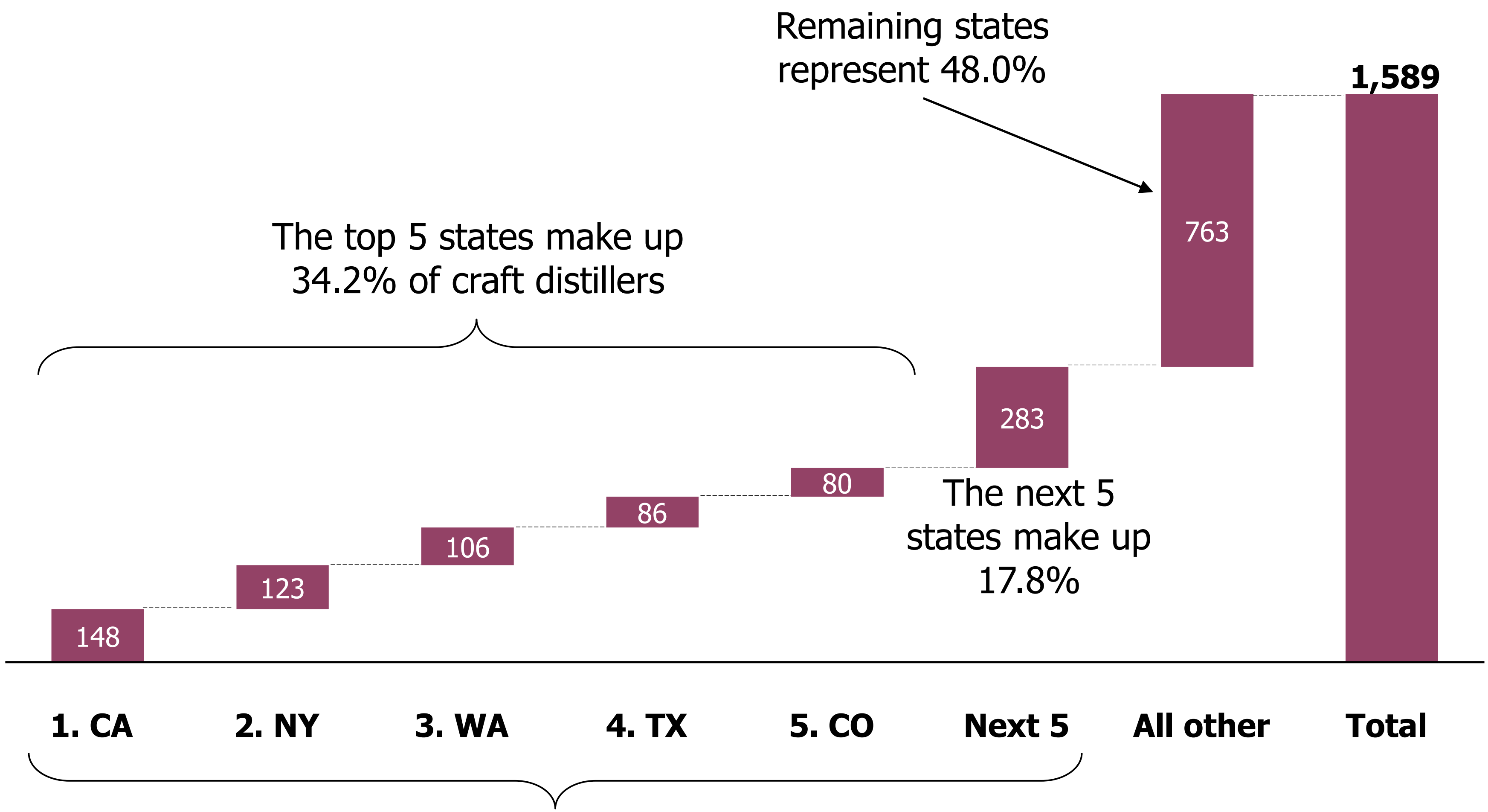
Active Craft Distillers by State

of Active Craft Distillers by State as of August 2017



Over half of active U.S. craft distilleries are located in ten states

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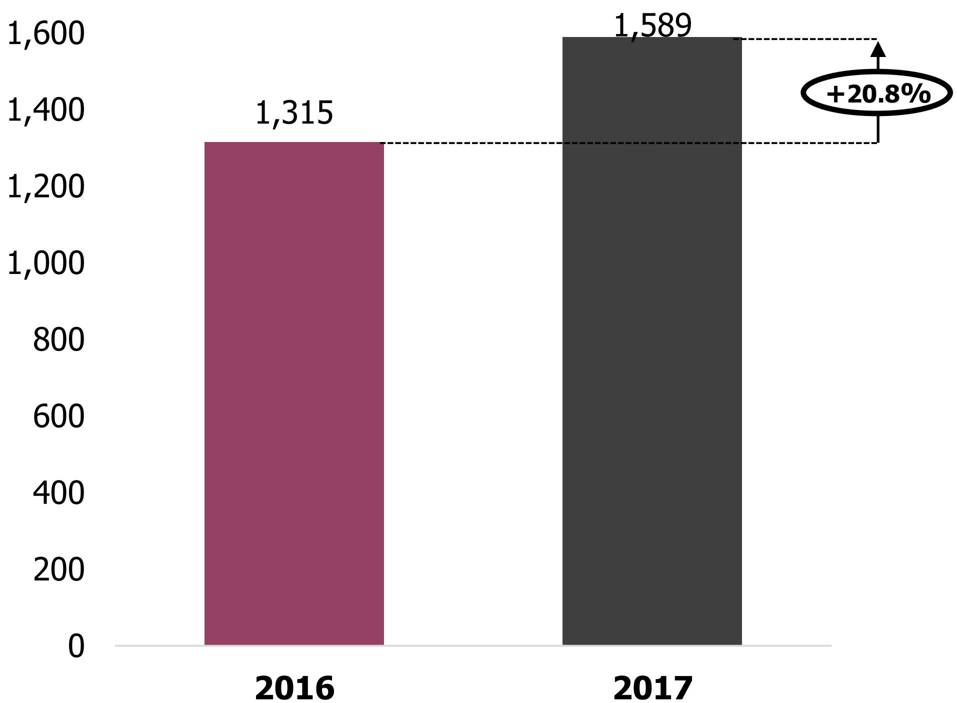
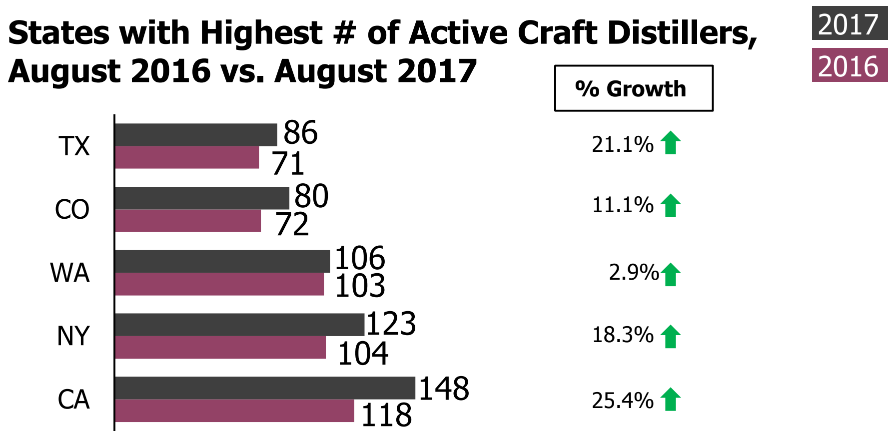
Number of Active Craft Distillers Has Grown Over 20% Since Last Year

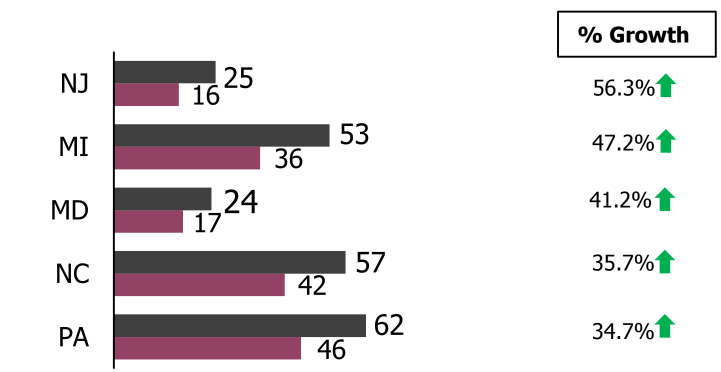
# of Active Craft Distillers, August 2016 vs. August 2017



States with Highest # of Active Craft Distillers, August 2016 vs. August 2017



States with Fastest Growth Rate of # of Active Craft Distillers, August 2016 vs. August 2017



- In August 2017 there were 1,589 craft distillers active in the U.S., up over 20% from 1,315 active distillers in August 2016
- The number of craft distillers in New Jersey, Michigan and Maryland grew by over 40%

Sources: IWSR, Team Analyses

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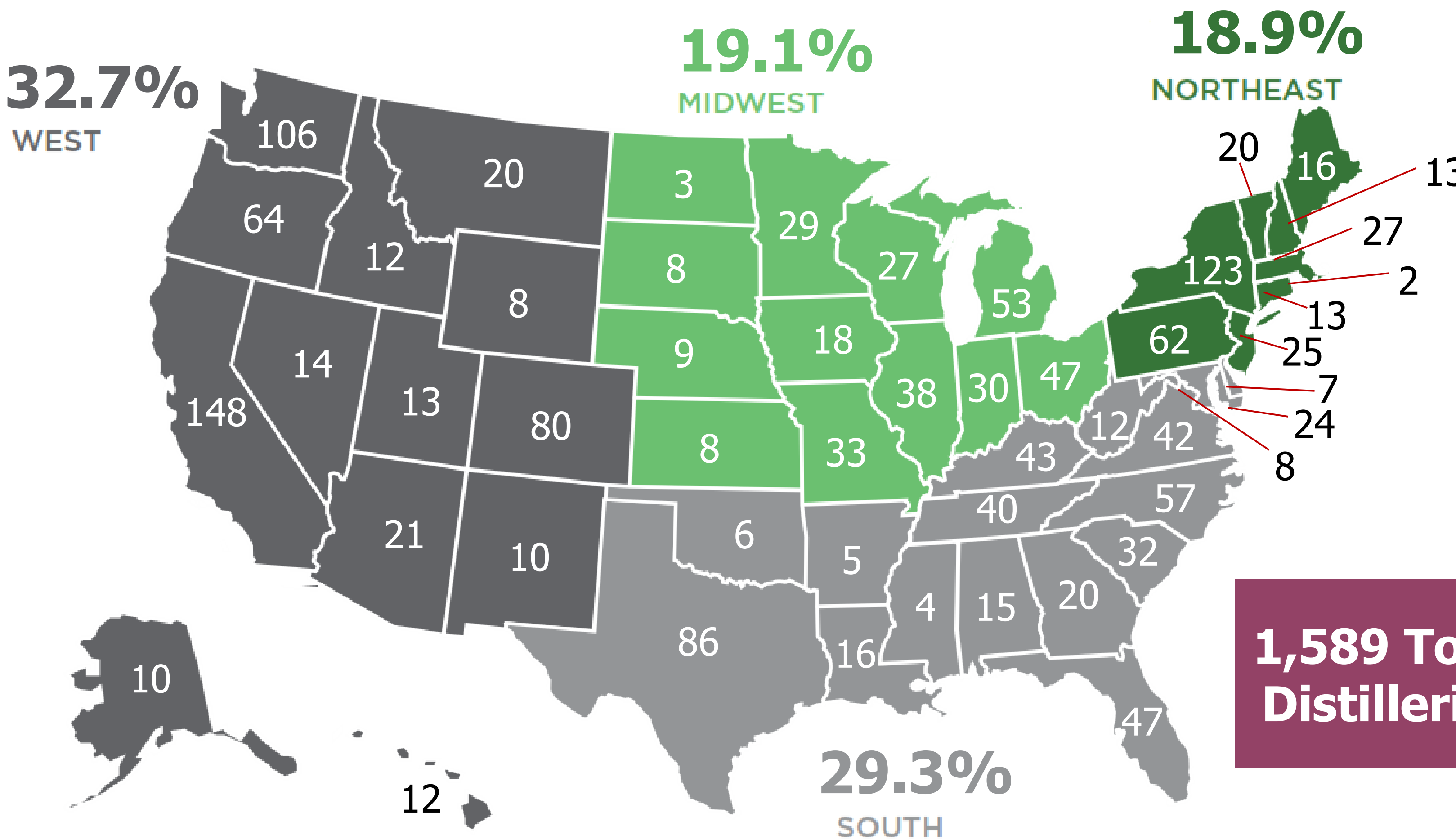
Active Craft Distillers by State and Region

of Active Craft Distillers by State and Region as of August 2017



1,589 Total Distilleries

Sources: TTB, ACSA, ADI, State ABC Boards, State Guilds, Team Analyses

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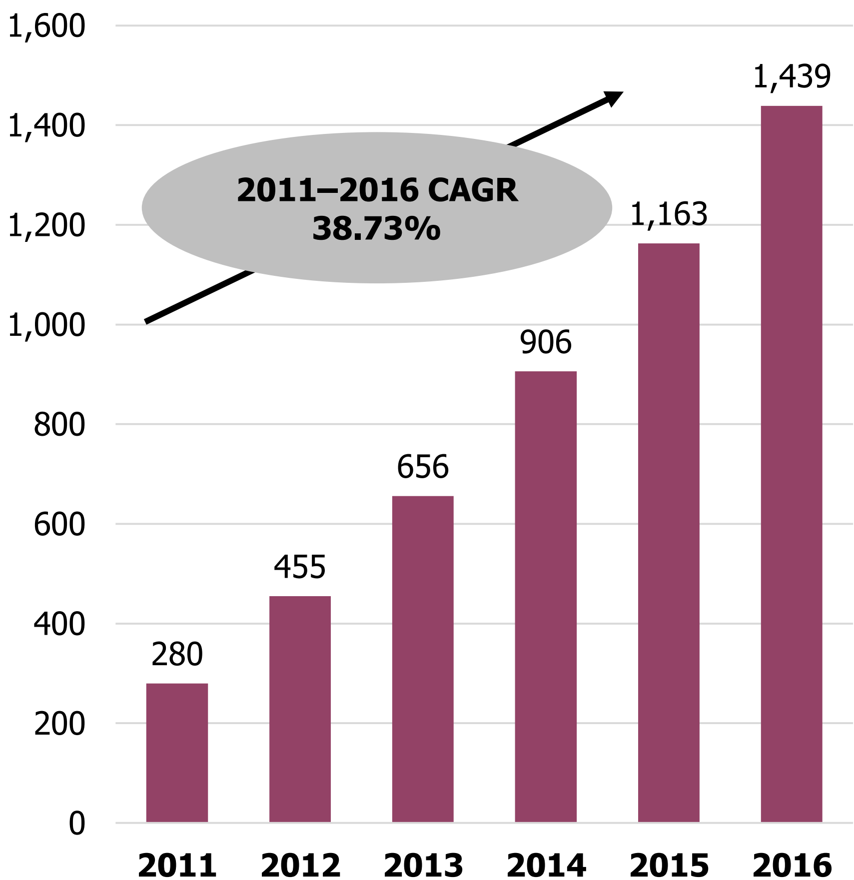
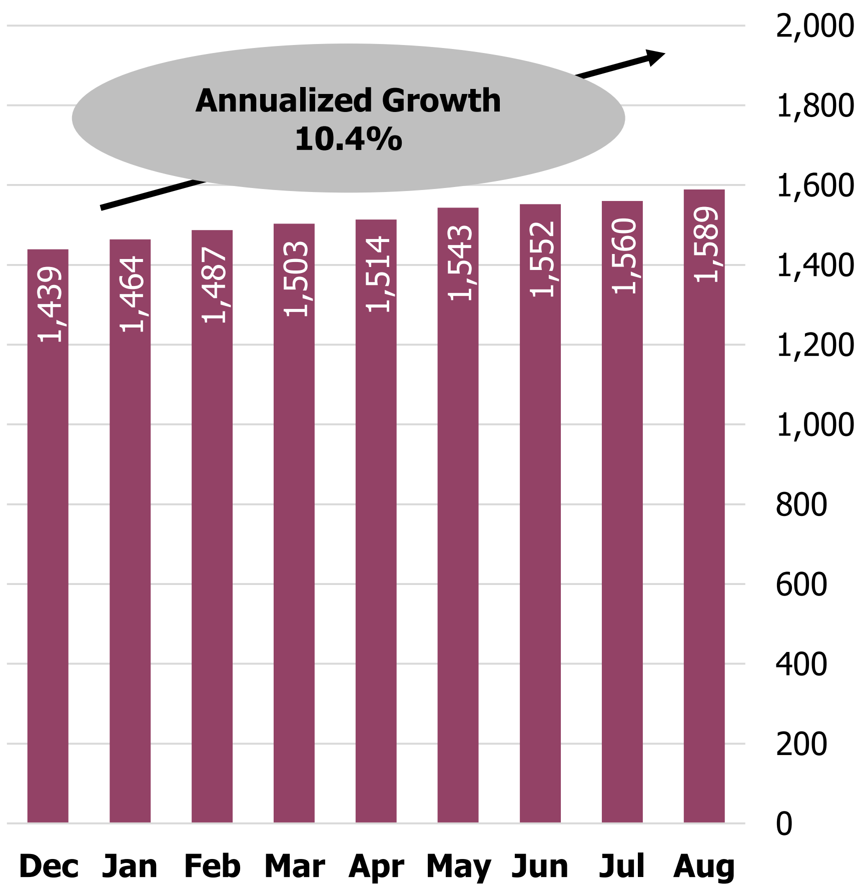
Number of Active Distillers Still Growing Rapidly

# of Craft Spirits Producers 2011 – 2016



# of Craft Spirits Producers December 2016 – August 2017



Sources: TTB, IWSR, Team Analyses

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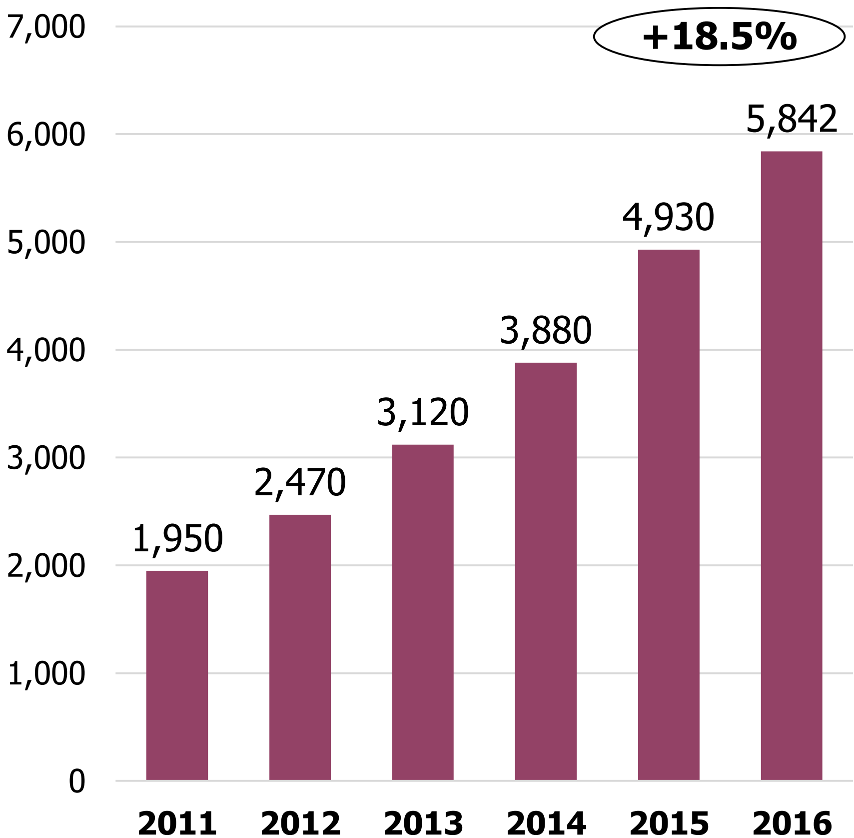
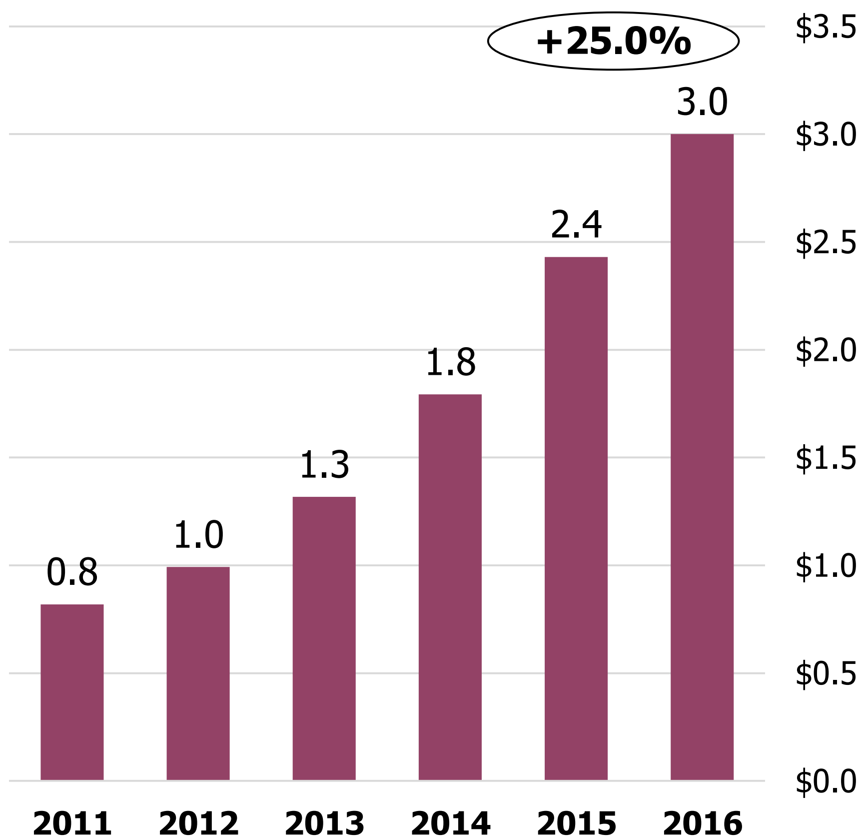
Craft Spirits Sales Are Growing Rapidly by Volume and Value

Craft Spirits Sales by Volume, 2011 – 2016
9L Cases (000)



Craft Spirits Retail Sales by Value, 2011 – 2016
$ Billions



Sources: TTB, ACSA, IWSR, State ABC Boards, State Guilds, Team Analyses

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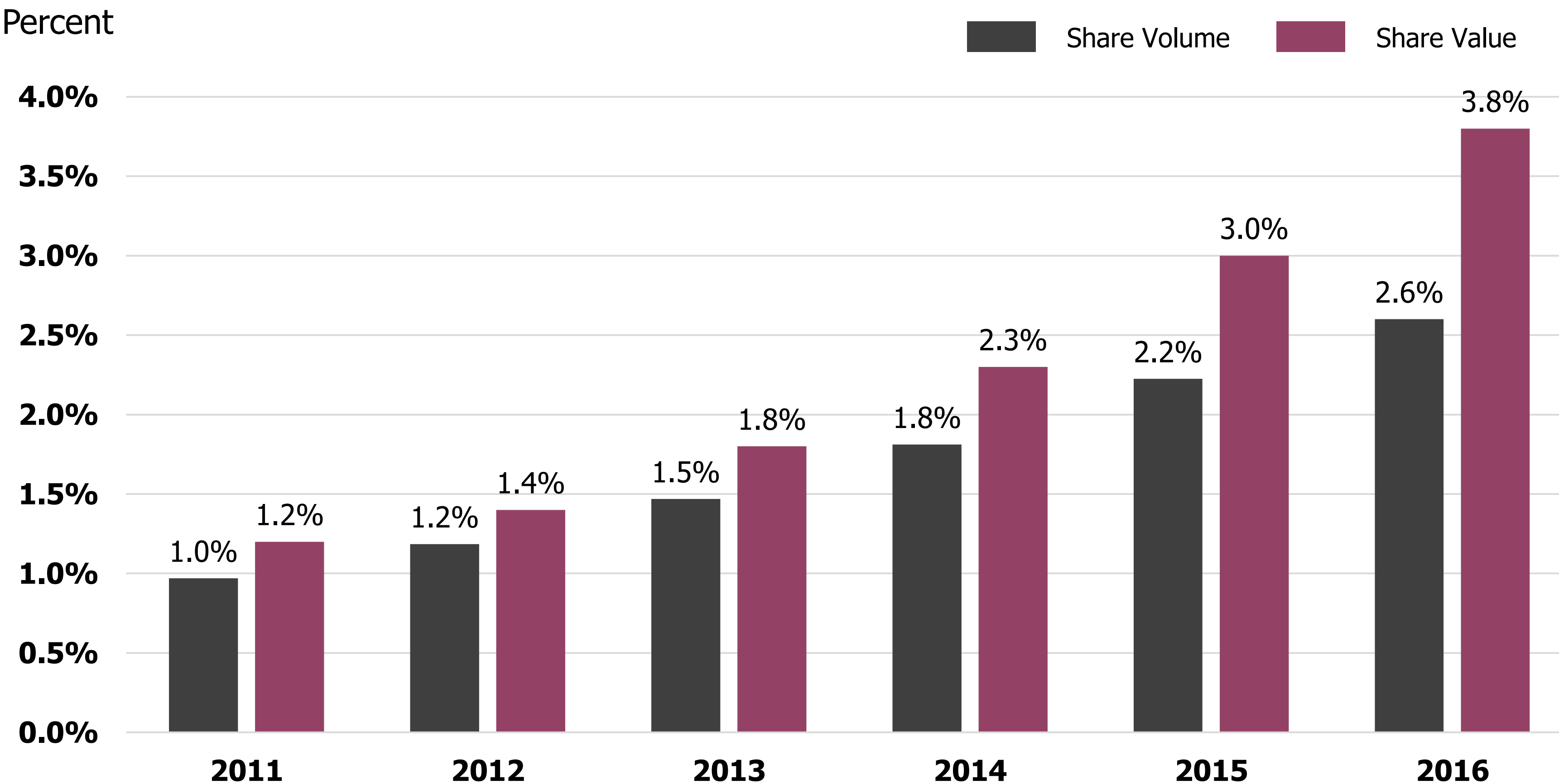
Craft Spirits Market Share at 3.8% in Value and 2.6% in Volume

Craft Distiller Sales as a Share of Total U.S. Spirits Volume and Value



- U.S. craft currently has an estimated market share of 2.6% in cases, up from 1.0% in 2011
- U.S. craft is clearly a contributor to the trend towards premiumization in the U.S. market
- The U.S. craft market share in value is estimated at 3.8%, up from 1.2% in 2011

Sources: TTB, ACSA, IWSR, State ABC Boards, State Guilds, Team Analyses

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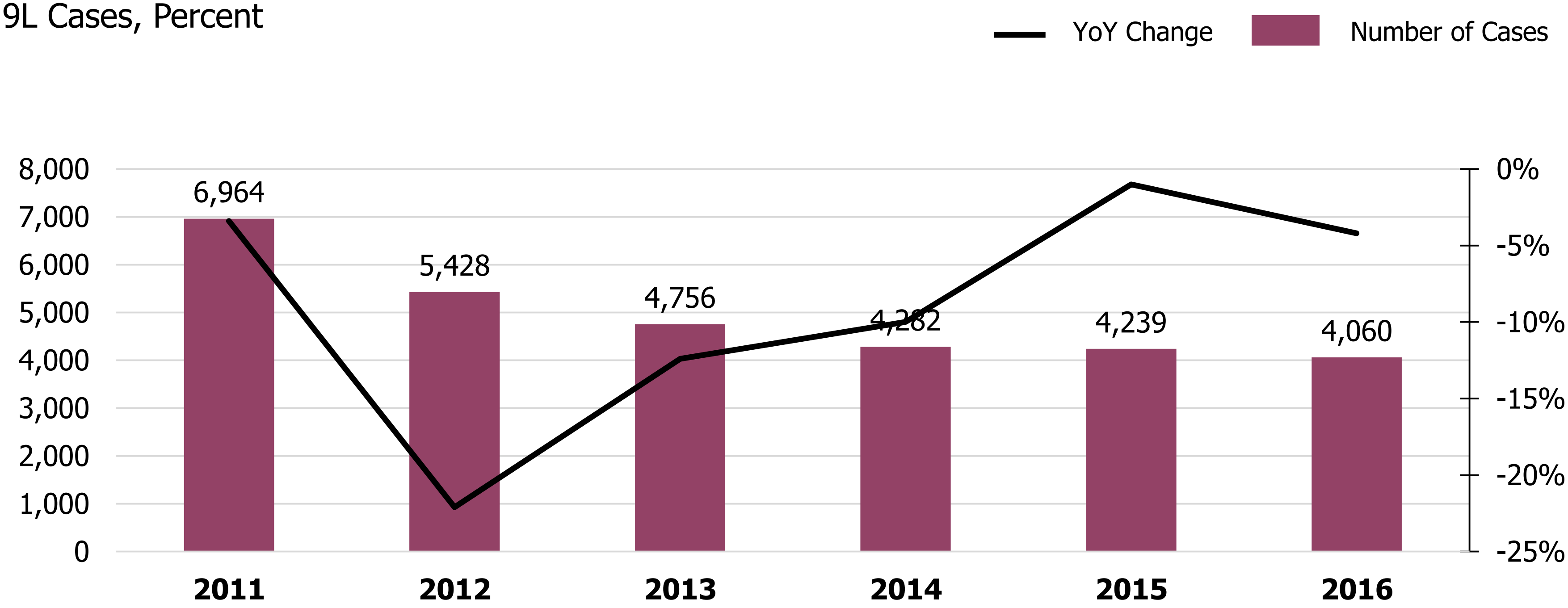
Average Volume Declining, Inflection Point Still in Reach

of Cases of Average U.S. Craft Distiller 2011 – 2016

9L Cases, Percent



- The volume of the average U.S. craft distiller has been declining since 2011, reflecting the strong inflow of new distillers
- The rate of decline has been slowing since 2012. At a rate of just 4.0% from 2015 to 2016, the market appears to continue to be close to an inflection point at which the volume growth will outpace the growth in number of distillers

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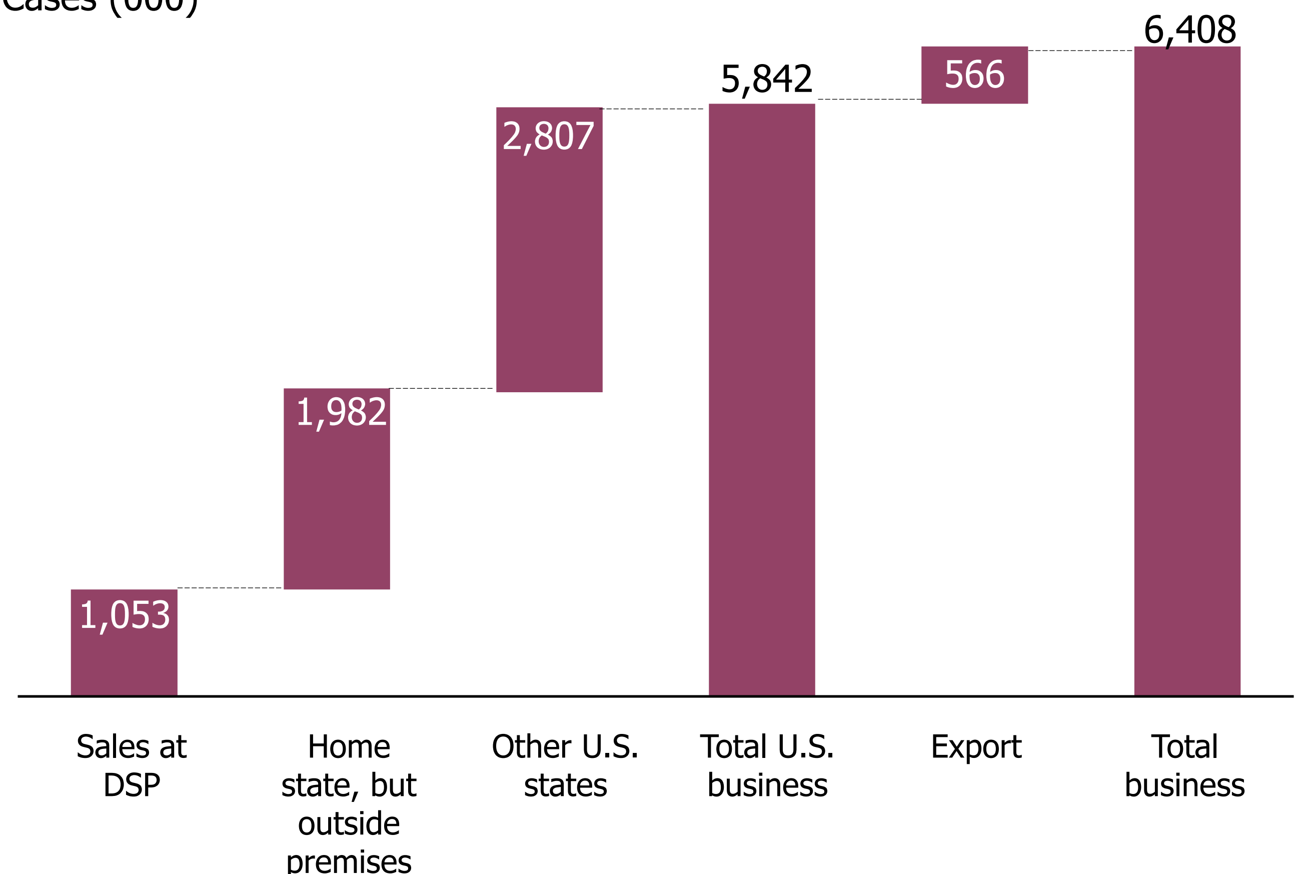
More Than 50% of the U.S. Craft Business Takes Place in the Home States

Sources of Case Sales – Total U.S. Craft Spirits Industry, Domestic and Export 2016

9L Cases (000)



% of total U.S. business **18%** **34%** **48%** **100%** **8.8%** **108.8%**

- More than 30% of the total U.S. craft business takes place in the home state of the craft distiller
- Exports add nearly 9% to the overall volume of the U.S. business

Sources: TTB, ACSA, ADI, State ABC Boards, State Guilds, Team Analyses

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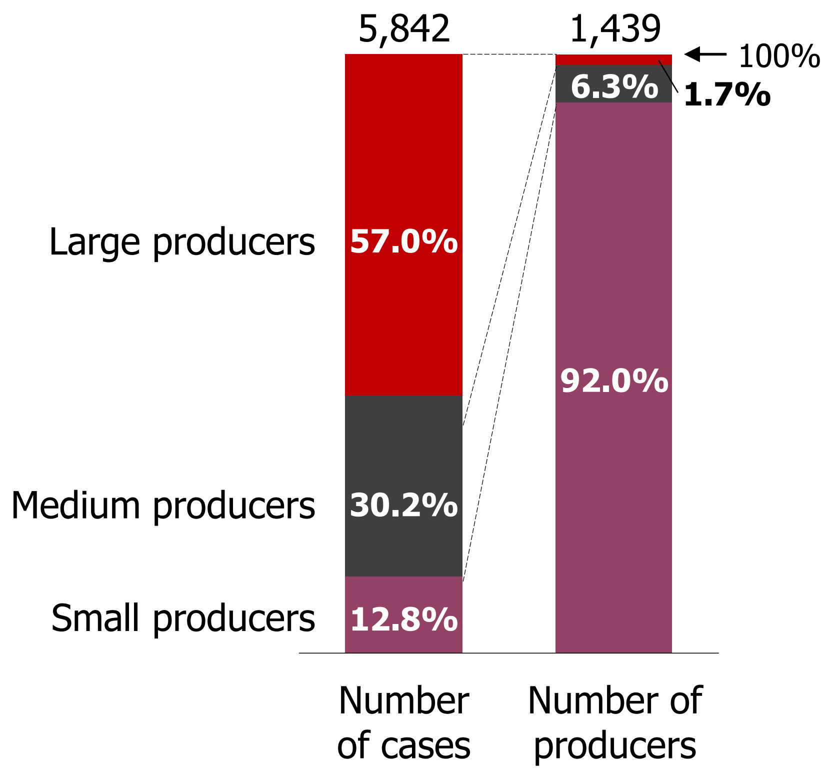
Craft Spirits Market Is Fairly Concentrated

of Craft Distillers and Case Volumes by Producer Size, 2016

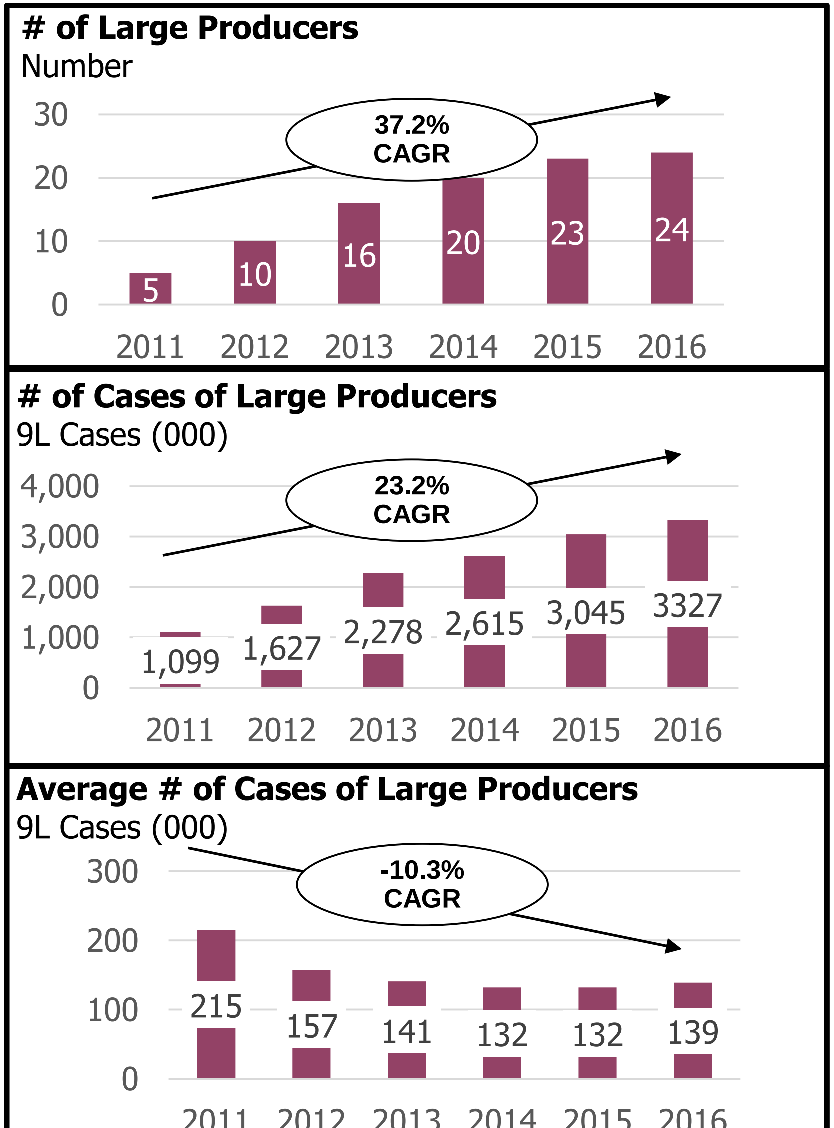
of Producers, 9L Cases (000)



- The U.S. Craft distilling market is fairly concentrated with nearly 2% of the producers being responsible for almost 60% of the cases
- 92.0% producers are classified as small producers. They are responsible for just 12.8% of the cases

© 2017 park street American Craft Spirits Association IWSR

Average Volume of Large Craft Producers Experienced Growth in 2016



- The number of large craft distillers as well as their number of cases has been growing rapidly
- The number of large craft distillers has grown almost six-fold from 5 in 2011 to 24 in 2016
- The number of cases of large craft distillers has grown from 1.1 million 9L cases in 2011 to over 3.3 million 9L cases in 2016
- The average number of cases of large craft distillers has decreased from 215k 9L cases in 2011 to 139k 9L cases in 2016

Sources: TTB, Distiller Surveys, Team Analyses

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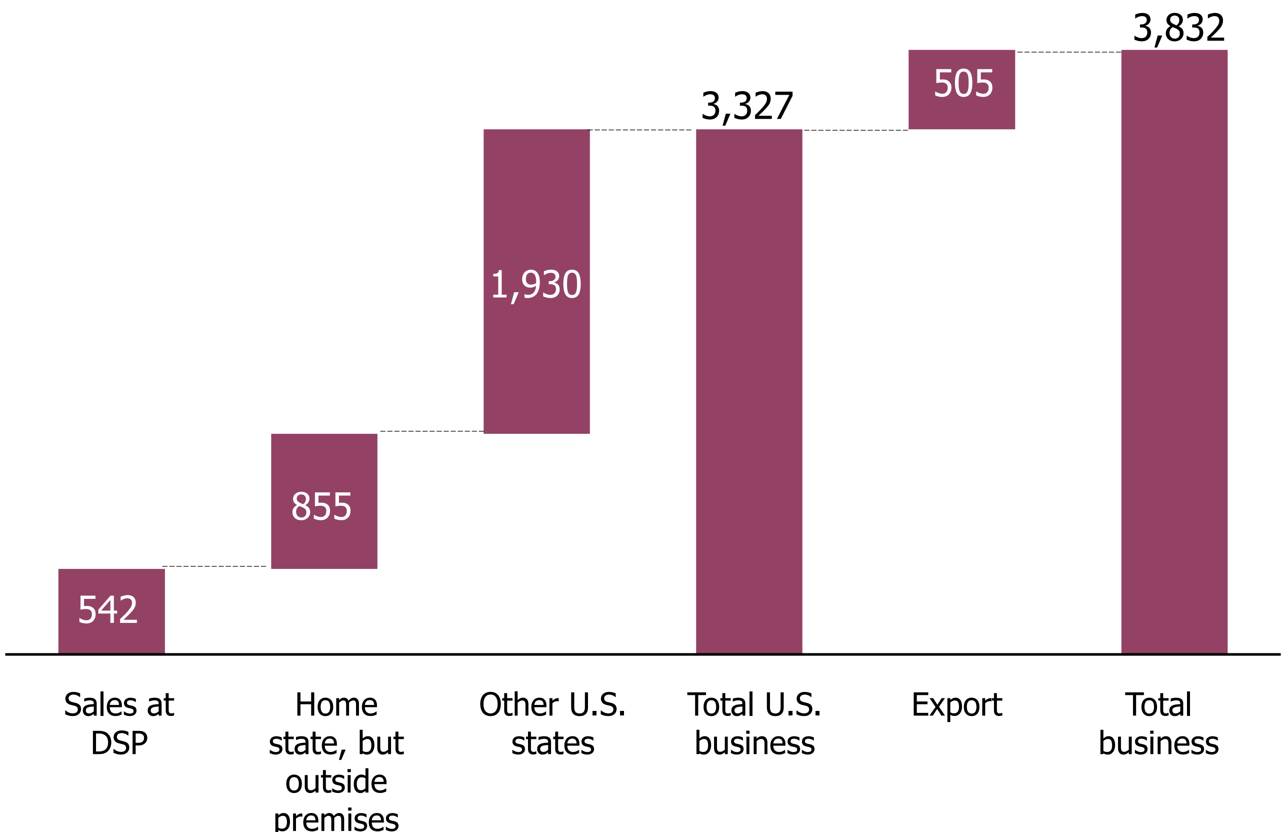
More Than 50% of the Business of Large Craft Producers Takes Place Outside the Home States

Sources of Case Sales – Large U.S. Craft Spirits Producers, Domestic and Export 2016

9L Cases (000)



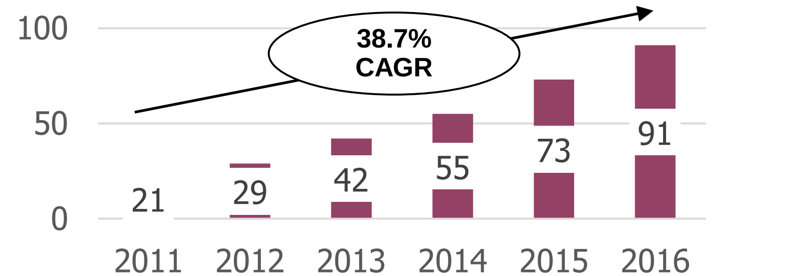
% of total U.S. business	16%	26%	58%	100%	13%	113%

- More than 50% of the total U.S. business of the large U.S. craft producers takes place outside the home state of the craft distiller
- Exports add more than 13% to the overall volume of the U.S. business

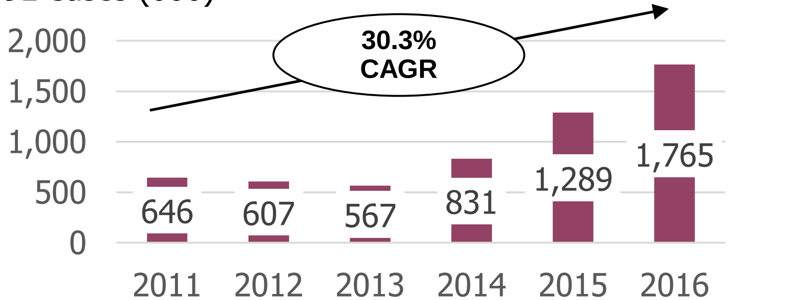
Sources: TTB, ACSA, ADI, State ABC Boards, State Guilds, Team Analyses

Medium-Size Craft Producers Have Been Growing Well

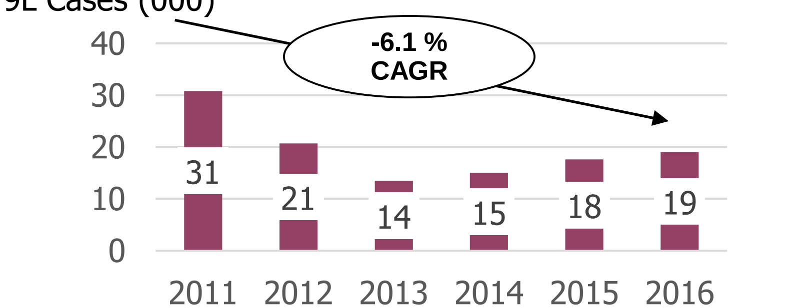
# of Medium-Size Producers
Number



# of Cases of Medium-Size Producers
9L Cases (000)



Average # of Cases of Medium-Size Producers
9L Cases (000)



- The number of medium craft distillers as well as their number of cases has been growing rapidly
- The number of medium craft distillers has grown almost six-fold from 21 in 2011 to 91 in 2016
- The number of cases of medium craft distillers has grown from 646k 9L cases in 2011 to over 1.7 million 9L cases in 2016
- The average number of cases of medium craft distillers has decreased from 31k 9L cases in 2011 to 19k 9L cases in 2016
- Medium-sized craft producers have positive growth year over year

Sources: TTB, Distiller Surveys, Team Analyses

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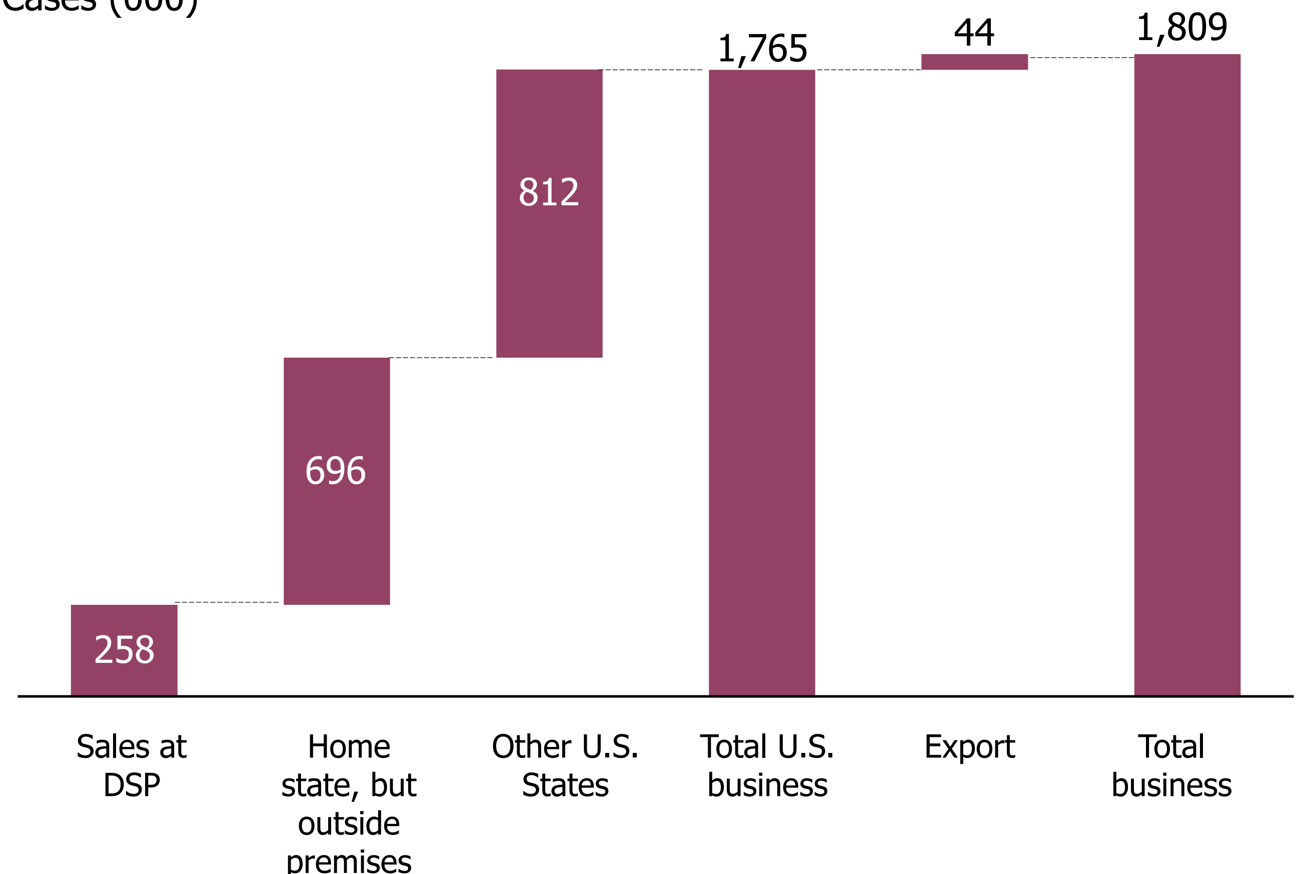
More Than 50% of the Business of Medium Craft Producers Takes Place in the Home States

Sources of Case Sales – Medium U.S. Craft Spirits Producers, Domestic and Export 2016

9L Cases (000)



% of total U.S. business	Sales at DSP	Home state, but outside premises	Other U.S. States	Total U.S. business	Export	Total business
	15%	**39%**	**46%**	**100%**	**3%**	**103%**

- 54% of the total U.S. business of the medium U.S. craft producers takes place in the home state of the craft distiller
- Exports add only about 3% to the overall volume of the U.S. business

Sources: TTB, ACSA, ADI, State ABC Boards, State Guilds, Team Analyses

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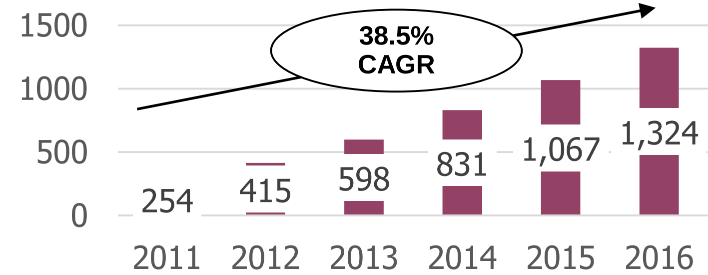
Small Craft Producers Have Been Growing Well

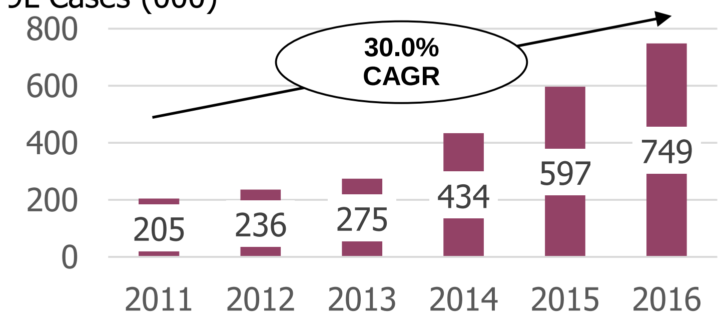
Number of Small Producers

Number



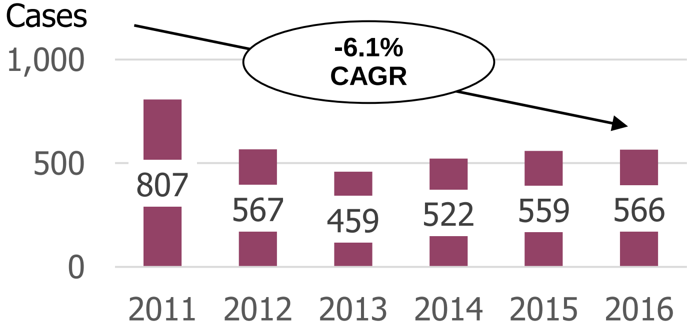
Cases of Small Producers

9L Cases (000)



Average Number of Cases of Small Producers

9L Cases



- The number of small craft distillers as well as their number of cases has been growing rapidly
- The number of small craft distillers has grown almost six-fold from 254 in 2011 to 1,324 in 2016
- The number of cases of small craft distillers has grown from 205k 9L cases in 2011 to 749k 9L cases in 2016
- The average number of cases of small craft distillers has decreased from 807 9L cases in 2011 to 566 9L cases in 2016

Sources: TTB, Distiller Surveys, Team Analyses

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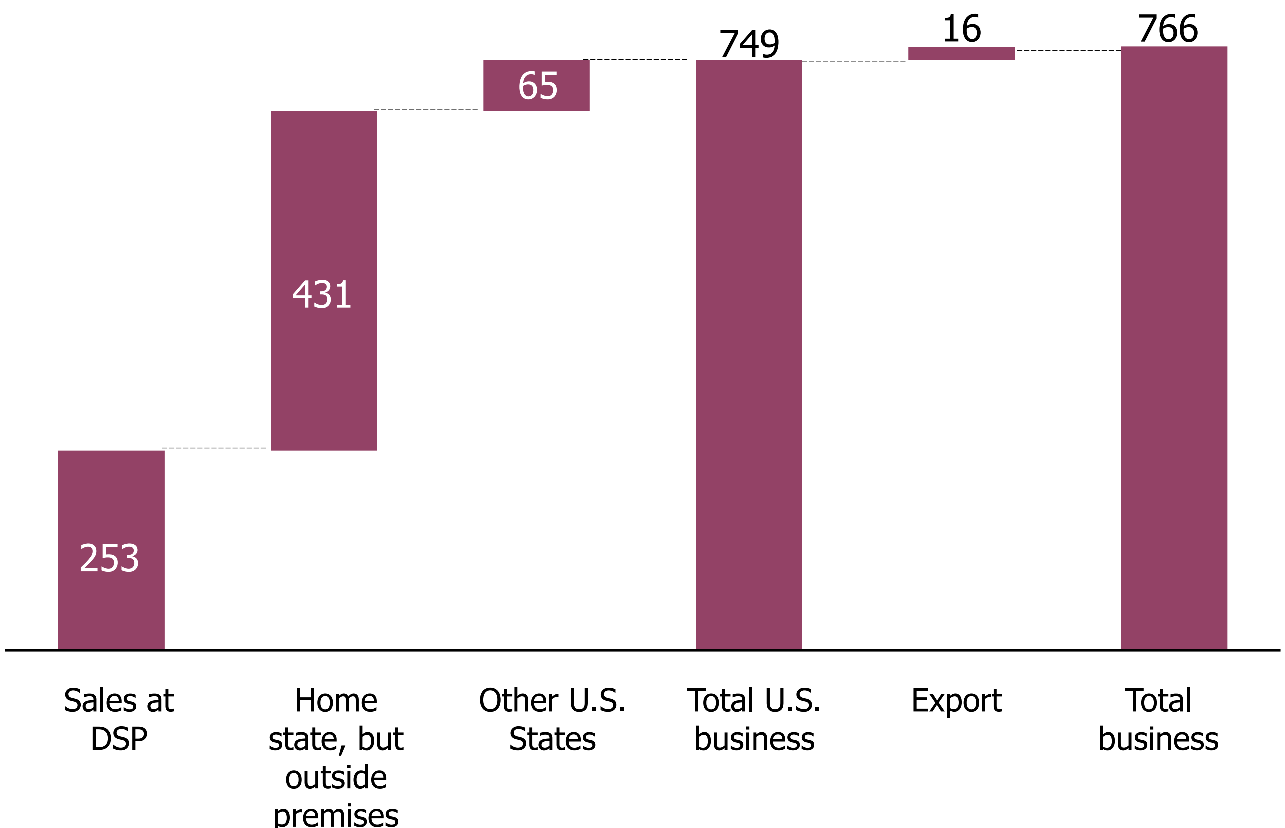
92% of the Business of Small Craft Producers Takes Place in the Home States

Sources of Case Sales – Small U.S. Craft Spirits Producers, Domestic and Export 2016
9L Cases (000)



% of total U.S. business	34%	58%	8%	100%	2%	102%

- 34% of the total business of small craft producers comes from sales at the DSP
- Less than 10% of the total business comes from sales outside the home state

Sources: TTB, ACSA, ADI, State ABC Boards, State Guilds, Team Analyses

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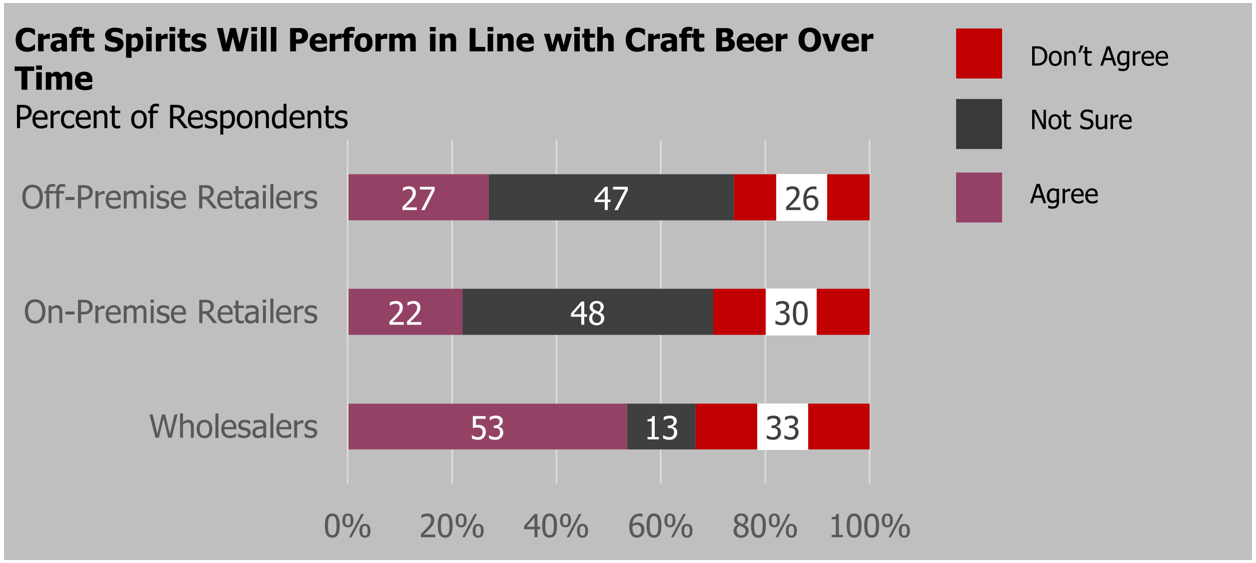
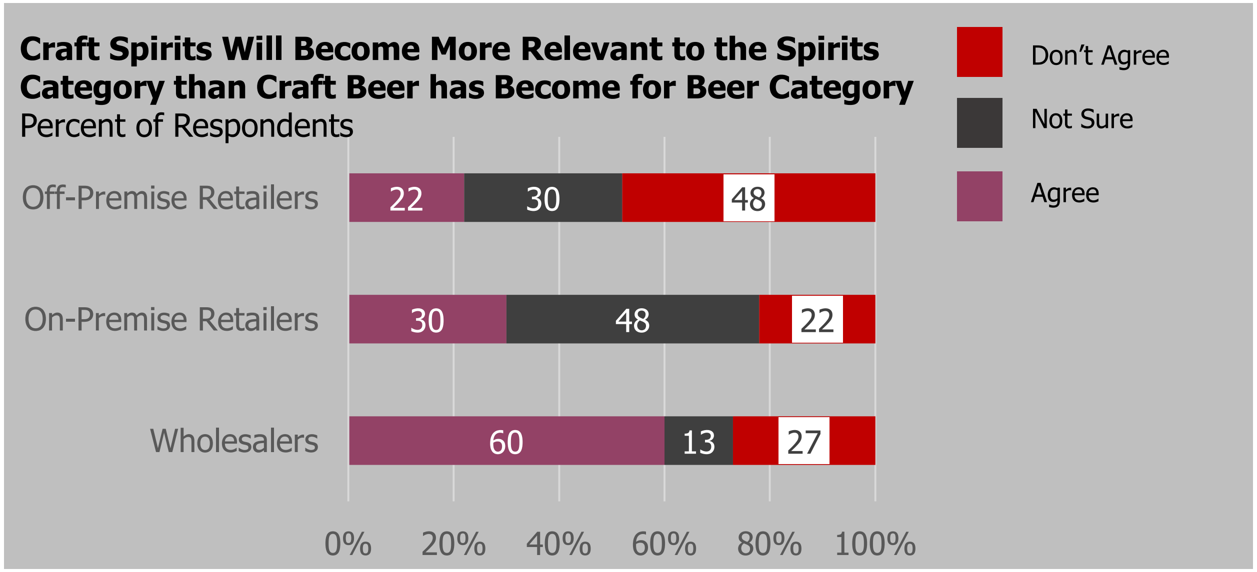
Many Retailers and Wholesalers See Potential for Craft Spirits to Perform in Line or Better than Craft Beer





- Many retailers and wholesalers see the potential for craft spirits to perform in line or better than craft beer
- With craft beer market share currently over 12% in the U.S., the craft spirits market is expected to continue to grow rapidly

Sources: WSWA Distributor Survey, ABL Retailer Survey, Team Analyses

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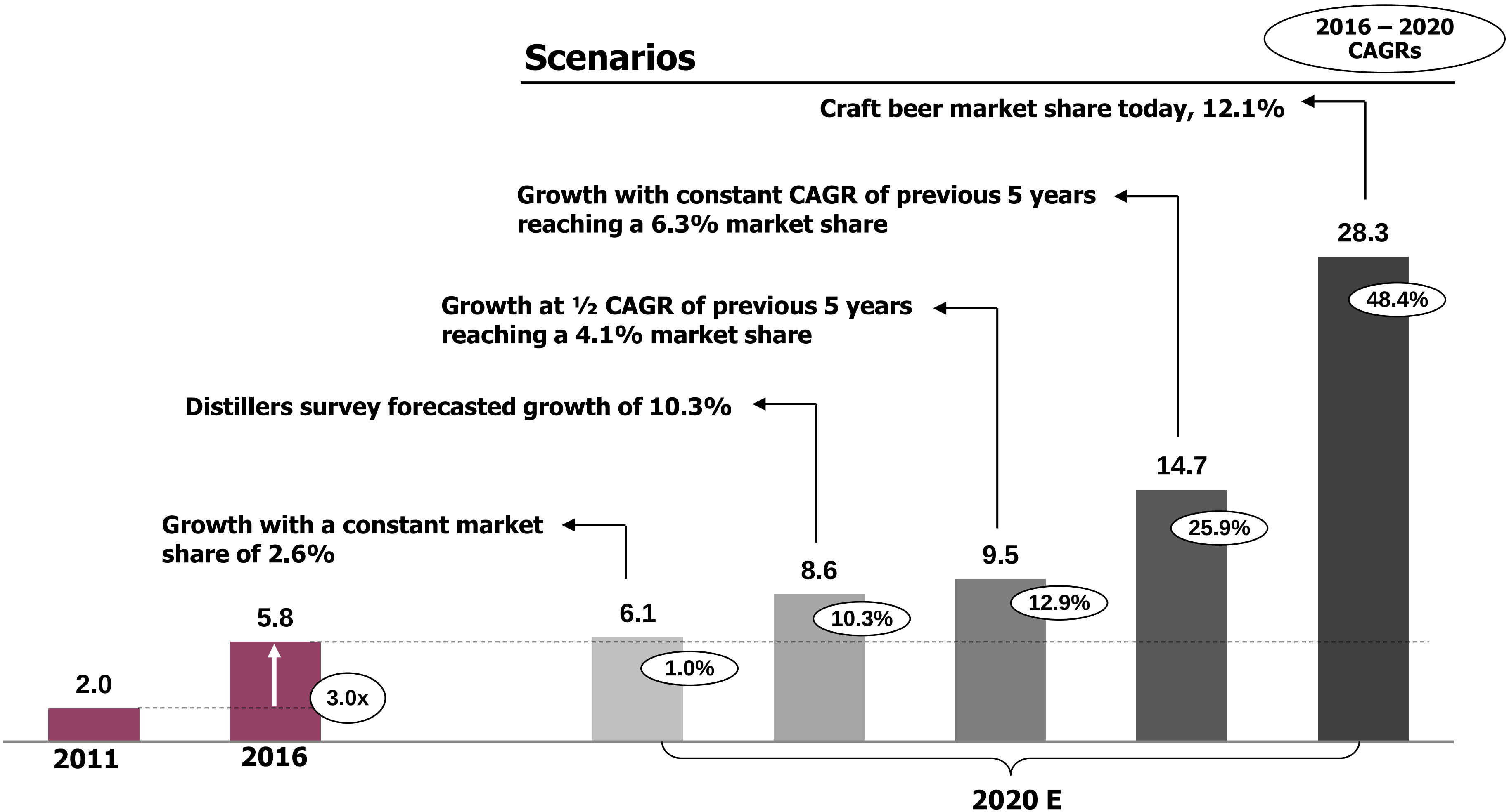
Craft is Still Small but Could Contribute Much More Towards Fragmentation in Future Years

U.S. Market Size Scenarios for 2020

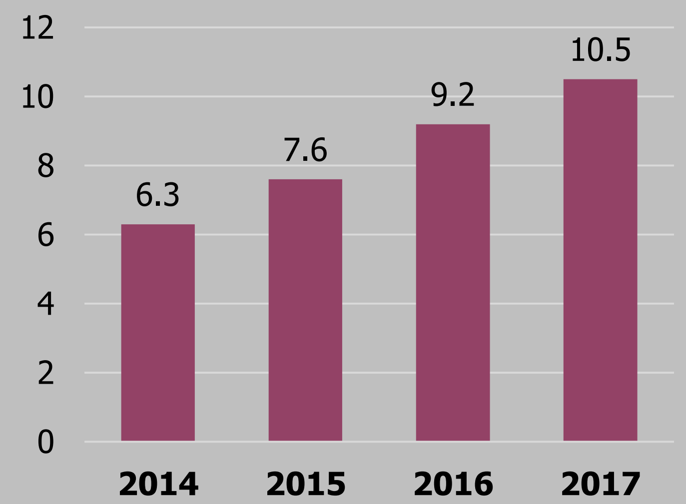
9L Cases (millions)



Sources: IWSR, Team Analyses

Employment in the U.S. Craft Industry Has Been on the Rise

Average Full-Time Domestic Employees of U.S. Craft Spirits Producers, 2014 – 2017
FTEs



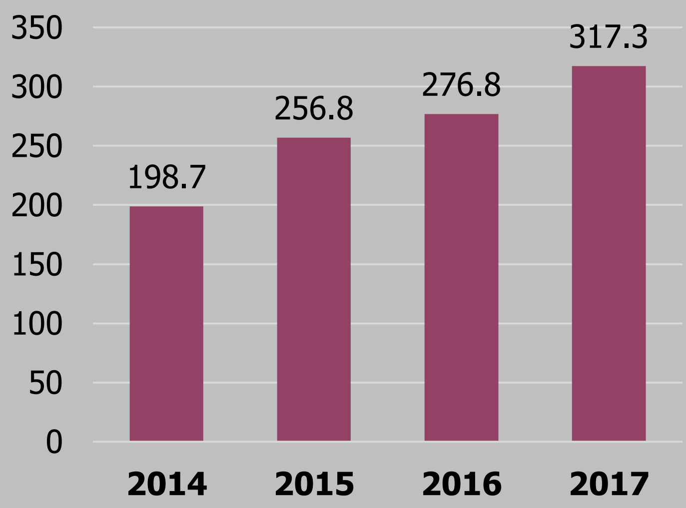
# of Full-Time Domestic Employees of U.S. Craft Spirits Producers, 2014 – 2017
FTEs

- Number of average FTEs has been increasing by almost 50% between 2014 and 2017
- Approximately 66% of the employment is created at the production facility and the tasting room operations, and roughly 33% of the employment is generated in the field
- Total employment has surpassed the 19,500 mark in 2017

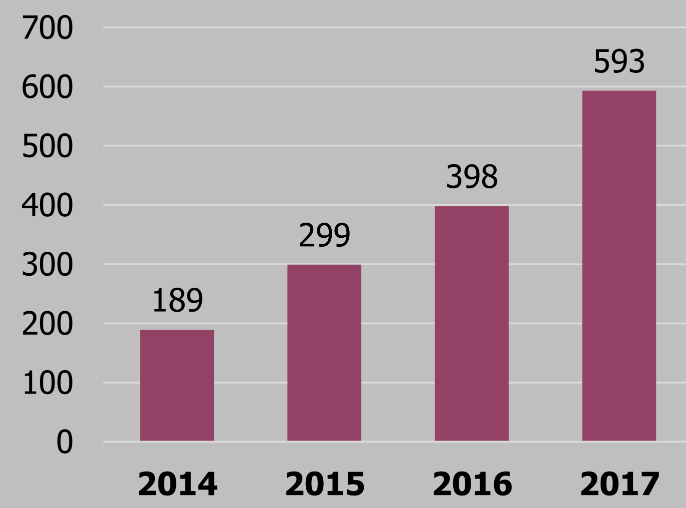
Sources: Distiller Surveys, TTB, Team Analyses

Investment in the U.S. Craft Industry Has Been on the Rise

Average Investment* of U.S. Craft Spirits Producers, 2014 – 2017
$ Thousands



Total Investment* of U.S. Craft Spirits Producers, 2015 – 2016
$ Millions



- The average investment of a U.S. craft producer has been increasing by almost 14.6% from $276.8k in 2016 to $317.3k in 2017
- Total investment has increased by 49% from $398m in 2016 to $593m in 2017

Sources: Distiller Surveys, TTB, Team Analyses. *Investments for expansions.

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Appendix

- Project Background and Craft Spirits Definition
- Craft Spirits – Selected Other Survey Results

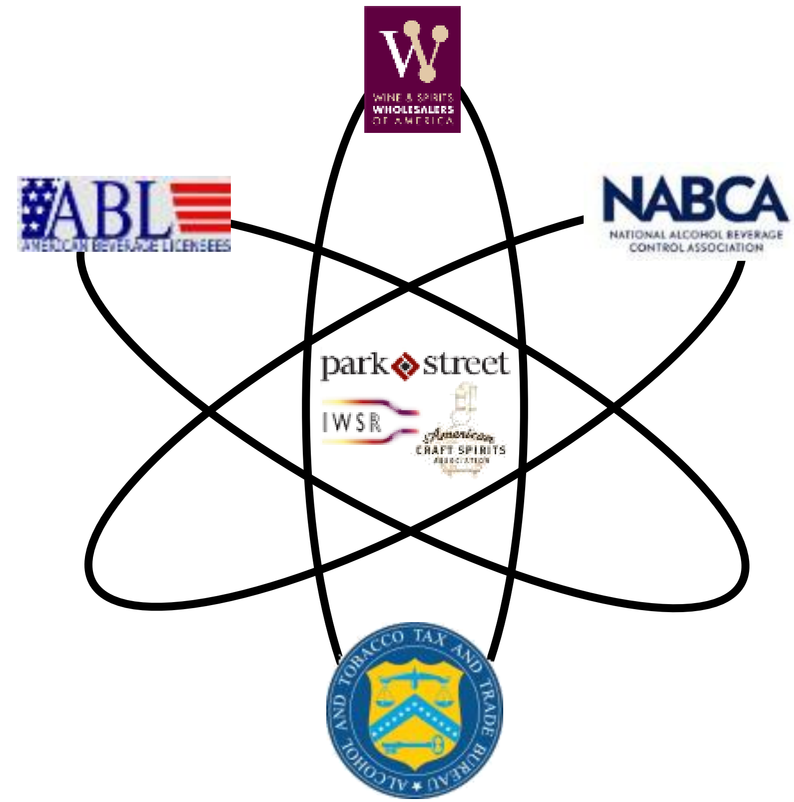
Project Background and Craft Spirits Definition

Craft Spirits Data Project - Industry Wide Collaboration

Teaming up for a common cause

The American Craft Spirits Association, International Wine and Spirits Research, and Park Street teamed up in 2015 to launch the Craft Spirits Data Project (the "Project"), a research initiative with the goal of providing a solid and reliable fact base for evaluating performance and trends in the U.S. craft spirits industry

- Major industry stakeholders such as the TTB, NABCA, WSWA, and ABL have committed resources to help the Project
- The fact base helps all stakeholders to make their respective investment cases and vastly improve an understanding of the full impact at the local, regional, and federal level
- The Project is set-up to provide a consistent fact base for all stakeholders on an ongoing basis. Update reports will be published annually



Project Background and Research Methodology

- **The project serves to:**
  - Quantify the number, size, and impact of craft spirits producers in the U.S.
  - Create a deeper understanding of the U.S. craft spirits landscape among four key groups: DSPs, wholesalers, retailers, and consumers
  - Provide findings on craft supplier best practices and success factors
- **The following information was collected** (all information was collected with the assurances of full confidentiality):
  - Data on craft distiller production size and patterns, sources of revenue, and the category's overall economic impact within the spirits industry
  - Data on craft spirits business size, patterns, and outlook on the wholesaler and retail levels (both on- and off-premise)
  - Input on craft spirits brand perceptions
- **Things to remember**:
  - When estimating the number of producers behind the U.S. craft spirits production, the Project team relied on a combination of official data released by regulatory authorities, survey data, other industry data sources both national (e.g., NABCA, ACSA) and regional (e.g., guilds), as well as interviews and team assessments using the craft distiller definition
  - In the accompanying data sets, the team assumes independent ownership as having equal or more than a 75% equity stake and/or operational control of the DSP. The team has set up a process that asks industry members to notify the ACSA of all ownership or strategy changes away from craft so the changes can be reflected accordingly in the database

Project Organizer: American Craft Spirits Association (ACSA)

The American Craft Spirits Association (ACSA) is the only registered non-profit trade association representing the U.S. craft spirits industry. Its mission is to elevate and advocate for the community of craft spirits producers. Membership in ACSA is open to anyone.

ACSA is governed by a Board of Directors elected by the eligible voting members of the Association. Voting members must be independent, licensed distillers (DSPs) annually removing fewer than 750,000 proof gallons from bond (the amount on which a federal excise tax is paid.)

ACSA was founded in 2013 by 23 founding craft distillers.

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Project Partners: IWSR and Park Street

CRAFT SPIRITS DATA PROJECT

IWSR

the Source for Wine & Spirits Analysis

The IWSR is the leading source of data and analysis on the beverage alcohol market. IWSR is the longest-running research company specializing exclusively in global alcoholic drinks. The IWSR's comprehensive database quantifies the global and local market of wine, spirits, beer, cider and prepared cocktails by volume and value, and provides insight into short- and long-term trends

park street

Park Street delivers productivity-enhancing and cost-saving back-office solutions, advisory services, and working capital to more than 4,500 alcoholic beverage brands from the U.S. and around the world. Established in 2003, the company provides a fast and reliable conduit to the U.S. and E.U. markets and a cost-effective operating platform. Park Street works with suppliers at all stages of growth and its clients range from entrepreneurial craft distillers to multi-brand global portfolios

© 2017 park street American CRAFT SPIRITS ASSOCIATION IWSR

Project Supporters: Broad Industry Collaboration

TTB: Provided Beverage Spirits Producers and Bottlers by Average Taxable Removals; agreed to change annual reporting moving forward to enable consistent fact basis

WSWA: Assisted in wholesaler survey design and execution with members

ABL: Assisted in on- and off-premise retailer survey design and execution with members

NABCA: Provided in-depth view of craft distillers using control state data

What Constitutes a Craft Spirit?

- There is no universally accepted definition of craft spirits in the industry, and the expression "craft spirit" is not protected in any way
- Given the positive trends for craft spirits from a consumer perspective (e.g., premium to other spirits, rising demand), there is a natural incentive for brands to utilize craft spirits cues and position themselves as a craft spirit
- The industry has responded with different definition attempts based on criteria for the producer of the craft spirit including production steps at the location, ownership and operational control of the distillery, subscription to an ethics code based on honesty and transparency, production methodology, and size of production
- Many of the criteria used or suggested by industry members would require a formal certification or peer approval process in order to be used as a universal base for quantification purposes
- As long as a universally accepted craft spirits certification or approval that could be used as an industry wide criteria remains unavailable, the quantification has to rely on certain verifiable quantitative metrics which are complemented by estimates to bridge gaps
- Looking at the manufacturer, size of production, ownership/control, and production specifics are criteria that could possibly be measurable and verifiable. However, the consistent collection of the data is not without barriers and could be very cumbersome, which suggests the potential use of a pragmatic approach

- U.S. craft spirits, as defined pragmatically for the purposes of the research, are distilled spirits that are produced in the U.S. by licensed producers that have not more than 750,000 proof gallons (or 394,317 9L cases) removed from bond, market themselves as craft, are not openly controlled by a large supplier, and have no proven violation of the ACSA Code of Ethics

Craft Distillers by Size – Classification Definition

	Range of gallons removed from bond annually*	Range of 9L cases removed from bonds annually*	Characteristics
Large craft distiller	100,001 – 750,000	52,577 - 394,317	▪ Often nationally distributed ▪ If negative cash flow, then by choice in favor of investment
Medium-size craft distiller	10,001- 100,000	5,259 – 52,576	▪ Often regionally distributed ▪ Often still cash flow negative
Small craft distiller	1- 10,000	1 - 5,258	▪ Often only locally distributed ▪ If no on-premise business, typically cash flow negative

Sources: TTB, Team Analyses' *Assuming on average 80 proof alcohol content; for purposes of the analysis removed from bond equals sales

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Craft Spirits - Selected Other Survey Results

Industry Recommendations for Craft Spirits Producers from Retailers, On-Premise

On-premise Retailer Suggestions to Craft Spirits Producers
% Agree

- On-premise retailers suggest that producers invest more resources against the consumer, both in terms of tastings, other consumer pull strategies, and branding
- Investments in staff training as well as more frequent market visits are also highly recommended
- From a product perspective, on-premise retailers recommend a focus on fewer products and higher quality

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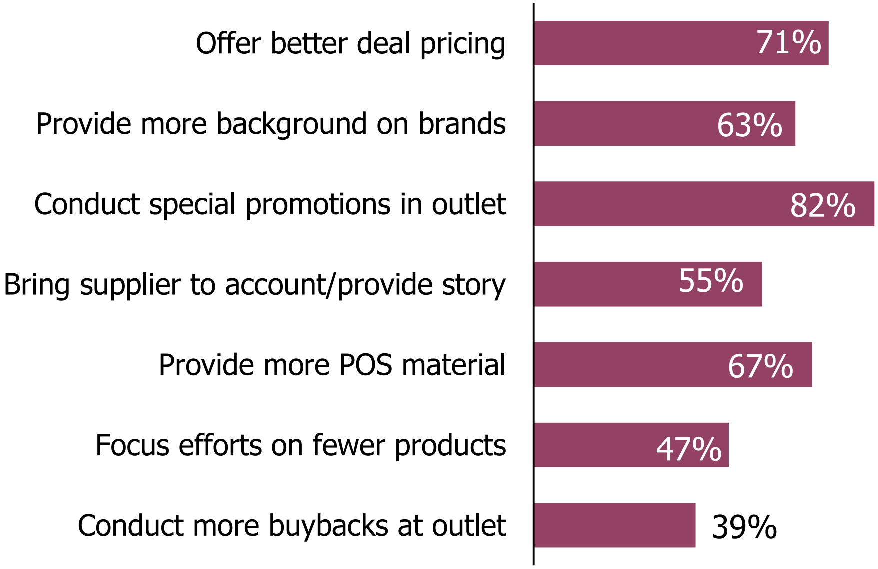
Industry Recommendations for Wholesalers from Retailers, On-Premise

On-premise Retailer Suggestions to Wholesalers
% Agree



- On-premise retailers suggest that wholesalers invest more resources against the accounts
  - Better deal pricing
  - Special promotions in the accounts
  - More buybacks (to a smaller degree)
- Investments in staff training as well as more frequent market visits by the craft spirits producer are also highly recommended
- From a product perspective, on-premise retailers recommend a focus on fewer products

Sources: ABL Retailer Surveys, Team Analyses

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Industry Recommendations for Producers from Retailers, Off-Premise

Off-premise Retailer Suggestions to Craft Spirits Producers
% Agree

- Off-premise retailers suggest that producers invest more resources against the consumer, both in terms of tastings, other consumer pull strategies and branding
- Investments in staff training as well as more frequent market visits are also highly recommended
- From a product perspective, off-premise retailers recommend a focus on fewer products and higher quality

Sources: ABL Retailer Surveys, Team Analyses

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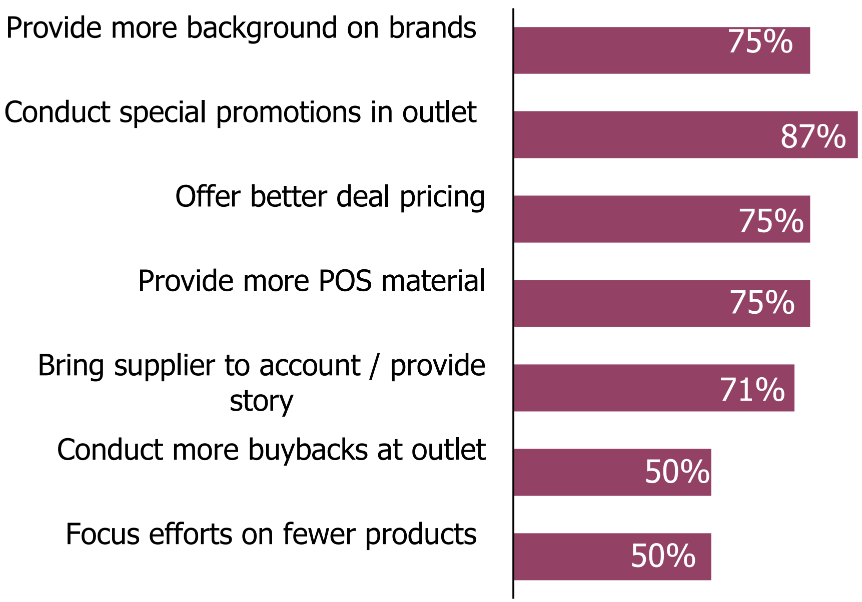
Industry Recommendations for Wholesalers from Retailers, Off-Premise

Off-premise Retailer Suggestions to Wholesalers
% Agree



- Off-premise retailers suggest that wholesalers invest in providing more background on the brands as well as more frequent market visits by the craft spirits producer
- Off-premise retailers also recommend higher investments against the accounts
  - Special promotions in the accounts
  - Better deal pricing
  - More POS material
  - More buybacks (to a smaller degree)
- From a product perspective, off-premise retailers recommend a focus on fewer products

Sources: ABL Retailer Surveys, Team Analyses

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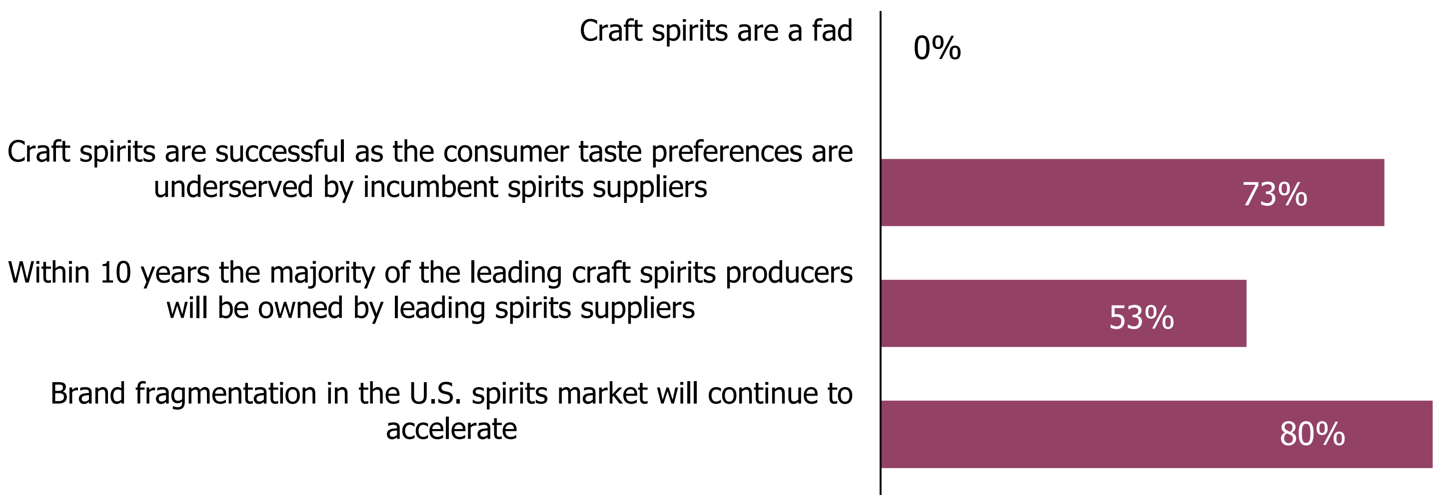
Craft Spirits Industry View from Wholesale Tier Perspective

Wholesaler View on Craft Spirits Industry
% Agree



- Wholesalers see the distilled spirits market continuing on the pathway to a more fragmented marketplace and believe that craft spirits are not a fad
- The majority of wholesalers believe that the majority of craft spirits producers will be acquired by larger suppliers

Sources: WSWA Wholesaler Surveys, Team Analyses

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Industry Recommendations for Craft Spirits Producers from Wholesalers

CRAFT SPIRITS DATA PROJECT

Wholesaler Suggestions to Craft Spirits Producers
% Agree

- Wholesalers recommend higher investments against the consumer
  - Consumer pull strategies
  - Better branding
  - Consumer tastings
- Wholesalers also recommend higher investments against the trade
  - Market visits
  - Training of salesforce
  - More POS material
  - Supplementary sales resources in market
  - More programming
- From a product perspective, wholesalers recommend fewer products and higher quality

Sources: WSWA Wholesaler Surveys, Team Analyses

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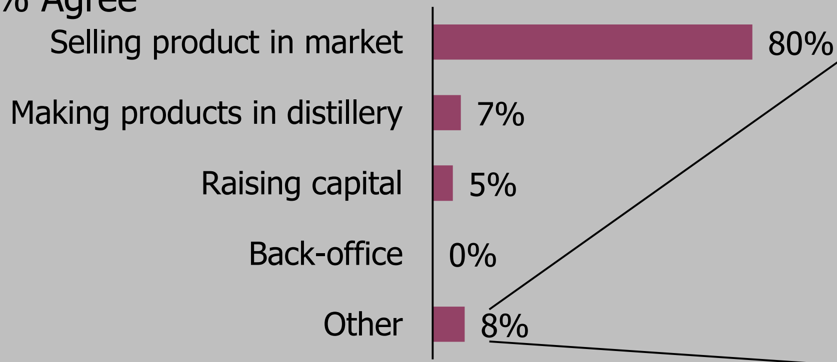
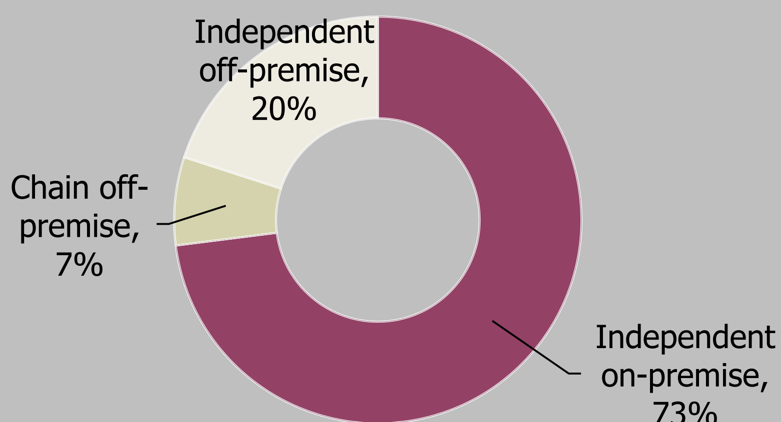
Industry Recommendations for Craft Spirits Producers from Wholesalers

If you were a craft producer, where would you try to spend more time?
% Agree



- Educating consumer, retailer, and sales force. Engage with all tiers and insure a clear consumer platform
- Making the product as well as telling the story in the market
- Creating consumer pull/developing relationships with key gatekeepers

If you were a craft producer, which type of accounts would you target first?
% Agree



- Wholesalers recommend craft spirits producers to increase their time in the market
- Wholesalers believe that craft spirit producers should initially target independent on-premise accounts when coming to market, then independent off-premise accounts

Sources: WSWA Wholesaler Surveys, Team Analyses

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