The U.S. Craft Distilling Market: 2017 Update

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This brief is an update to the White Paper I released in April, 2012, "The U.S. Craft Distilling Market: 2011 and Beyond," and the annual updates that followed.

The original paper and subsequent updates are available here: http://bit.ly/HxUwj1.

Introduction

The US Craft Distillery market has not only continued its torrid growth, but looks to build on existing numbers with an unprecedented increase in new DSP listings in 2017. The number of Craft Distilleries has blown through the 1000 mark, and the future shows no let-up…

On current trends we will have 2000 operating Craft Distilleries by 2020.

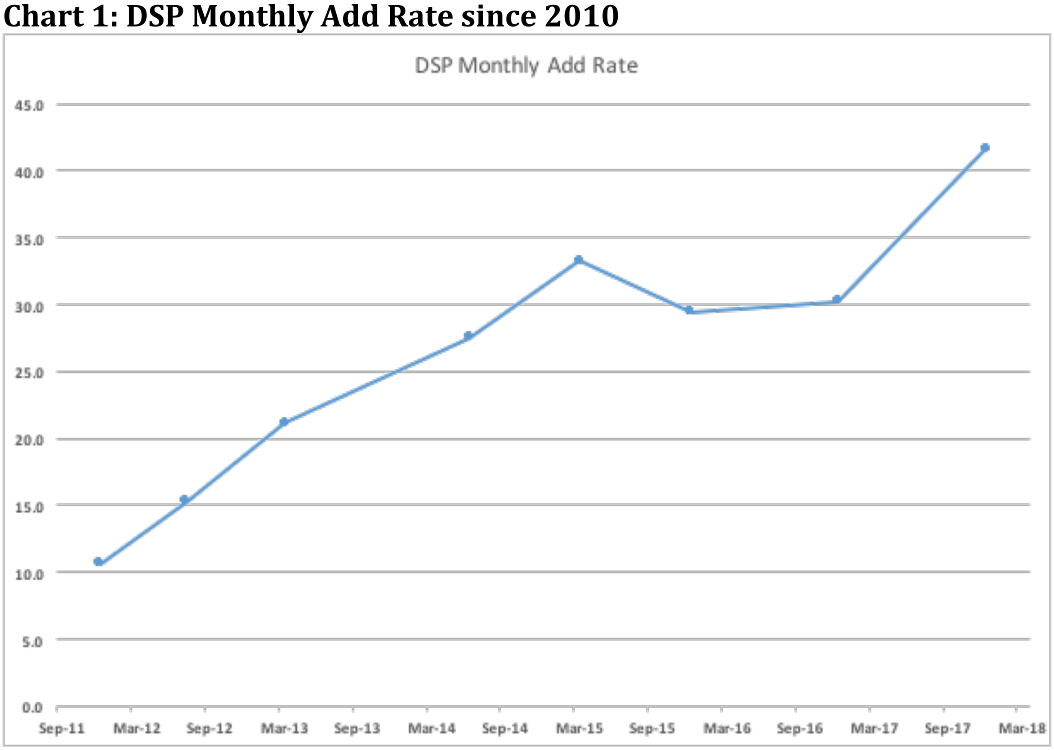
We base our numbers on a rigorous analysis of *all* listings in the ADI's (American Distilling Institute) annual Directory, and selective analysis of the DSP listings in the TTB "Producers & Bottlers" file available online. This year we also did a full analysis of the 2015 new DSPs, whether ADI-listed or not, to ensure the accuracy of our statistics. We believe this produces the most accurate estimate of the true number of operating, production craft distilleries in the United States.

This year we distinguish between those distilling spirit from raw ingredients "Craft Distilleries"), and those infusing liqueurs or Amari, or blending from spirit made elsewhere ("Other Craft Producers"). **At year end 2017 we estimate 1400 Craft DSPs, including 1200 Craft Distilleries and 200 Other Craft Producers.**

DSP Listings

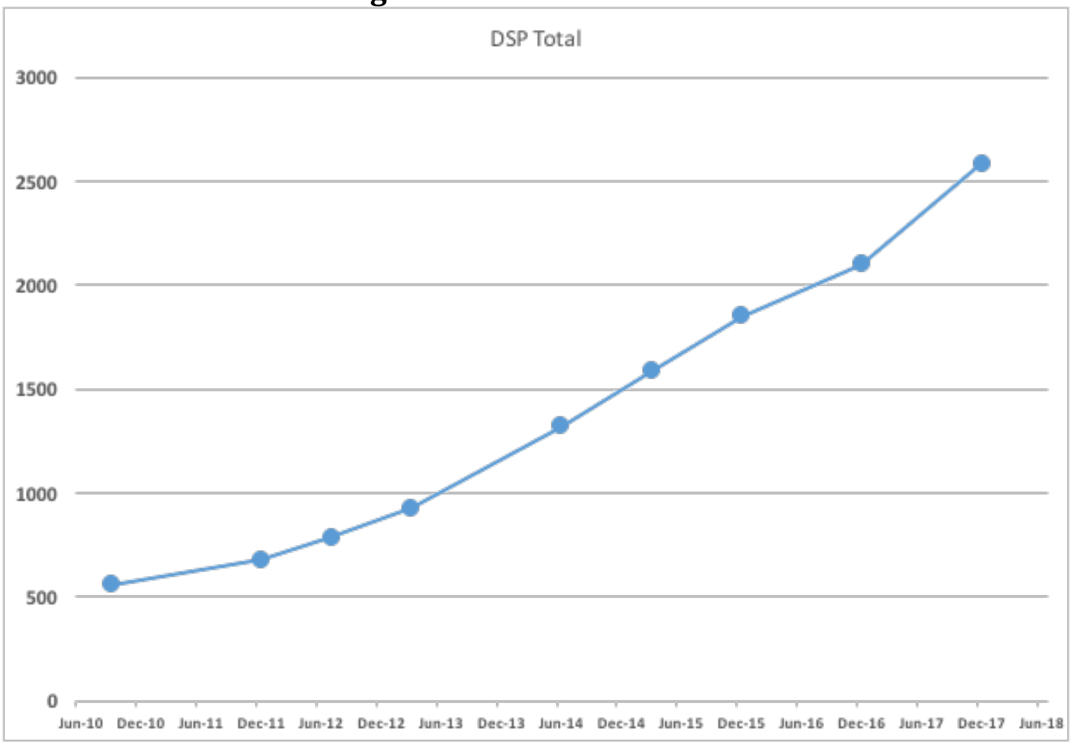
The rate of new DSP formation has increased from its recent plateau of about 350/year to **over 500/year in 2017**. There are now 2 DSPs being issued every working day.

Chart 1: DSP Monthly Add Rate since 2010



With new DSPs being added at an increasing rate, total DSPs have been rising at the same kind of exponential growth rate as operating Craft Distillers.

Chart 2: DSPs Outstanding 2010-2017



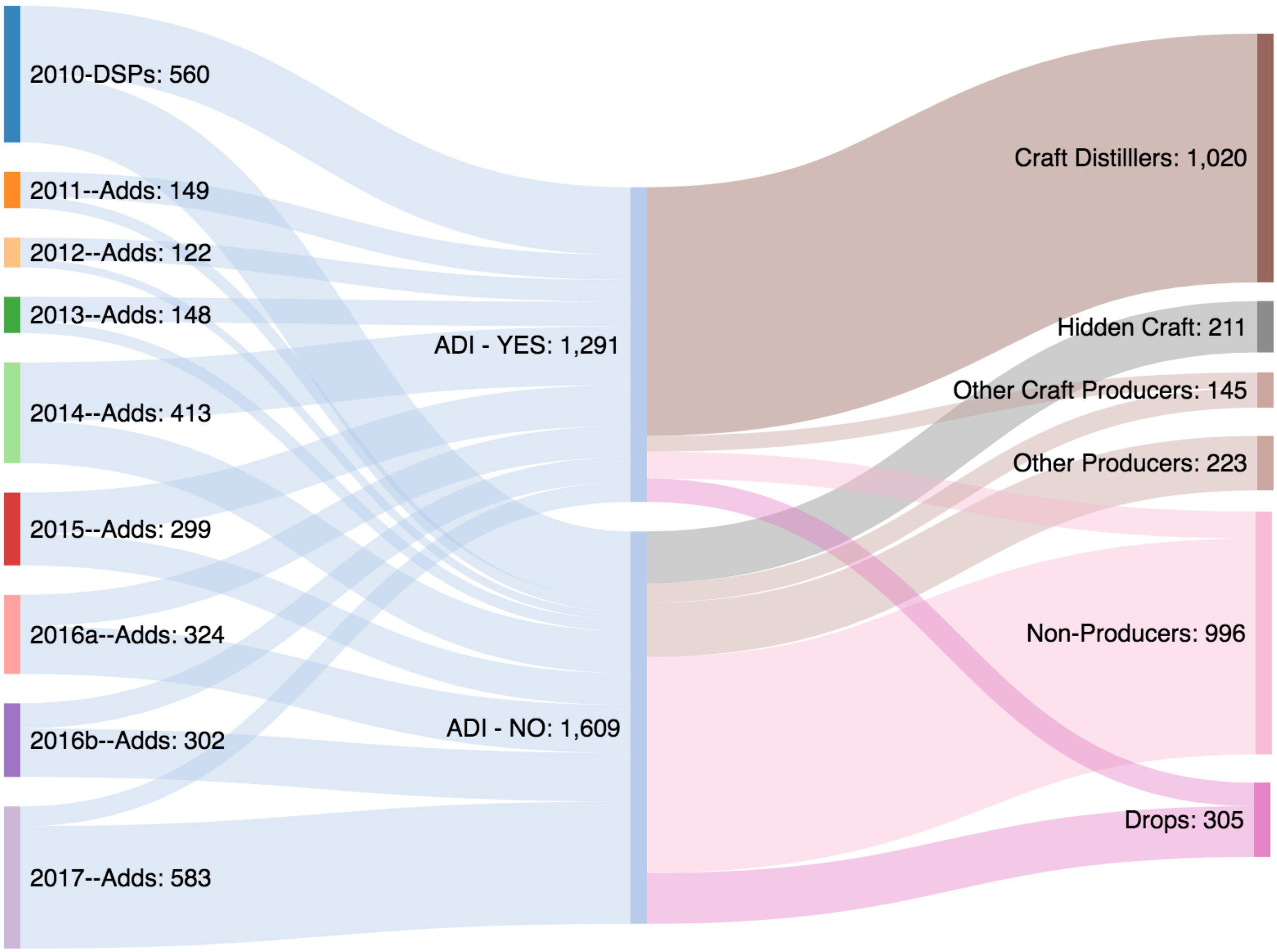
DSP stands for Distilled Spirits Plant and we use it to mean the TTB Permit of the same name. Why are DSPs important? All spirits manufacturers in the United States require a DSP Permit to process beverage alcohol. So, listings in the ADI Directory or State Guilds without a corresponding DSP are guaranteed to be non-producers. However, not all DSP holders are "Distillers" in the sense that we normally associate: making spirit alcohol from fruit or grain mash.

Our analysis classifies DSP holders into several categories. First, we see whether the DSP has been listed in the ADI Directory. The ADI has published their Directory annually since 2006, providing a consistent benchmark of listings through time. We find that a significant majority of Craft producers become ADI-listed within a couple years of beginning production. We then classify them into the following categories:

- "Craft Distillers" are ADI-listed DSPs making spirit from raw materials
- "Hidden Craft" are Non-ADI-listed DSPs making spirit from raw materials
- "Other Craft Producers" are infusers, blenders, rectifiers, and other Craft DSPs who are manufacturing with sourced spirit.
- "Other Producers" are Major beverage alcohol companies (Diageo, Beam-Suntory, Korbel, etc.), Co-packers, and other non-Craft manufacturers (RTD, etc).
- "Non-Producers" are active DSPs who have not (yet) begun production
- "Drops" are former DSPs who do not have an entry as-of January, 2018

We base our classification of non-ADI holding DSPs on previous sampling of several entry cohorts, and a full analysis of the 299 DSP Adds in the 2015 cohort. We chose to look at 2015 because it straddles the earlier and more recent cohorts. This analysis yields the following path diagram for the 560 DSPs in our initial panel and the 2300 Adds since then.

Chart 3: Outcome Paths of 2900 DSPs Listed 2010-2017



While this "wide-angle" view provides significant insights just by itself, looking more closely at the development of the market through time yields better conclusions.

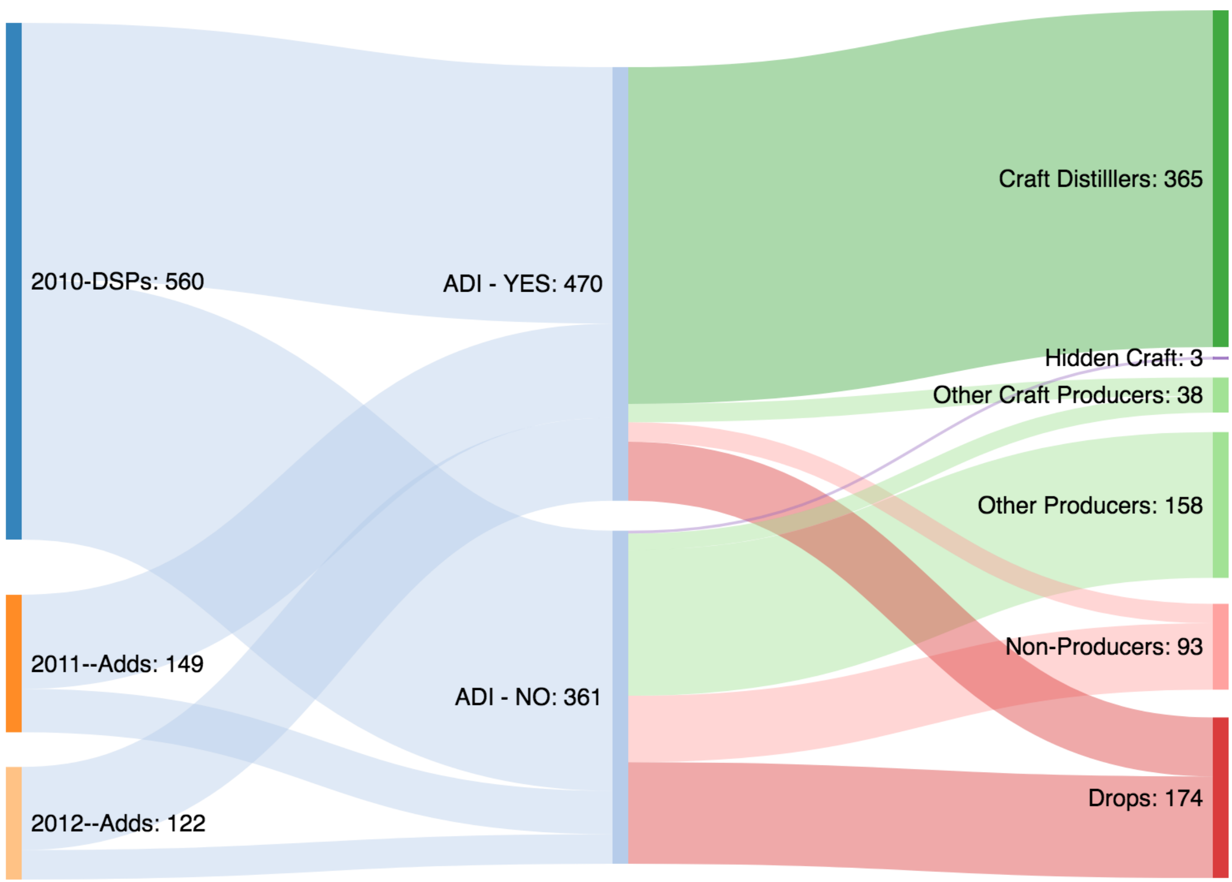
Chart 4 below shows only the 2010 DSP listings and 2011-12 Adds. This group has had plenty of "seasoning" after appearance to make these inferences:

1. Virtually all of the Craft entrants are observed.

2. Very few ADI-listed Non-Producers remain
    a. After 5 years they typically drop or get into production

3. There may be a small number of Hidden producers aging spirit for later release

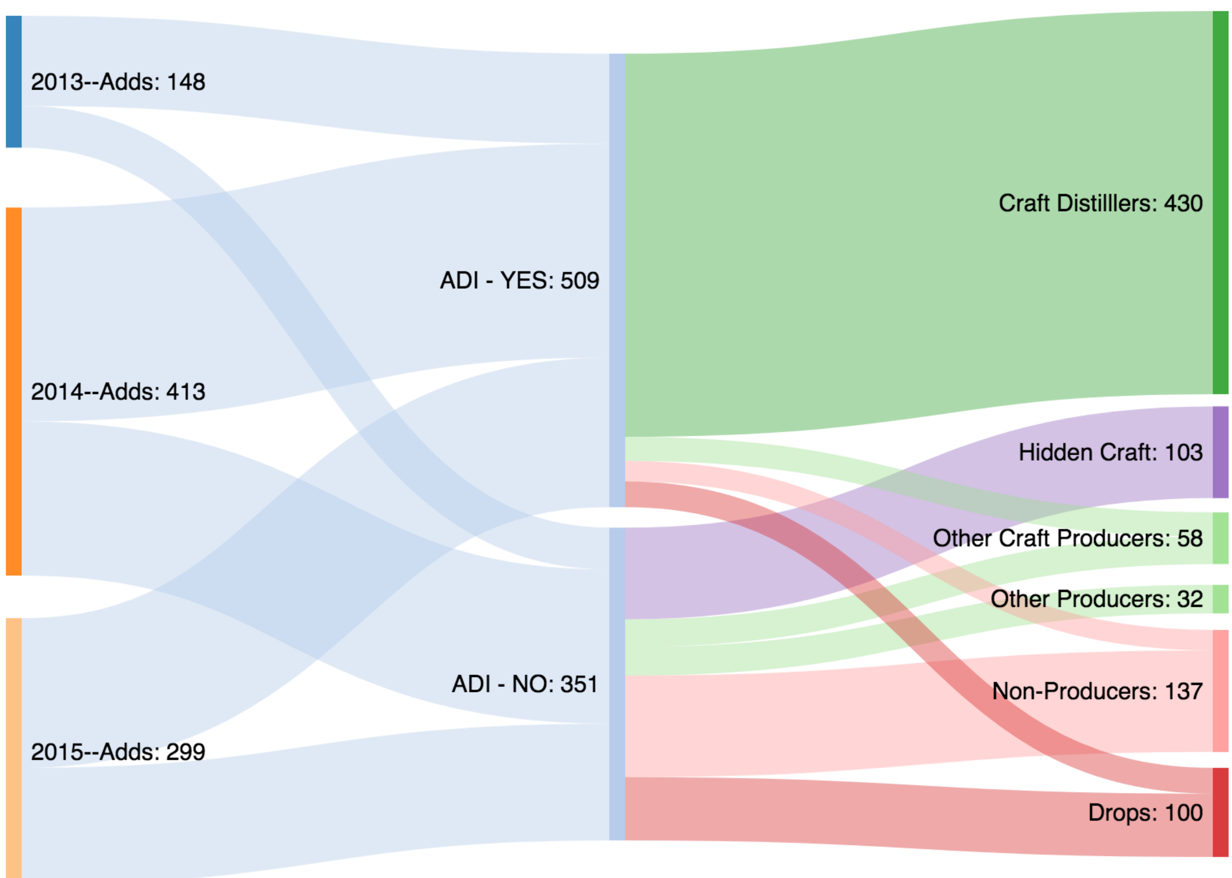
Chart 4: Outcome Paths DSPs Listed 2010-2012



As we move into the thick of the middle set in Chart 5, we see DSPs making the transition from Permit to ADI Directory listing to production. The vast majority of ADI Directory-listed DSPs from this period are producers. One point: a dropped DSP does not (necessarily) mean a vanished company. We have seen many distilleries change location (including some to other states!), which often leads to a new DSP in the new location and a dropped DSP in the old.

However, the disparity between ADI-listed DSPs and non-ADI-listed ones starts to manifest, also. As time goes on the Hidden producers become seen, and the Non-Producers go on to become either Producers or Drops.

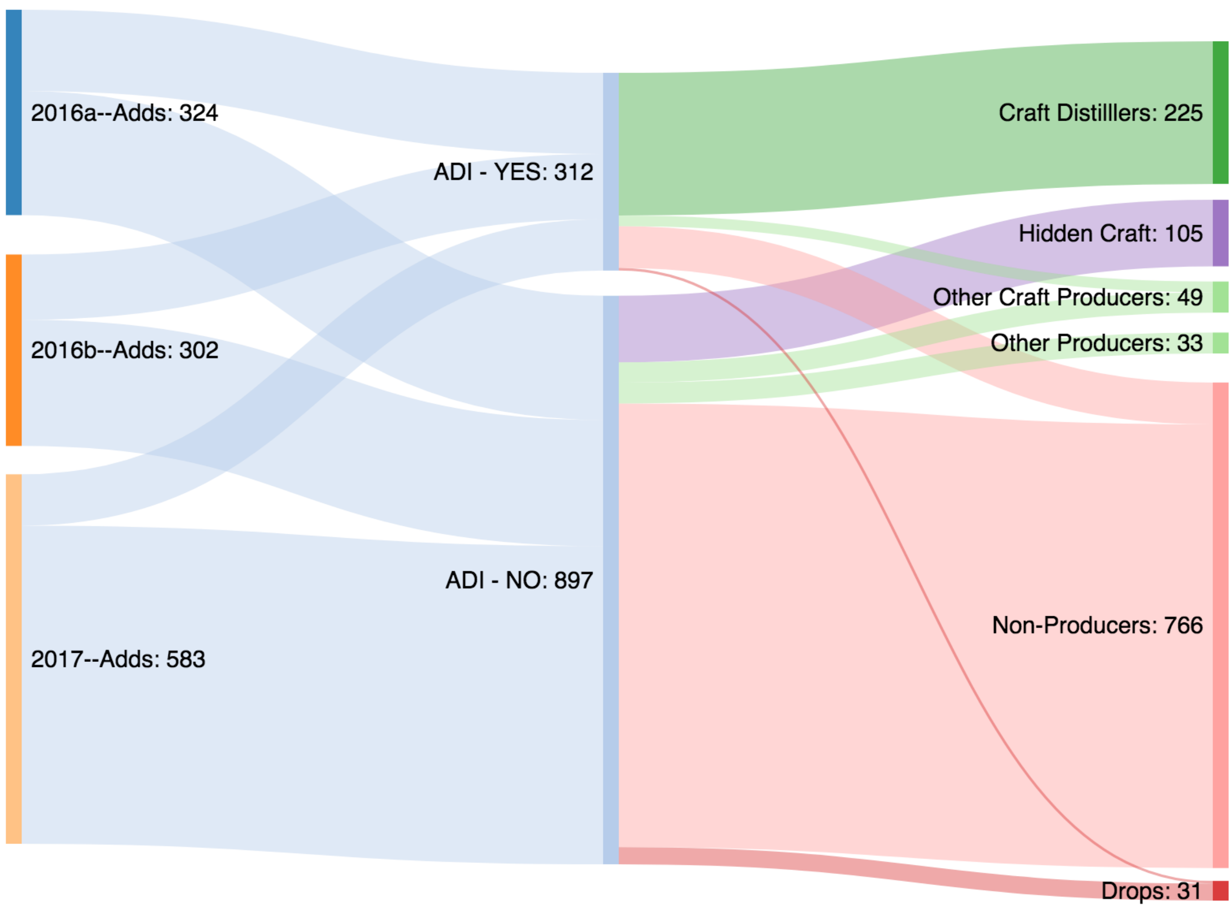
Chart 5: Outcome Paths DSPs Listed 2013-2015



With the youngest set of DSPs in Chart 6 we see the extraordinary potential waiting in the wings. The 2017 cohort of 583 Added DSPs is larger than the entire set of listings in 2010!

While only a handful of the 93 Non-Producers from 2012 and prior will become producers, we can say with high confidence that many of the more recent 766 Non-Producers will go on to enter the market. We also see with this young cohort that hardly any Drops have registered.

Chart 6: Outcome Paths DSPs Listed 2016-17

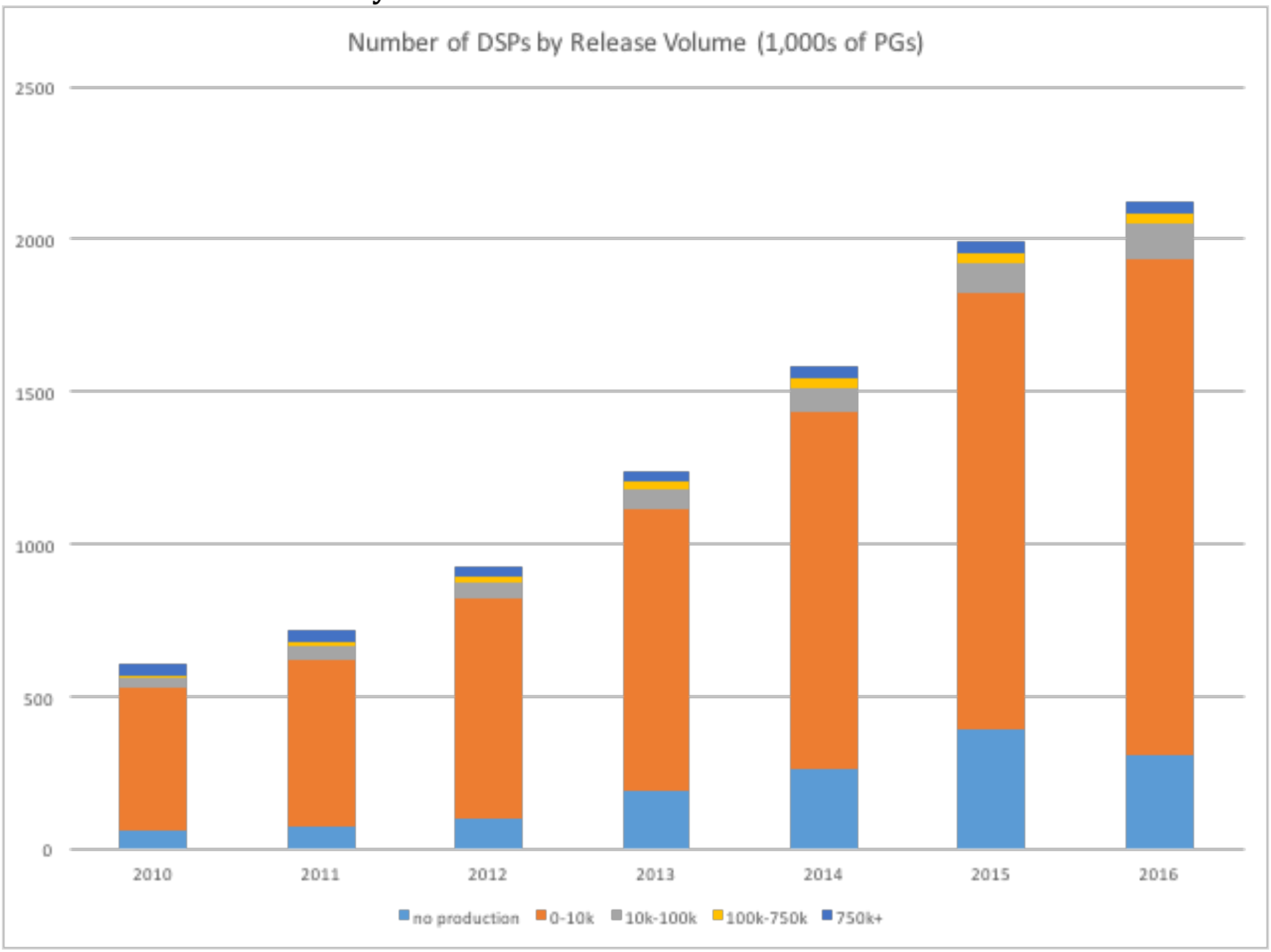


Analyzing entry and drop rates over time suggests that recent Adds are acting similarly to earlier cohorts. Recent TTB changes making it easier to get a DSP Permit might have been expected to lead to a reduced entry rate of new DSPs, but that does not appear to be the case. Earlier cohorts have yielded 70% Craft producers, suggesting 500 (or so) of those current "Non-producers" will join the ranks of active manufacturers over the coming few years.

Craft Production

The TTB started publishing data on removal of spirit from bond by size. With several years of this data we can see clear growth trends. First, Chart 7 shows that the significant growth in DSPs has come in the smaller segments of the market, consistent with our analysis of new DSP listings.

Chart 7: # of DSPs Listed by Withdrawal Size 2010-16

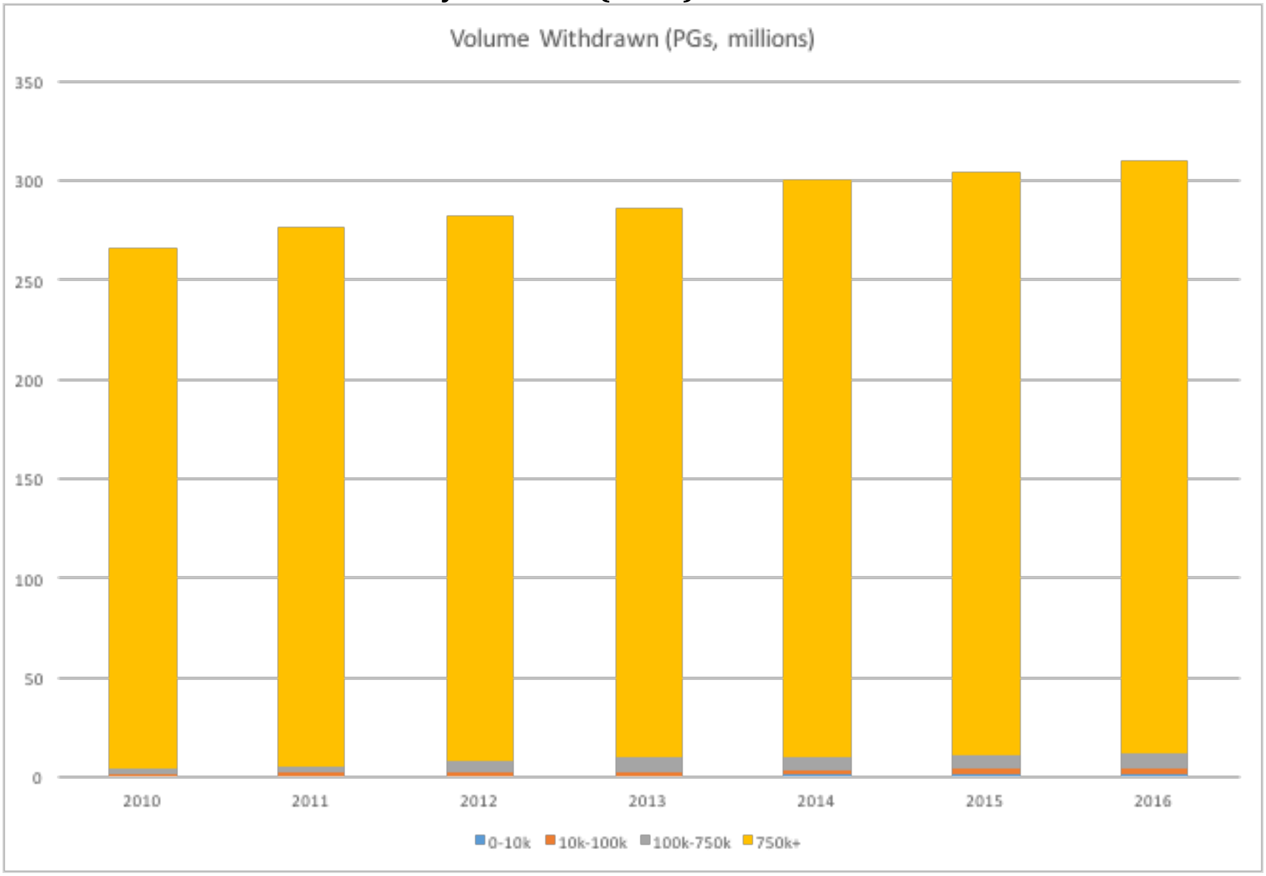


Looking at the actual volumes withdrawn in Chart 8 shows a very different story. Simply put, the few dozen large Plants not only massively out-produce all the others, the ***growth*** in output volume at those few dozen DSPs over the past 5 years is greater than 3X total current production volume at all the others combined.

Some of those 750k+ Plants are certainly the mega grain processors like ADM making GNS and industrial ethanol. And some are certainly producing large volumes of whisky for Brown-Forman, Beam/Suntory, Diageo, and the like.

Consider that the *average* withdrawal from each of those plants is over 7m Proof Gallons, as much as all the DSPs in the 100-750k category release. On that basis, the significant growth (200%+) in volume from the smaller producers barely registers, but it also suggests significant room to grow for smaller manufacturers.

Chart 8: Volume Withdrawn By DSP Size (in Ks) 2010-16

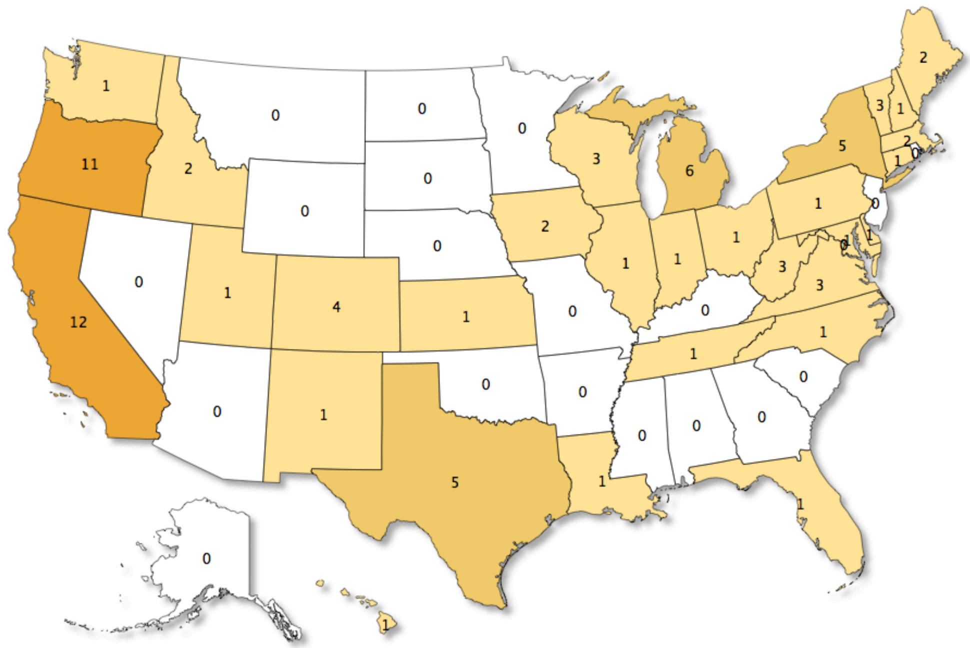


Craft Distilleries by State

Looking back 10 years to 2007 we observe:

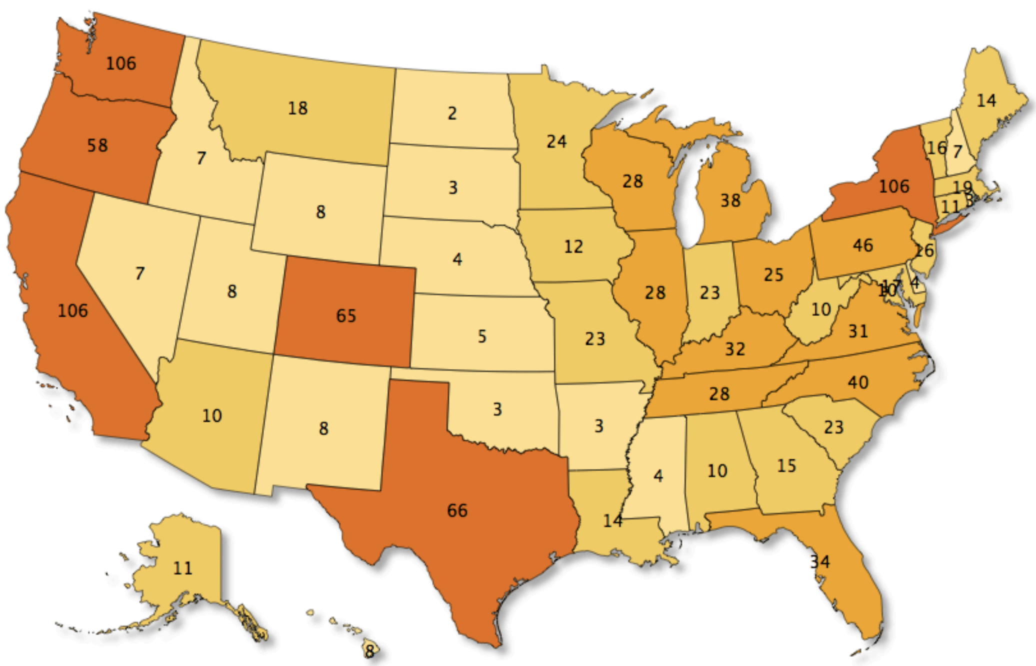
- 19 states did not have a craft distillery
- 16 states had exactly one, including current leaders like WA
- 15 states had more than one.

Map 1: Craft Distilleries by State, 2007



Today's landscape, with 1200 identified producers and our estimated 200 Hidden ones looks very different. Several states have retained their positions as leaders in the craft distilling community, while others have exploded beyond expectation.

Map 2: Craft Distilleries by State, 2017

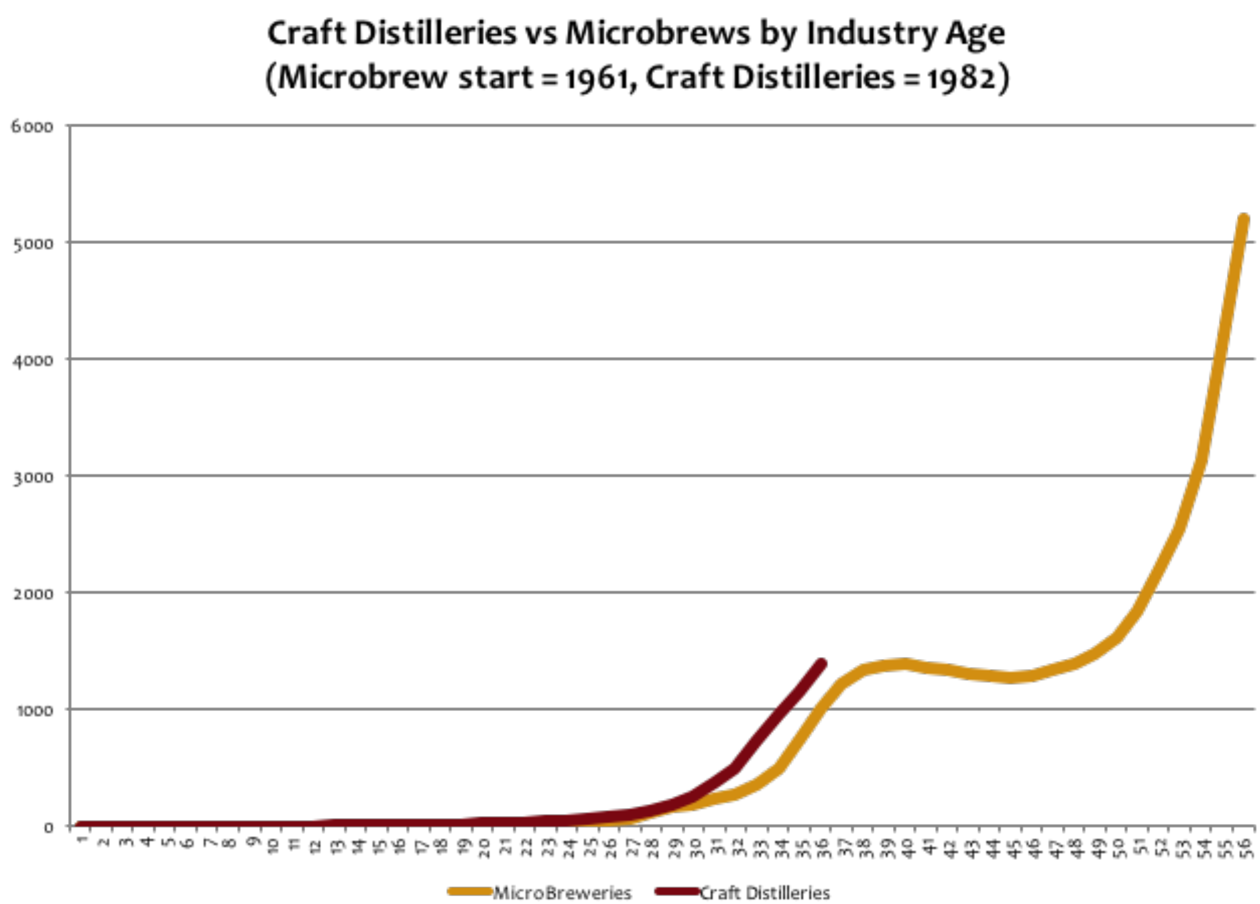


California’s sheer size has kept it near the front, and Colorado, New York, Texas, and Oregon have similarly maintained their role. The Southeastern states with a strong historical association with folk distilling (ie., moonshining) have grown their numbers more recently, but it has taken changes to Prohibition-era laws at the state level to accelerate those developments. What is really stunning is the complete coverage, and the ongoing growth in numbers across every state in the country.

Comparison with Craft Brewing Market

As noted previously, after torrid initial growth the craft beer market saw a roughly 10 year period of consolidation and “churn” between entrants & exits from 1997-2007 before finding new energy and skyrocketing again. So, while the chart may suggest a similar period of consolidation looms, every market is different, and there have been no signs of one yet.

Chart 9: Craft Distillers vs. Craft Brewers (from Industry Founding Date)



The growth from 1200 breweries 10 years ago to over 5000 today has been unprecedented, especially given the broad availability of excellent products. *More microbreweries alone have opened in the past 2 years than there are craft distilleries in operation today*.

Conclusion

Market acceptance of the Craft Distillery as a social form is now well established. Many new establishments are, like their “Brewpub” forebearers, launching as “Barstilleries” where the on-premise experience is built into the business. These “Nano Distilleries,” often with no pretension of distribution beyond their doors, are a key part of the next wave.

We get asked these key questions frequently:

- Have we reached “Peak Craft”?, and

- Is the CraftPocalype coming?

The answer to both *at this time* seems to be a resounding “No!”

We have seen no sign of a slowdown in the number of prospective new entrants as indicated by added DSPs. In fact, to the contrary, the rate of new DSP adds has only gone up. And nor have we seen any signs that recently added DSPs are behaving any differently in their progress towards becoming producers. The pipeline remains as full and robust as ever.

On the other side, there is no indication of any acceleration in DSP drops or uptick in ADI Directory listing removals that would suggest Exits at a rate higher than previous. We would expect the sheer *number* (of Drops) to go up simply because the pool of potential Drops (in the form of current Permittees) is so much larger. But the analysis by cohort indicates a rate consistent with prior history.

In terms of market penetration, Craft producers have gone from 1.5% to 1.75% of total volumes, even while the mega DSPs are also growing. With Craft Beer at about 12-15% of US beer volumes, Craft Spirits have a long way to go before they begin to reach similar volume market share.

Finally, Chart 10 offers a really long-term perspective on the structure of the US distilled spirits market. We see a highly fragmented market consolidate to a small number of producers from both the market pressure of scale production and modernization and the social pressure of Prohibition. Now that highly consolidated market is giving way again to increased diversity.

Chart 10: Operating US Licensees, 1880-Present