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U.S. Distributor Acquires Prominent Tequila Distiller Casa Herradura

by LADB Staff

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Tequila, one of the most enduring symbols of Mexican culture, is increasingly falling into the hands of foreign liquor distributors. On Aug. 28, US-based Brown-Forman Corp. acquired Casa Herradura, manufacturer of the famous tequila brands Herradura and El Jimador, for US\$876 million. In recent years, foreign interests have acquired Mexico's most popular tequila brands. Jose Cuervo is a property of British-based Diageo PLC, Sauza is owned by US-based Fortune Brands, Tequila Cazadores belongs to Bermuda-based Bacardi, and Olmeca is part of French company Pernod Ricard's holdings.

The sale of Casa Herradura, which is 136 years old, hit especially hard because the announcement came as tequila consumption increased in Mexico ahead of the Sept. 16 Independence Day celebrations. By some estimates, seven of every ten Mexicans who drink celebrate the holiday with tequila, said the Mexico City daily newspaper La Cronica de Hoy.

"There is bad news during the month when we celebrate our country," said Arturo Balderas Rodriguez, a columnist for the Mexico City daily newspaper La Jornada. "One of the companies that most symbolizes our national beverage became property of foreign investors." Balderas and others acknowledged that tequila is not considered a strategic industry like petroleum, but they noted that the sale is part of a troubling trend in which Mexico's assets are being transferred to foreign hands.

"The tentacles of globalization are once again reaching into the heart of what we hold sacred," said Moises Andrade, who writes a column for La Jornada's sister newspaper, La Jornada del Oriente. "Some companies most identified with the tequila industry are now in the hands of foreigners."

"US, British, and French companies now own the eleven most prominent brands of tequila in the world," said the Mexico City daily newspaper Excelsior. Mexican tequila "is losing its nationality," noted Santiago Lopez Ayala, president of the Consejo Consultivo de Productores de Agave, which represents growers of the agave plants used to manufacture the Mexican spirit.

Foreign ownership helps tequila marketing efforts

This trend toward foreign ownership of the tequila industry has sparked some debate in Mexico on whether the changes are beneficial or harmful to the industry. The most significant disadvantage, said industry sources, is that many decisions that affect the production and marketing of tequila would be made in overseas boardrooms. "The one thing I don't like is that many decisions will not be made by Mexicans," said Eduardo Orendain Giovannini, former president of the Camara Nacional de la Industria Tequilera (CNIT).

The foreign ownership, however, does not change the regulations that require tequila to be manufactured on Mexican soil under certain quality specifications, said Hector Quirarte, director of institutional relations at Casa Herradura.

The Mexican government has worked zealously to maintain the quality of tequila. In 2004, the government announced tight restrictions that would require all tequila to be bottled in Mexico, but it has since rescinded those restrictions and is now allowing bulk exports to accommodate foreign distributors (see SourceMex, 2003-10-01 and 2004-04-28).

Ramon Gonzalez, director of the Consejo Regulador del Tequila (CRT), said the industry and the government continue to ensure that tequila maintains its high quality, regardless of who owns a company. Even with all the acquisitions, Gonzalez noted that foreign interests control only about 35% of Mexico's tequila industry. "We can still say that this is an industry dominated by small and medium-sized Mexican companies," said the CRT director.

Orendain and other industry sources note that the foreign ownership has contributed greatly to the industry's ability to expand its market in the US and other countries, especially for premium brands. "Tequila that is 100% agave, which is bottled in Mexico, has grown at a rate of 25% annually in the US market, and no other spirit has grown at that rate," Orendain told Excelsior.

Mexico has increased overall shipments of tequila to the US by about 8.6% annually since 2002, with exports of premium brands growing about 20% during the same period, the Distilled Spirits Council of the United States recently reported.

Casa Herradura was the one major tequila manufacturer that had not been able to take full advantage of the growing demand in the US, with the export market accounting for only 20% of its sales. The company sold 380,000 cases of Tequila Herradura on the global market in 2005, of which 70,000 were shipped to the US. Sales of El Jimador, which carries a lower cost than Tequila Herradura, reached 1.4 million cases, of which 150,000 went to the US market. Tequila Herradura sells for US\$40 a 750 ml bottle in the US, while El Jimador carries a retail price of about US\$20.

Casa Herradura executives said the new association with Brown-Forman would help expand marketing possibilities overseas. "We are very pleased with this agreement and believe Brown-Forman is the best company to grow our brands in the global spirits market," said Casa Herradura chief executive Rafael Obregon.

Brown-Forman officials, based in Louisville, Kentucky, reinforced Obregon's sentiments. "We think we can do a better job with wider distribution," said spokesperson Phil Lynch. "We will have more resources to build the brands." The transaction is also expected to help Brown-Forman boost sales of its line of whiskeys, wines, and other spirits in Mexico through Herradura's distribution network.

The US company said the Herradura and El Jimador brands were the most important assets acquired in the transaction. Herradura ranks third and El Jimador 10th among the world's top tequila brands, "In Herradura and El Jimador, we are acquiring two strong brands competing at the

super-premium and premium levels in the world's largest tequila markets the US and Mexico," said Brown-Forman chief executive officer Paul C. Varga. Brown-Forman which owns and distributes the internationally famous spirits Jack Daniels, Southern Comfort, Canadian Mist, and Finlandia Vodka is also proprietor of two lesser-known brands of premium tequilas, Pepe Lopez and Don Eduardo.

Brown-Forman was not the only company seeking to acquire Herradura, with Pernod Ricard and Bacardi also placing bids. "We were initially seeking a buyer to acquire 25% of the company," said Hector Quirarte, director of institutional relations at Casa Herradura. Herradura, which has about 1,100 employees in Mexico, reported net earnings of US\$200 million in 2005.

Some analysts said Brown-Forman might have paid too steep a price to acquire Herradura. "It's an expensive acquisition," analyst Timothy S. Ramey of D. A. Davidson & Company told the New York Times. Oversupply could hurt agave prices The growth in global sales of tequila could eventually boost demand for blue agave, with the industry currently consuming about 668,000 tons of agave-based raw material per year. Any increase in demand, however, will not be sufficient to reverse a hugely oversupplied market, said the Consejo Consultivo de Productores de Agave.

In response to a surge in prices, caused by a shortage in the 1990s, many producers expanded their agave crop significantly in 2000 (see SourceMex, 2000-06-14). The fields planted that year are expected to be ready in 2006 and 2007, as agave plants typically take six to seven years to mature. About 46.4 million plants were expected to be ready this year, compared with 24.8 million planted in 2000 (see SourceMex, 2004-10-20). The expected surplus has created several problems for growers, including very low prices and lack of market. Only 8,000 of the 13,000 producers who grow blue agave in the certified region around Jalisco in western Mexico have contracts to sell to the tequila industry.

The agave-producers council sees some possibilities in alternative agave-based products, such as syrup and other distillates, but those markets have been slow to develop. Agave producers would like the federal and the Jalisco state governments to find solutions to the overproduction problems, including constructing more facilities to process agave into products other than tequila. "Much has been said about the possible construction of new plants to manufacture agave syrup," agave-producers council president Lopez Ayala said in an interview with the Mexico City daily newspaper Excelsior. "But this is not much of an option for producers because only two such plants are in existence and similar facilities are slow to get off the ground." If prices continue to decline as a result of the large supply of agave, many producers could start to look at other crops. This, he said, could potentially lead to a shortage of agave similar to the one experienced in the 1990s. (Sources: Spanish news service EFE, Notimex, Associated Press, Reuters, Forbes.com, 08/28/06; Milenio Diario, The New York Times, 08/29/06; Radio Formula, 08/28/06, 08/30/06; Reforma, 08/29/06, 08/31/06; La Jornada, 09/04/06; La Jornada del Oriente, 09/07/06; Excelsior, 09/08/06, 09/12/06; La Cronica de Hoy, 9/15/06)

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