

# IMPACT

GLOBAL NEWS AND RESEARCH FOR THE DRINKS EXECUTIVES

**IMPACT SEMINAR CELEBRATES 30 YEARS**  
Coverage Begins On Page 24

**SURGE SPREADING**

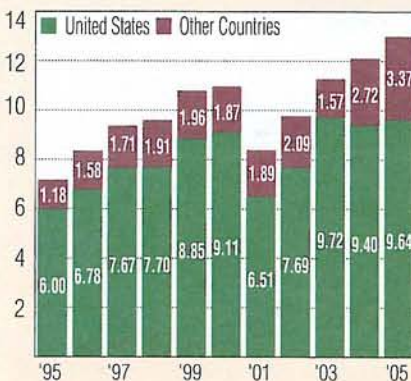
## Tequila Sizzling In US, Catching On Around Globe

The global Tequila category is firing on all cylinders, but there are some speed bumps on the horizon due to an unstable supply situation (*story page 14*). Despite minor setbacks for a couple of top brands, the category is swiftly developing in key export markets aside from the dominant US. From relatively small bases, Germany (up 18.8%), the UK (up 20.9%) and Spain (up 33.4%) led the way for non-US export markets and have a lot of topside growth potential. In the US, the category is enjoying brisk expansion on many fronts as major players are increasing their focus on higher-end, 100% blue agave Tequilas—which are growing at double-digit rates—and flavored line

(Continued on Page 8)

**TEQUILA SURGING IN US, EMERGING OVERSEAS – EXPORTS BY DESTINATION\* – 1995-2005**

(Millions of Nine-Liter Case Shipments)



\*Includes Tequila for pre-mixed cocktails, RTDs, etc.

Source: Camara Nacional de la Industria Tequilera

## Costco Court Win Likely To Fuel Big Changes In Three-Tier System

Costco Wholesale Corp's triumph over Washington state's wine and beer distribution laws could portend further challenges against state governments' control of the alcohol industry—as the US Constitution's Commerce Clause has again taken prece-

(Continued on Page 4)

## Constellation's Vincor Buy Makes It A Force In Fast-Rising Canada

Constellation Brands, the world's largest wine company by far, now appears to be the top player in its native North America as well. Through its C\$1.5 billion (\$1.3b) acquisition of Toronto-based Vincor International in April,

(Continued on Page 4)

**TRYING TURNAROUND**

## Spirits Marketers Aim To Reverse Negative Trends In Ailing Mexico

The global spirits renaissance and the broader success of the alcoholic beverage industry, so keenly felt in the US market in recent years, has remained largely absent from Mexican shores, as that country's spirits sales tumbled throughout the 1990s and the first half of the current decade. Total spirits shipments in Mexico fell another 7.8% in 2005 to 16.2 million nine-liter cases, a figure representing a volume loss of more than one-third since 1992, when the industry hit its high-water mark of 25.2 million cases.

(Continued on Page 20)

**COUNTING ON CURRENCY**

## Newfound Stability Spurs Promise As Brazilian Market Moves Forward

These are heady times in Brazil, as the country's 180 million consumers are gearing up for the approaching presidential election (in which participation is mandatory for all citizens over age 18) and soccer's World Cup (beginning in early June in Germany). Following grave economic turmoil in the earliest years of the 21st century, Brazil now finds itself in a period of relative stability, which it has used to attract large multinational companies and underscore its potential for economic growth. Brazil's spirits market has largely mirrored the evolution of the

(Continued on Page 16)

**BRAZIL – DISTILLED SPIRITS MARKET SHARE BY CATEGORY/TYPE\***



\*Excludes aguardente/cachaça

Source: Impact Databank

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## With Tequila On Fire, Marketers Aim To Add Flavor, Color And Prestige

(Continued from page 1)

extensions are entering the market at an opportune time. Trading up trends, the continued surge of flavored white spirits, the cocktail rage and the growing popularity of Latino culture continue to stimulate Tequila sales in the US, and some of these trends are gaining traction elsewhere.

Tequila volume in the US continues to grow from its large base, but the US's share of total category exports has been steadily declining as it rises in Western European markets and elsewhere. In 1999, the US accounted for 81.9% of all Tequila exports, but that figure was down to 74.1% by last year. While the category has been enjoying healthy single-digit growth in the US, it advanced by approximately 24% in all the other export markets combined in 2005. This diversity is promising for a category only just starting to emerge on a global scale.

Grupo Cuervo, the number-one Tequila producer, stresses the importance of

developing international export markets. In 2005, the US and Mexico accounted for 74% of Jose Cuervo's volume, down from nearly 80% in 2004. Moreover, other markets besides the US and Mexico accounted for approximately 79% of Cuervo's total growth last year of 550,000 cases. "We've been able to surpass our goals and lessen our dependence on the top two Tequila markets," says Carlos Arana, managing director, Jose Cuervo International, adding that Cuervo's key non-US export markets include Greece (the Tequila giant's third-largest market), the UK and Spain.

### Tequila Playing Flavors

Sanctioning the addition of flavors to Tequila by the Consejo Regulador del Tequila (CRT) has been the biggest recent development for the category. Effective March 7, the new Official Mexican Standard for Tequila began for both categories of Tequila—100% agave and mixto, or 51% agave—and all classes (silver, gold, aged, extra-aged and ultra-

aged) may be enhanced by the addition of sweeteners, coloring and or flavors.

Tequila's biggest player is wasting no time trying to tap the US flavored spirits craze, which has been primarily the domain of vodka and rum brands. This month, Cuervo is launching a line of flavored Tequilas—Jose Cuervo Citrico (lime), Oranjo (orange) and Tropina (pineapple). The Tequila giant's national brand launch in the US will be supported by a fully integrated marketing effort.

Two Fingers Tequila (Heaven Hill Distilleries) has been at the forefront of flavors, launching lime and raspberry line extensions even before the CRT changed the law. "We were a little ahead of the curve. We're treating the Two Fingers flavored line extensions just like we would flavored vodka," says Reid Hafer, brand manager for Two Fingers Tequila. "With the growth of the Tequila category and the flavor segments in other categories, it's a natural progression for Tequila."

Hafer notes that since the flavors are being blended into the Two Fingers brand in Kentucky, they're technically "distilled spirits specialties." Flavors must be blended into Tequila in Mexico for a product

## TEQUILA – TOP 10 BRANDS WORLDWIDE

(Thousands of Nine-Liter Cases)

Rank	Brand	Company	2000	2004	2005	AACGR <sup>1</sup> '00-'05	Percent Change <sup>2</sup> '04-'05
1	JOSE CUERVO <sup>3</sup>	Grupo Tequila Cuervo	5,355	5,520	6,070	2.5%	10.0%
2	SAUZA	Beam Global Spirits & Wine	2,100	3,000	3,200	8.8	6.5
3	EL JIMADOR	Tequila Herradura	1,175	1,375	1,400	3.6	2.0
4	CASCO VIEJO	Tequila Supremo	300	630	670	17.4	6.3
5	PATRON	The Patron Spirits Co	100	390	635	44.5	63.4
	<b>Total Top 5</b>		<b>9,030</b>	<b>10,910</b>	<b>11,975</b>	<b>5.8</b>	<b>9.7</b>
6	CABRITO	Tequila Centinela	250	500	625	20.4	26.0
7	CAZADORES	Tequila Cazadores de Arandas (Bacardi)	600	680	620	0.6	-9.0
8	MONTEZUMA	Barton Brands (Constellation)	620	600	565	-1.8	-5.3
9	JUAREZ	Luxco	350	450	465	5.2	3.5
10	HERRADURA	Tequila Herradura	275	250	250	-1.9	1.0
	<b>Total Top 10</b>		<b>11,125</b>	<b>13,385</b>	<b>14,500</b>	<b>5.4</b>	<b>8.3</b>
	Other Brands		3,525	1,595	1,525	-15.3	-4.3
	<b>Total Tequila<sup>4</sup></b>		<b>14,650</b>	<b>14,975</b>	<b>16,025</b>	<b>1.8%</b>	<b>7.0%</b>

<sup>1</sup> Average annual compound growth rate.

<sup>2</sup> Based on unrounded data.

<sup>3</sup> Includes 1800.

<sup>4</sup> Addition of columns may not agree due to rounding.

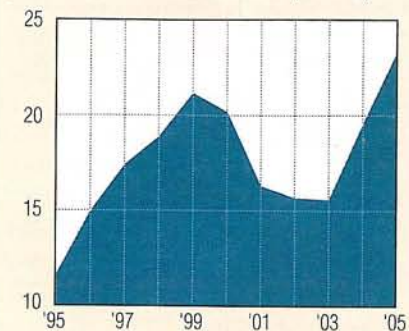
Source: Impact Databank



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## TOTAL TEQUILA PRODUCTION – 1995-2005

(Millions of Nine-Liter Case Shipments)



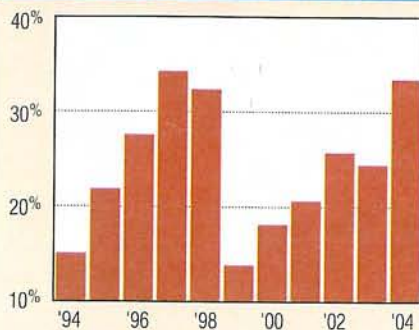
\*Includes Tequila for pre-mixed cocktails, RTDs, etc.

Source: Consejo Regulador del Tequila

to be considered flavored Tequila. US consumers, however, don't seem to mind the distinction, and the line extensions are off to a strong start. "It gives us increased shelf presence at retail and provides consumers new and different ways to drink our Tequilas," says Hafer. "It may take a while to develop because it's new, but the market is very excited about flavors." Hafer anticipates that flavors will account for 5%-10% of Two Fingers' volume by year-end and then continue growing.

Not all major Tequila players are jumping into the flavor game. Sauza, for example, isn't currently considering it. "If we do it, we won't come out with generic flavors like orange, lemon or pineapple. It would have to reinforce our positioning. The major Tequila houses have to make sure they don't bastardize the category with this move into flavors," says Andrew Floor, US brand director for Sauza (Beam Global Spirits & Wine).

## 100% AGAVE'S SHARE OF TOTAL TEQUILA PRODUCTION – 1994-2004



Source: Camara Nacional de la Industria Tequilera

Other upscale Tequila brands such as Porfidio, Corazón, Tezón and Cazadores have no current plans for flavored line extensions. Some see the Tequila flavor segment remaining at the mixto level and following the trends in rum and not vodka, where upscale brands have been successful with flavors. "It will be like the rum category, and you don't have expensive flavored rums. The price-sensitive brands will add flavors, but I don't foresee any line extensions into flavors for upscale brands," says Martin Grassl, production manager of Destileria Porfidio. "Tequila won't follow the same flavor trends as vodka brands."

### Giving It 100%

Tequila's 100% blue agave sector now comprises more than 33% of total category production, up from 13.8% in 1999, and this trend is continuing with gusto. During the first quarter of 2006, over 98,000 tons of agave were used to produce 100% agave Tequila, while 76,000 tons were used to produce mixto Tequila, according to the CRT. These figures are essentially the reverse of first quarter 2005, when 97,000 tons of agave were used to produce mixto Tequila and 79,000 tons were used to produce 100% agave Tequila.

Patrón is undoubtedly the number-one brand capitalizing on this trend. The deluxe brand surged 80.9% in the US last year to 615,000 cases, and it's expected to continue its phenomenal growth. In fact, if Patrón can maintain the explosive growth it enjoyed through the first few months of 2006, the brand could challenge Sauza as the market's number-two player by year-end.

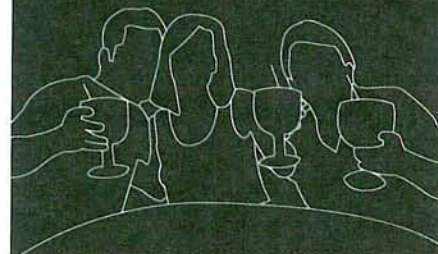
"The biggest factor behind our success is that Patrón has transcended the Tequila category and become its own brand," says Ed Brown, ceo of Patrón Spirits Co. "We could never enjoy this type of growth if we weren't pulling consumers from across other categories and branching out through the entire business." The US accounts for 97% of Patrón's total volume, but the brand is trying to replicate its success in other markets and is now stepping up its focus on Europe and Asia.



## SantaRita

The Margarita Evolution

1 1/2oz. HDC  
 1/2 oz. Premium orange liqueur  
 3 oz. Margarita Mix  
 1 oz. Fresh orange juice  
 A soft touch of Premium melon or green mint liqueur  
 Hand Shake or blend with ice  
 Strain into a salt rimmed glass  
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While Tequila's ultra-premium standouts may be transcending the category, it appears that the category itself has taken on a new identity. High-end aged Tequilas are increasingly taking a backseat to upscale white Tequilas, as marketers are meeting consumer demand by emphasizing their Blanco offerings. Lee Einsidler, ceo of Sidney Frank Importing, expects Corazón to double its business this year, as it basically did in 2005. Einsidler credits Blanco Tequila's surge for much of his brand's success. "While the entire ultra-premium Tequila category is hot, Blanco in particular is surging as it's very versatile and customers enjoy consuming it straight in snifters," he says.

Meanwhile, Cazadores (Bacardi), one of the few large brands to lose volume last

year, is stepping up its marketing and promotional activities in its two key markets of the US and Mexico. While Cazadores has prospered in the former of late, earning IMPACT Hot Brand status after advancing by 10% in 2005, it has struggled mightily in the latter, tumbling by 80,000 cases last year.

Pernod Ricard has been busy rolling out Tezón in the US. An ultra-premium Tequila, Tezón is being offered for limited distribution to top on- and off-premise accounts. The brand was introduced in 10 US markets in January and rolled out to a second wave of markets in April. "We expect growth for high-end Tequilas to continue at double-digit rates in the US," says Chris Willis, vice president of marketing, Chivas & Martell and Tequila Tezón.

Cuervo continues to focus on its upscale offerings, including 1800, Tradicional and Reserva de la Familia. For 1800 in the US, Cuervo will continue running national print ads with the tagline, "A Little Bit Older, A Whole Lot Bolder—100% Agave Tequila." The spots have appeared in publications such as Maxim, Playboy, Stuff, FHM, ESPN and Rolling Stone. Four new print executions were recently introduced: "The Ultimate Night Out," "The Ultimate Body Shot," "The Ultimate Smooth Move" and "The Ultimate Ice Breaker."

Cuervo is also introducing two new products in the US—1800 Colección Tequila and 1800 Ultimate Margarita, a super-premium ready-to-serve cocktail made with 100% blue agave Tequila.

## UNITED STATES – TOP FIVE TEQUILA BRANDS

(Thousands of Nine-Liter Case Depletions)

Rank	Brand	Importer	2000	2004	2005	AACGR <sup>3</sup> '00-'05	Percent Change '04-'05
1	JOSE CUERVO <sup>1</sup>	Diageo North America	3,325	3,580	3,680	2.0%	2.8%
2	SAUZA <sup>2</sup>	Future Brands	965	1,225	1,350	6.9	10.2
3	PATRON	The Patron Spirits Co	85	340	615	48.6	80.9
4	MONTEZUMA	Barton Brands (Constellation)	610	595	565	-1.5	-5.0
5	JUAREZ	Luxco	335	425	440	4.9	3.5
<b>Total Top 5</b>			<b>5,320</b>	<b>6,165</b>	<b>6,650</b>	<b>4.5%</b>	<b>7.9%</b>

<sup>1</sup> Excludes 1800.

<sup>2</sup> Acquired from Allied Domecq in 2005.

<sup>3</sup> Average annual compound growth rate.

Source: Impact Databank

## TEQUILA – TOP FIVE EXPORT MARKETS BY VOLUME<sup>1</sup>

(Thousands of Nine-Liter Case Shipments)

Rank	Country	1999	2004	2005	AACGR <sup>2</sup> 1999-2004	Percent Change <sup>3</sup> 2004-2005	Share of Exports <sup>3</sup>		
							1999	2004	2005
1	United States	8,855	9,400	9,639	1.2%	2.5%	81.9%	77.6%	74.1%
2	Germany	291	552	656	13.7	18.8	2.7	4.6	5.0
3	UK	27	186	225	47.1	20.9	0.2	1.5	1.7
4	France	170	239	216	7.0	-9.4	1.6	2.0	1.7
5	Spain	63	156	208	19.8	33.4	0.6	1.3	1.6
<b>Total Top Five</b>		<b>9,406</b>	<b>10,532</b>	<b>10,945</b>	<b>2.3</b>	<b>3.9</b>	<b>87.0</b>	<b>86.9</b>	<b>84.1</b>
Other Markets		1,409	1,587	2,063	2.4	30.0	13.0	13.1	15.9
<b>Total Exports<sup>4</sup></b>		<b>10,815</b>	<b>12,120</b>	<b>13,008</b>	<b>2.3%</b>	<b>7.3%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

<sup>1</sup> Includes Tequila used for pre-mixed cocktails, ready-to-drink flavored alcoholic beverages, etc.

<sup>2</sup> Average annual compound growth rate.

<sup>3</sup> Based on unrounded data.

<sup>4</sup> Addition of columns may not agree due to rounding.

Source: Camara Nacional de la Industria Tequilera



## MEXICO – TOP FIVE TEQUILA BRANDS

(Thousands of Nine-Liter Cases)

Rank	Brand	Distiller	2000	2004	2005	AACGR <sup>1</sup> '00-'05	Percent Change <sup>2</sup> '04-'05
1	SAUZA	Tequila Sauza	800	1,255	1,150	7.5%	-8.5%
2	EL JIMADOR	Tequila Herradura	1,110	975	950	-3.1	-2.4
3	JOSE CUERVO	Tequila Cuervo	1,085	800	815	-5.6	1.6
4	CASCO VIEJO	Tequila Supremo	285	600	615	16.7	3.1
5	CABRITO	Tequila Centinela	250	475	585	18.8	23.3
<b>Total Top 5<sup>3</sup></b>			<b>3,525</b>	<b>4,100</b>	<b>4,115</b>	<b>3.1%</b>	<b>0.3%</b>

<sup>1</sup> Average annual compound growth rate.

<sup>2</sup> Based on unrounded data.

<sup>3</sup> Addition of columns may not agree due to rounding.

Source: Impact Databank

Sauza's Floor says the brand's upscale Hornitos, Tres Generaciones and Commemorativo editions continue to outpace the category and the upscale segment. "We have strong brands that are deeply rooted in authentic heritage and quality," Floor says. He adds that Sauza is also trying to introduce the Paloma, which mixes Tequila with carbonated grapefruit juice, in the US.

Elsewhere, Diageo is increasing its investment behind its ultra-premium Tequila brand Don Julio. In the US, a new print campaign is being launched and public relations events are being ramped up with activity in both the on- and off-premise through point of sale, tastings, education and menu programs. The brand will also feature value-added packaging to capture the gifting occasion.

### Mexican Spirit

The major Tequila brands in Mexico were stagnant last year, but change is afoot. One of the biggest recent developments for Tequila in Mexico has been Beam Global's agreement to have Bacardi distribute Sauza in its domestic market. Bacardi already has a very strong presence in Mexico with its flagship rum brand. "What Bacardi brings to the table is a very strong on-premise capability. That's incredibly important for Sauza because that's where you start developing the direct relationship with the younger adult consumer," says Floor.

While some major brands struggled in Mexico, production destined for the

***Outside the US and Mexico,  
Tequila is still  
underdeveloped, but it's on  
the rise in Europe and Asia,  
as more attention is being  
paid in those markets.***

domestic market jumped 38.5% to 10.3 million cases. This figure was almost back to the 10.4-million-case zenith achieved in 1999. In 2003, production for the domestic market bottomed out at 4.3 million cases.

Nevertheless, Mexico's Tequila market isn't nearly as dynamic as the US market, particularly at the high end. The country's per-capita income (\$10,100) is only about one-fourth that of the US (\$42,000), and there is substantially less disposable income. "In Mexico we're seeing growth in 100% agave but more in the mid-price range, and that comes down to socioeconomics," notes Floor.

Value Tequila brands are expected to grow in Mexico at higher rates than premium and upscale offerings. "Higher-priced brands are finding it more difficult to maintain volume, let alone grow, and

they will have to fight harder to provide a reason why consumers should pay more for their 100% agave Tequila," says Guy Lawrence, global brand director of Cazadores. "Furthermore, the brands in these segments are older brands with less relevant positioning to the consumer."

### Breaking Records

During the first quarter of 2006, total Tequila production reached 55.6 million liters, surpassing the record level attained in first quarter 2000, when it reached 50.2 million liters, according to the CRT. Moreover, total exports for first-quarter 2006 reached 34.4 million liters, surpassing last year's record level by 25%.

Outside the US and Mexico, the category is still quite underdeveloped, notes Rob Warren, Diageo's senior vice president of global Tequilas. But he sees currently strong growth for all types of Tequila in many markets in Europe and Asia. "We see great potential for Tequila to become a much more important spirit on a global level over the next five to 10 years," Warren says.

Some industry insiders say mixto Tequila faces some challenges in certain export markets from other emerging Latin American spirits such as cachaça. "In markets like Germany and Scandinavia, cachaça is now the biggest exotic product on the market. It's outselling mixto Tequila. The US hasn't seen this phenomenon yet, but it will probably come very soon," says Grassl of Destileria Porfidio.



## Agave's Boom-And-Bust Cycle A Major Concern For Tequila Industry

The Tequila category has ascended rapidly since the dawn of the new millennium. The Mexican spirit's apparent silver cloud, however, has a serious touch of gray because agave supply and demand remain out of balance. Agave production hasn't yet escaped the vicious cycle of shortages and oversupply. With the agave shortage of 2000 still fresh in the memory of Tequila producers, the industry now faces oversupply. Many producers are finding it less expensive to buy Tequila on the open market than to cultivate their own crops. While this has reduced operating costs, it's undermining the category's stability and could be a harbinger of stormy weather.

Indeed, the bottom has already fallen out for some growers, and a number of agave fields have been abandoned. "We're heading toward an oversupply of agave. You see more and more fields being neglected and left to grow wild because the price of agave on the open market is so cheap," says Andrew Floor, US brand director for Sauza (Beam Global Spirits & Wine). "We're playing a leading role in trying to achieve a balance between supply and demand. We have an incredibly strong and close relationship with the growers. We're not driving toward 100% self-supplying. We have to get the balance right and make sure we don't expose ourselves to an agave shortage."

While the supply of agave historically has gone from periods of oversupply to shortages, the dearth that hit the industry a few years ago was the most pronounced. "A combination of several factors—including a blight and bacteria that attacked some plantations, an unusually harsh winter, soaring demand for Tequila and a lack of strategic plan-

ning—created a perfect storm," says Judith Meza Nixon, CRT (Consejo Regulador Del Tequila, AC) representative for the US and Canada.

This crisis was supposed to be a catalyst for treating the plant as a commercial crop. Historically, however, a lot more control has been put on Tequila production than on agave cultivation. The main control on agave cultivation has been applied where it's grown, but that's changing. "We're in a period of oversupply of agave. But, as opposed to other times, several mechanisms have been put in place by the agro industry as well as the CRT to secure the supply in the future," Nixon says, adding that all agave plantations are now registered at the Plantation Property Registry kept by the CRT. "Any agave newly planted must be registered within the first year of age. Also, the registration may include the identification of all agave that has been committed for sale by any legal means to a Tequila producer."

Many boutique producers claim to control their own supply and express no concerns about the agave situation, but other industry players paint a grim picture of a situation they say won't go away until Mexico adopts land reform. Since the Mexican Revolution in 1910, the government has supported the ejido socialistic system, whereby large plantations have been subdivided into smaller land holdings under the guise of social justice to increase the production of subsistence food.

Martin Grassl, production manager of Destileria Porfidio, says the system has failed and it's very difficult to control supply with poor farmers often running the agricultural side of the business.

"The peasant farmers don't have the knowledge or the financial strength," Grassl says. "They're subsistence farmers who don't have bank accounts, can't read or write and can't make long-term investments. It's a very difficult situation and that's why Tequila is overpriced."

There is a presidential election in Mexico this July, but land reform isn't a major issue at the moment. President Vicente Fox's six-year term ends this year and presidents can't run for a second term in Mexico.

"A new president might be inclined to take on the land reform issue and to legalize big land holdings," Grassl says. "The US is very competitive agriculturally because it can have huge plantations. It's the only way you can achieve economies of scale. If you don't have economies of scale, your product will be too expensive for the export markets."

Although agave takes a long time to grow (about 10 years), it can be cultivated in regions of inexpensive farmland where nothing else will grow. Requiring only 12 to 15 inches of rainfall per annum, agave is drought resistant and requires minimum maintenance.

The price of agave on the open market has currently dwindled to only about 2 Mexican pesos (18 US cents) per kilo, and it takes about 10 kilos of agave (the core of the plant usually weighs 50 to 100 pounds or 22.7 to 45.4 kilos) to produce one liter of Tequila. "The agricultural system is so inefficient that most peasant farmers abandon the land and migrate to the US," says Grassl. "The pressure to implement land reform in Mexico won't come from within, but from the US."

Despite concerns about the long-term future of agave production and mixto Tequilas, most producers appear to be very upbeat about the category's outlook. "We're extremely optimistic about the future of the category," says Arana. "Jose Cuervo has enjoyed significant interna-

tional growth. We expect to have a truly global brand."

Tequila is unique and it's carving a niche right alongside other fine spirits on the top shelf. "Tequila has the romantic heritage of Cognac, the production controls

of Champagne, the quality potential of single malt Scotch whiskies and the versatility of rum and vodka," says Floor. "You add the Tequila attitude and personality that no other category can bring, and that's incredibly attractive." ■

—Kevin Barry