

THE CRAFT SPIRITS DATA PROJECT

IMAGE DATA SOURCED FROM THE CSDP INAUGURAL CRAFT SPIRITS ECONOMIC BRIEFING

WRITTEN BY CHRIS LOZIER

The distilling industry is expensive, highly regulated, and challenging to navigate, making progress hard-earned for craft distillers. And when it comes to changing legislation, raising capital, or otherwise trying to open, expand, or improve their distillery, convincing gatekeepers and regulators that lowering barriers will benefit them and their community is tough to do without data.

“Craft spirits have been a very important part of the industry for the last 10 years, but there’s been a relative lack of actual data to prove it,” explains Paul Hletko, founder of Few Spirits (Evanston, IL) and president of the American Craft Spirits

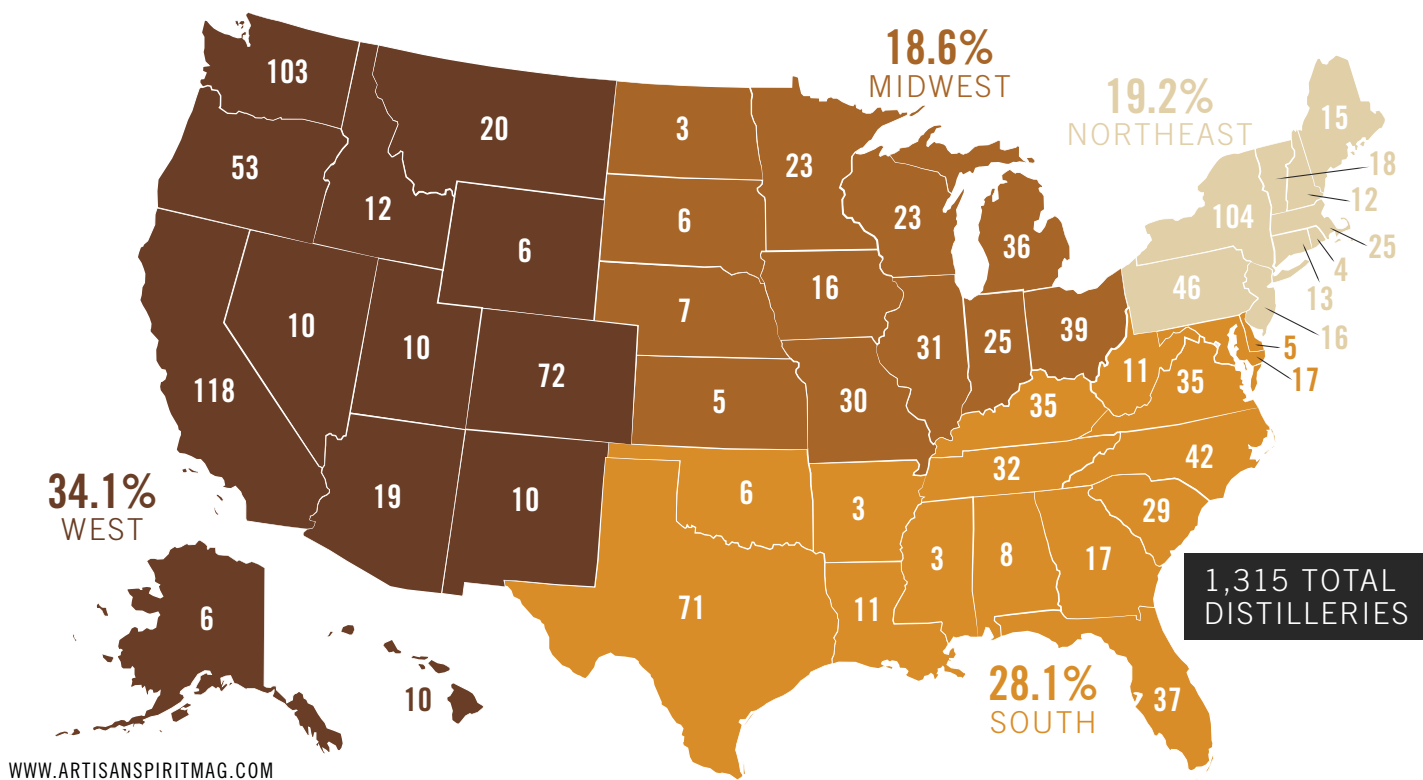
Association (ACSA). That’s why ACSA, Park Street, and International Wine & Spirits Research (IWSR) launched the Craft Spirits Data Project in 2015, and now the results are in. Some of the key findings:

- As of August, 2016 there were 1,315 active “project-defined” craft producers in the U.S.
- Those craft producers sold 4.9 million cases, with a retail value of \$2.4 billion in 2015.
- Craft’s project-defined market share climbed to 3 percent by value, 2.2 percent by volume in 2015.

The Project unofficially began at the Austin, Texas ACSA Convention in February 2015. ACSA leadership pitched the idea to Harry Kohlmann, Ph. D., co-founder and CEO of Park Street, a firm that provides back office, advisory, and working capital assistance to over 3,000 alcohol beverage brands. Kohlmann and ACSA worked to form a plan, and by October the Project was formalized.

Kohlmann and Park Street worked on the Project pro bono from start to finish, ACSA sponsored it, set up meetings with TTB and others, and collected data from members, and IWSR provided data collection and processing in exchange for the right to

NUMBER OF ACTIVE CRAFT DISTILLERS BY STATE AND REGION AS OF AUGUST 2016



sell their own private studies based on the Project. Other partners included TTB, Wine & Spirits Wholesalers of America (WSWA), American Beverage Licensees (ABL), National Alcohol Beverage Control Association (NABCA), Nielsen, Liquor.com, and Acturus.

All the research gathered through August 2016 was included in the Project release this October. Periodic updates are planned for certain data categories, and a complete update and upgrade of the whole economic dataset will be released annually.

WHAT IS A CRAFT PRODUCER?

In order to begin the Project, researchers had to define the “craft universe,” which was not simple given the many definitions of “craft.”

“If everyone understands something differently, how do you measure it?” asked Kohlmann. He and other researchers surveyed consumers and industry members and compiled a list of state and guild definitions, and from the commonalities and ACSA’s guidelines they defined the universe like this:

“For the purposes of the Project, U.S. craft spirits were defined as 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 controlled by a large supplier, and have no proven violation of the ACSA

Code of Ethics.”

While that definition will please some and upset others, without a threshold the Project would have been impossible.

“We took the criteria that are measurable, and put a couple of elements around it with regards to the voluntary disclosure,” explained Kohlmann. “And if somebody claims they’re craft, we believe them until it’s proven otherwise, if they are within the certain boundaries that we set.”

Also important, presenters noted, is that this definition was created only for the Project, and it does not validate a producer as craft for any other purpose.

With the universe defined, researchers gathered data from surveys, databases, guilds, voluntary DSP disclosures, and other sources, which gave them a largely consistent and cross-referenceable overview of the industry.

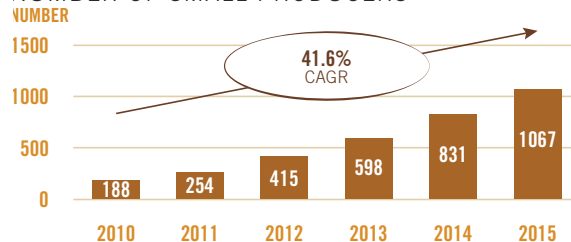
“It took so much work to build up the trust among all of our distillers to actually feel comfortable in providing this information,” explained ACSA executive director Margie A.S. Lehrman, who said that Nicole Austin, formerly of Kings County Distillery (Brooklyn, NY), was instrumental in facilitating that work. Lehrman says that at nearly every step, people told them the Project was “impossible,” but ACSA believed it could happen.

While the data they gathered looked good, they wanted confirmation, so Lehrman reached out to TTB contacts she had developed working through Lehrman Beverage Law. The researchers sent TTB a large list of data and tax requests, and after several meetings and long negotiations TTB gave them a bracketed tax dataset, which has never been done before.

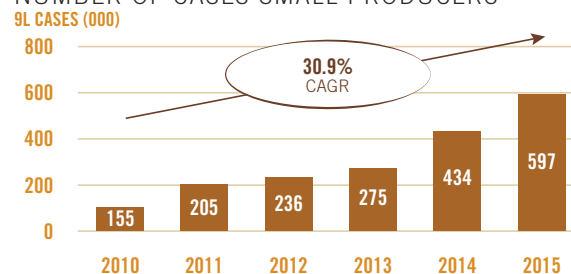
The brackets are large enough to protect individual company tax data,

SMALL CRAFT PRODUCERS HAVE BEEN GROWING WELL

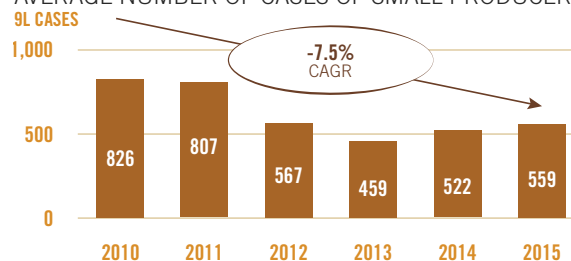
NUMBER OF SMALL PRODUCERS



NUMBER OF CASES SMALL PRODUCERS



AVERAGE NUMBER OF CASES OF SMALL PRODUCERS



but they do give some helpful delineation by separating the producer universe into three categories measured by proof gallons removed from bond, which Project researchers converted into 9-liter cases based on an 80-proof ABV average:

- **SMALL CRAFT DISTILLER**
1 - 10,000 pg
1 - 5,258 cases
- **MEDIUM CRAFT DISTILLER**
10,001 - 100,000 pg
5,259 - 52,576 cases
- **LARGE CRAFT DISTILLER**
100,001 - 750,000 pg
52,577 - 394,317 cases

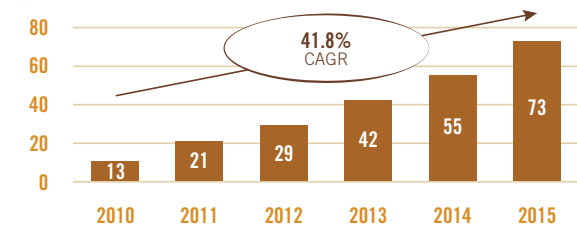
Once the Project crew obtained that tax data, they triangulated it against their own research and found that they had been about 95 percent accurate. “Without that tax data,” Kohlmann explains, “it would have been really difficult to feel comfortable about the quality of the data.”

ACSA’S CODE OF ETHICS

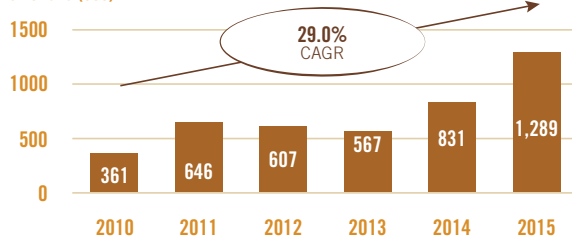
“We operate in an honest, transparent and non-deceptive fashion. We inform consumers truthfully and accurately about the sources and methods used to make our spirits through our labels, materials and communications. We expect fair dealing and respect amongst members. We obey all federal, state, and local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

MEDIUM-SIZE CRAFT PRODUCERS HAVE BEEN GROWING WELL

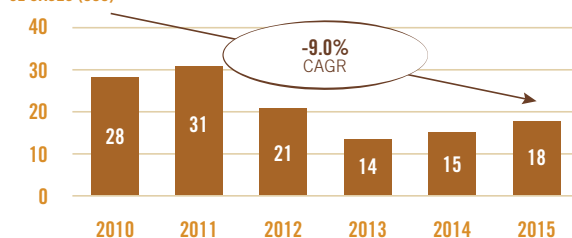
NUMBER OF MEDIUM-SIZE PRODUCERS
NUMBER



NUMBER OF CASES MEDIUM-SIZE PRODUCERS
9L CASES (000)

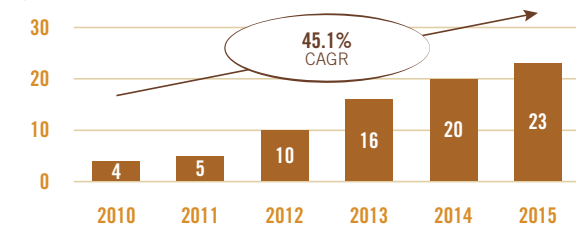


AVERAGE NUMBER OF CASES OF MEDIUM-SIZE PRODUCERS
9L CASES (000)

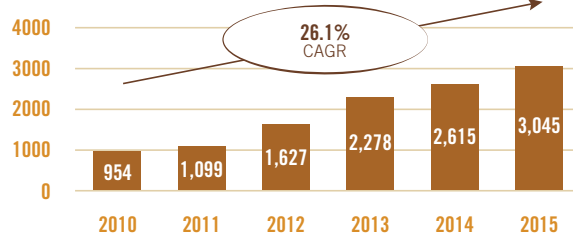


LARGE CRAFT PRODUCERS CROSSED THE 3 MILLION CASE MARK IN 2015

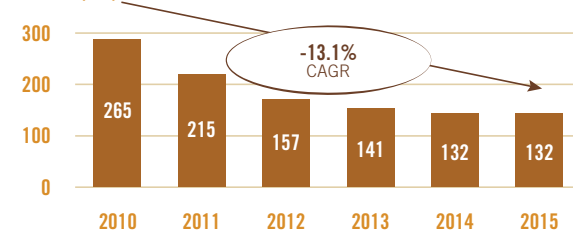
NUMBER OF LARGE PRODUCERS
NUMBER



NUMBER OF CASES LARGE PRODUCERS
9L CASES (000)



AVERAGE NUMBER OF CASES OF LARGE PRODUCERS
9L CASES (000)



TTB plans to provide this bracketed tax data to the industry annually now, which the Project crew applauded them for. Lehrman and Kohlman say several people at TTB were extremely helpful, assisting in ways they were not required to.

THE CURRENT INDUSTRY LANDSCAPE

As of August, 2016 there were 2,006 total licensed DSPs, 1,483 of which were project-defined craft producers. After removing the 168 in planning, it was determined there were 1,315 active craft producers in the U.S.

That number was used for parts of the project, but much of the research is based on year-end 2015 data. At year-end 2015, there were 1,163 craft producers — 23 large, 73 medium, 1,067 small — and their sales were concentrated. More than 60 percent of total sales came from just 2

As of August, 2016 there were 2,006 total licensed DSPs, 1,483 of which were project-defined craft producers.

percent of the producers, while the small producers, who represent 91.7 percent of the craft producer universe, sell just 12.1 percent of the cases.

For all three sizes, the number of producers and cases grew rapidly between 2010 and 2015, while the number of cases per producer decreased at a lower rate. Since more producers are entering the market, the average production per producer has fallen (down to 559 cases for small producers), which is natural given the often lower production of new entrants. Low average volumes also suggest that there is a lot of aging product yet to be

released.

As those entrants increase production and release aged product, however, and as more entrants start out with larger production numbers, the average cases per producer volume should increase, and in some cases it already has. In fact, volume growth is expected to outpace entrant growth soon, which researchers call the inflection point.

WHAT'S NEXT?

Between 2010 and 2015, the number of producers grew at an aggressive compound annual growth rate (CAGR) of 41.6 percent. **In only five years, 959 new producers opened, 879 of which were small (91.7 percent), and 257 joined just in 2015.**

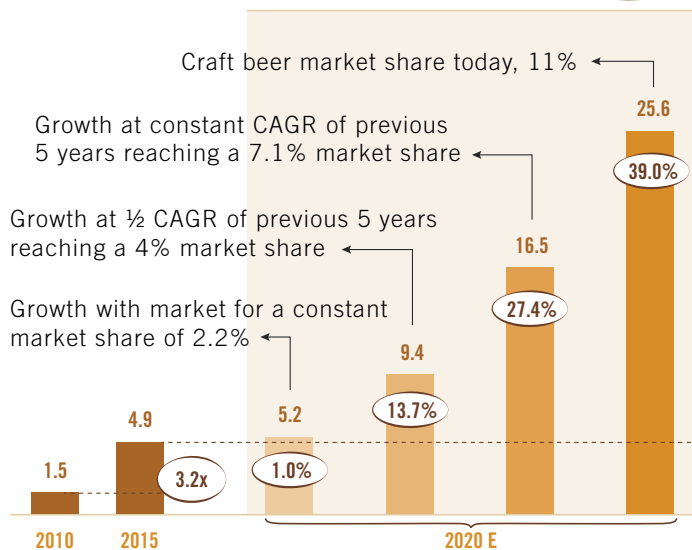
January through August, 2016 brought 152 new producers at an annualized growth of 19.6 percent, which projects nearly 1,400 total producers by year-end. Using that projection, the five-year CAGR

CRAFT COULD CONTRIBUTE MUCH MORE TOWARD FRAGMENTATION IN FUTURE YEARS

9L CASES (MILLIONS)

U.S. MARKET SIZE
SCENARIOS FOR 2020

2015 - 2020
CAGRs



will actually be higher than 41.6 percent between 2011 and 2016.

That growth percentage should decelerate though, even if the number of new entrants remains steady or increases, simply because the dataset is getting larger and shows less change. Assuming the current 19.6 percent rate, the number of producers would reach 2,847 by 2020, but many speculate that a more reasonable estimate may be around 2,000.

In the future, focus may shift from the number of producers to the volume produced. The graph above provides projected scenarios of what future growth could look like in terms of market share. Project researchers believe that market share will likely grow from the current 2.2 percent by volume to between 4 and 7.1 percent by 2020 (potentially 16.5 million cases), though of course anything could happen. For reference, craft beer held about 12 percent of the beer market at year-end 2015 according to the Brewers Association.

SOCIAL AND ECONOMIC IMPACT

Project data supports the popular belief that craft spirits have helped to drive premiumization, a trend that has affected

the entire spirits market. While craft's volume market share is 2.2 percent, the value is 3 percent, meaning the average price per bottle is higher and consumers are willing to pay the difference.

Craft spirits retail sales were \$2.4 billion in 2015, the majority of which (approximately \$1.3 billion) likely went to taxes based on ACSA's

estimate that taxes typically account for 54 percent of spirits prices. Most of that tax is Federal Excise Tax (FET), and according to ACSA, "a craft spirits producer pays 5.4 times more FET than a craft brewer, and 16.4 times more FET than a small winery, for equal quantities of beverage alcohol."

Beyond sales and tax revenue, craft producers are pouring a lot of money into their communities, investing \$299 million in 2015. Average investment per producer is \$256,000.

The craft industry also has more than 12,000 full-time employees now, two-thirds of which work at production facilities and tasting rooms while the other third works in the field. On average, each producer employs 9.2 people.

"The employment in this industry has doubled in the last two years," said Kohlmann, who explains that based on a market-share-to-employee ratio, craft producers often employ at least 100 times more people than large industry members.

"If you think about being a regulator and thinking about job growth ... this is an engine," he said. "This is not just craft distilling, this is all kinds of local businesses, and you look at all kinds of fast-moving goods here, this is a playbook to create employment here in the United States."

MARKETS ARE SIZE-DEPENDENT

The leading market for a craft producer seems to depend on their size. For large producers, out-of-state markets account for 55 percent of sales. Exports also play a role, and of the 523,000 cases exported by craft producers in 2015, 95 percent came from large producers.

Medium producers do well with out-of-state sales too, but in-state sales account for the majority of their business at 59 percent. The other 5 percent of the export market was theirs.

For small producers, in-state sales are crucial, accounting for 92 percent of their business. Further, **a quarter of all small producer sales occur at the DSP**, emphasizing the importance of tasting room sales.

"We know that direct sales are incredibly important for the small craft spirits producer," said Lehrman, "so this gives new evidence for DSPs to go into the state and help push legislation that can make a difference for them to be able to have bottle sales at their tasting room, and also perhaps liberalize some of the tasting room rules."

BEYOND THE NUMBERS

Craft producers, retailers, and wholesalers were surveyed for the Project, and their answers offer insights into the current state of the industry and what to expect in the future.

The majority of producers said they were not satisfied with current legislative efforts, commonly citing tax reduction, increased efficiencies, and reduced regulation as focus areas. Many are frustrated by the lack of parity with other beverage alcohol producers, some expressed dissatisfaction with the performance of their wholesalers, and some plan to shift their sales focus from off-premise accounts to on-premise.

Wholesalers largely said craft producers should target on-premise markets first, then move to independent off-premise, and two-thirds said they would spend more time selling their product in-market

if they were a producer. The majority of wholesalers also anticipate more brand fragmentation, and believe the majority of leading craft producers will be acquired by large spirits suppliers within 10 years.

Wholesalers, on-premise, and off-premise retailers had different advice for craft producers, but they all agreed on two things: Producers need to focus on making fewer, but higher-quality, products, and they need to offer more support to their wholesale and retail partners to increase consumer pull.

According to consensus, craft producers may be wise to focus on on-premise accounts, concentrate their efforts on making high-quality, recognizable products, and spend more time and resources encouraging people to buy those products.

MOVING FORWARD


“Having practiced in the area of alcohol law, I will tell you that what we are doing today makes a great impact,” said ACSA’s Lehrman at the Project’s October release,

“at a level you might not even think of.”

In light of the Craft Spirits Data Project’s findings, it is clear that craft spirits producers are generating a great amount of social and economic benefit in their communities, states, and country. And considering that half of the 1,315 craft producers are located in just 10 states — states that were willing to revamp Prohibition-era legislation earlier than many others — the numbers suggest that improving the business climate for craft spirits producers creates much more economic value than stifling their growth with oppressive regulation and taxation. As craft producers expand, they will generate even more jobs and revenue, and create additional business for their local farmers, contractors, design firms, and other providers.

Speaking alongside Lehrman, Kohlmann, and other presenters at the October release was past ACSA president Tom Mooney, co-owner and CEO of House Spirits Distillery (Portland, OR). Mooney called the data “astounding, even at this very early level,”

saying the industry is even bigger and more influential than he and many others thought.

“As all of you are either a craft distiller or know a craft distiller, you’ll know that we’re not short on opinions, but at some point you need some data to back up those opinions,” Mooney said with a laugh. “With this data, we can go to the world, whether it’s to our commercial partners, or our legislative affairs efforts in Washington, or at the state level, or at the city level, and really address those remaining obstacles, that if taken out of the way will cause some of the data you see today to very quickly become twice, three times, four times what we’re seeing — in terms of industry impact, in terms of jobs, in terms of investment — all things that the economy needs and that the consumer is driving.” 

A free copy of the October Project briefing is available courtesy of ACSA, IWSR, and Park Street. Find it at www.americancraftspirits.org under the “Media - News” section or by emailing info@parkstreet.com.



Cooper's Reserve Barrels

Build a unique barrel program with our Cooper's Reserve barrel. Choose wood types, grain, char levels and toasting options to achieve your perfect vision and push your brand forward.

www.iscbarrels.com

Chad Spalding • 270.699.1557
chad.spalding@independentstavecompany.com