

The Business of Whisky

Wednesday December 17 2014

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Distillers look beyond sales fall

Exports fell in the first half of this year, but the industry is bullish, says *Mure Dickie*

For an industry that has enjoyed years of heady growth, the news that exports of Scotch whisky fell more than a tenth by value in the first half of 2014 was sobering.

As this special report explores, the fall has raised questions about the strength of demand for whisky in important mature markets such as the US, and about the prospects for emerging sources of demand such as China on which the Scotch sector has pinned much of its hopes.

Any sustained slide will raise doubts about the likely returns on what has been an extraordinary surge in investment in distilleries, warehouses and bottling operations across Scotland in recent years. At least £2bn in new investment is set to flow into the sector in Scotland over the four years from 2013, according to the Scotch Whisky Association.

About 30 new distilleries are planned, under construction or have recently started production, the SWA says. The bursting of whisky bubbles in the past, however, has shown all too clearly that distilleries can close as well as open.

Still, industry leaders insist there is no reason to doubt the underlying fundamentals of the whisky business, or to be concerned that there will be a lake of unwanted Scotch.

Pierre Pringuet, chief executive of Pernod Ricard, the French drinks group



New markets: a worker pours a glass of whisky at a distillery in Taiwan — Reuters/Nicky Loh

that owns Chivas Brothers, says his company sees no need to change its investment plans and that its problems still hinge on the shortage of stock. "I don't think a whisky lull is something to worry about," Mr Pringuet says.

Scotch is still placed to benefit from the emergence of millions of aspira-

tional middle class consumers in emerging economies, he says, and while China's crackdown on conspicuous consumption by officials has chilled demand, the pain will be temporary.

"China is definitely taking a longer time than we expected initially, but the prospects for the Chinese market are

huge," says Mr Pringuet, who this month was appointed SWA chairman. "There is no panic at all about that."

There is also comfort in recent data from the US, which, with more than £800m in sales in 2013, is easily Scotch's biggest export market.

Some in the US market say Scotch's

image has suffered in comparison with more lively US whiskey brands. As detailed in this report, US International Trade Commission data suggest Scotch has shrugged off the sharp fall recorded in the first half and is now on track to top last year's \$1.2bn record.

How long the rebound continues will depend in part on how innovative the sometimes staid whisky sector can be in product development and marketing. In one of the bolder moves of recent times, some leading drinks companies are looking to single grain whisky to boost growth.

Grain whisky, which is produced in large industrial "Coffey" stills, is the generally overlooked main ingredient in blends, but proponents say it can stand alone as a drink category alongside single malts. And with a relatively mild taste profile, it can potentially appeal to consumers turned off by the often pungent flavours of malts. It is also more easily matched with foods and could become a flexible ingredient in cocktails.

Drinks groups are also being more inventive with their marketing, to boost brand loyalty and encourage acceptance of new products such as the introduction of whisky expressions (or versions) that do not rely on an age statement.

Engagement with international consumers now includes William Grant & Sons' pop-up events intended to mimic the experience of a distillery visit and Diageo's rollout in Chinese cities of Johnnie Walker House outlets dubbed "part-museum, part brand experience and part retail".

"The long-term future of our industry is very, very strong," says Laurent Lacassagne, chairman and chief executive of Chivas Brothers.

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The Business of Whisky

A wee dram of the real Scottish distillery experience

Marketing

The industry is finding inventive ways to recruit new advocates of its brands, says *Mure Dickie*

The distillery visitor centre is a standard feature of Scotland's whisky industry and a great way to build brand loyalty. But as an international marketing tool it has one major limitation — it has to be located in the distillery.

That is quite a disadvantage given that only a small fraction of the world's whisky drinkers are likely to travel to Scotland, never mind to the often inconveniently located distilleries on which much of the sector's romantic charm rests.

But the way independent whisky group William Grant & Sons sees it, even if the customer cannot visit the distillery, then at least some of the distillery experience can be brought to the customer.

That is the thinking behind the

pop-up Glenfiddich Experience rolled out by the company this year in Thailand. Set up in Bangkok's grandly colonial Neilson Hays Library, the five-day event offered "tours" of the whisky-making process with the aid of interactive technology and tastings.

Marcus Low, regional marketing manager, says William Grant has found that taking guests to the Glenfiddich distillery in northeastern Scotland's Dufftown tends to make them "huge advocates" of the brand. "That's why we wanted to bring the distillery experience to those who are not fortunate enough to get there yet," he says.

About 1,000 visitors attended the pop-up event and 150 were invited to a dinner prepared by a celebrity chef who matched Glenfiddich expressions (different versions of the single malt) with whisky-marinated foie gras terrine and a whisky-flamed oatmeal dessert.

Matthew Fergusson-Stewart, Glenfiddich regional brand ambassador, says highlights included "3D" distillery art and interactive tables that told visitors more about the whisky they were drinking.

The Glenfiddich Experience is hardly the first to try to give visitors a flavour of whisky making from afar. In the Scottish capital Edinburgh, The Scotch Whisky Experience takes visitors on a tour through the various stages of distilling that ends surrounded by golden bottles of the world's largest Scotch collection. Established by 19 whisky companies in 1987 as a heritage centre, the Experience has become an attraction in

'We wanted to bring the distillery experience to those who are not fortunate enough to get there yet'

its own right, with more than 308,000 visitors in the year to end-November, of whom 157,000 took the tour.

Julie Trevisan Hunter, head of marketing at the Experience, says it has been investing heavily over the past five years and aims to be a vital marketing tool for the Scotch industry. "We also provide a much-needed whisky destina-

tion for those people visiting Scotland who aren't able to travel to outlying distilleries," she says.

As well as offering a restaurant boasting 365 whiskies and whisky liqueurs, the Experience hosts weekly tasting sessions and an annual two-day Distillers' Fair.

Such urban substitutes have hardly eclipsed the now traditional distillery visitor centre, however. Many of the flock of start-up distilleries opening across Scotland see visitor centres as an important source of revenue and exposure even before they have any mature whisky to sell.

Established visitor centres are being upgraded. At the beginning of December, independent distiller Edrington held the groundbreaking ceremony for a new £100m distillery and visitor centre for its Macallan single malt brand.

One way to build customer loyalty is to allow visitors to stay on site. Last year Ardbeg Distillery on the island of Islay restored a cottage on its grounds and now rents it out to visitors.

Distilleries are also making increasing efforts to offer varied experiences for

visitors who range from keen drinkers to tourists with little previous interest in whisky.

From January, the free tour of Glenfiddich's Dufftown home will be replaced with a choice of options starting with a standard £10 tour and the chance to shell out a further £25 to draw their own 20cl bottle from a selected cask.

For £35 visitors can have a tutored tasting that introduces them to the brand's Solera ageing techniques and then blend their own version to take home. The keenest tippers can go for the £95 "half-day immersive experience" that also includes a tasting class at the Grant family home.

Meanwhile, the Glenfiddich Experience certainly looks set to travel.

The company has replicated the Experience for nine days at a department store in the South Korean capital Seoul, and marketing managers are looking at rolling it out in China, Mexico and Venezuela.

"The Nordics as well," says Mr Low. "They are very excited to look at it for next year."

Beckham helps kick off promotion for single status

Scotch

The 'single grain' is being pushed as the next big thing to a rising generation of drinkers, writes *Mure Dickie*

Grain whisky is the unsung hero of Scotland's spirits industry, usually relegated to a quiet role as a core constituent of blended Scotch — but that low profile is something David Beckham hopes to change.

The English footballer lent his name and considerable fame to the launch of Haig Club, a single grain whisky that drinks group Diageo says is going to be a marketing "game-changer" for the category.

"There is a whisky renaissance going on and we feel that single grain is the next big trend that is about to come on to the scene," says Kathy Parker, senior vice-president at Haig Club, which is also backed by British entrepreneur Simon Fuller.

Diageo is not the only whisky powerhouse excited about single grain. Independent distiller William Grant & Sons is ramping up promotion of its own new brand, Girvan Patent Still Single Grain.

The family-owned company claims credit for pioneering single malt as a sales category with Glenfiddich, which it started promoting internationally in 1963. Glenfiddich now sells more than 1m 9-litre cases a year and Kevin Abrook, William Grant's global whisky specialist for innovation, says Girvan single grain could be just as successful.

"The big idea was to create a third pillar of Scotch. You have blends, you have single malts, but nobody was really doing anything with single grain," Mr Abrook says. "Wouldn't it be great if in 50 years' time you could establish another category and have another million-case brand?"

A first step to establishing the new single grains is explaining to consumers the distinction between them and the more famous single malts. While malt whisky is made from barley in batches using distinctive copper stills, grain whisky is made in a continuous process using an elaborate column contraption known as a patent or Coffey still.

The technology, developed in the early 19th century, turns grains such as maize or wheat into a relatively cheap and pure spirit, which traditionally has then been married to more flavoursome malt whiskies as part of a blend.

But some drinkers have always appreciated grain's milder taste and now Diageo and William Grant see it as a way to widen Scotch's appeal.

Pungent single malts can put off some consumers, making single grain a gentler introduction to Scottish spirits. Single grains also have potential for use in cocktails that a malt might overpower.

With Haig Club, Diageo is targeting drinkers in China and other countries where whisky is not just drunk on its own, hoping that its taste will complement food. And the Beckham tie-up is intended to help it reach people who have never tried whisky before — or who have, but did not like it very much.

"We wanted to bring in a brand that would help us to recruit the next generation of whisky drinkers," Ms Parker says.

The very accessibility of single grains creates challenges, however. Some in the whisky business are not convinced the

Sweden moves from devoted consumer to skilled producer

Europe New distilleries with global plans reveal the quality of Nordic malts, writes *Louis Leslie*

Scotch in Sweden has been radically rebranded. Gone are the traditional grouse and stag's antlers, and all that remains is the brand name in a crisp sans

serif along with the blue and yellow logo of the bottler: Svenska Eldvatten, an independent company that specialises in bottling imported whisky and other spirits for the Swedish market. Yet while the contents are Scottish, the bottle's design is unmistakably Scandinavian. The company is just part of the country's growing whisky industry, which has quietly started producing its own single malts.

The Swedes are among the top whisky drinkers in the world. According to the Scotch Whisky Association, annual exports of Scotch whisky to Sweden rose by £10m between 2003 and 2013 to £36.4m. "Swedes love peated whisky, so single malts like Laphroaig, Ardbeg and Lagavulin are very popular here," says Peter Sjögren, co-owner of Svenska Eldvatten. "We Swedes also like to explore new ground, like Japanese whisky."

Last month, the annual *Jim Murray Whisky Bible* caused a stir when it named Japanese distillery Yamazaki's Single Malt Sherry Cask 2013 as the number one drink. The global market for whisky production has changed dramatically in the past few years, and Scotland's place as the top producer of whisky is no longer safe. Throughout the world, from Tanzania to Taiwan, distilleries are

being established to cater to local tastes. Sweden is now turning its hand to whisky making — 10 new distilleries have started producing whisky since 2013.

Box Distillery opened in 2010, and has produced small-scale but popular offerings. In June this year, its batch of 700 bottles sold out within a day. Hven distillery produces a number of single malt offerings, and has won a number of awards at the International Wine & Spirit Competition (IWSC) since 2013.

The biggest distillery in Sweden is Mackmyra, with the capacity to produce 1.2m litres a year. The company was created when eight friends from Sweden's Royal Institute of Technology met for a reunion in 1998. Each of them had brought a bottle of malt whisky, and soon someone asked why Swedes do not make whisky. Spotting an opportunity, the next year the group set about creating Sweden's first single malt.

"Sweden produces some of the best-tasting barley — some Scottish distilleries even import it from us — so we wanted to create a whisky that showcased Sweden's natural offerings and reflected the country's tastes," says Lisa Collins, Mackmyra's export sales manager.

After experimenting with 170 different recipes, in 2001 the company settled on two, converted a deserted mill in Gävle into a distillery and started producing single malts in 30-litre casks



Personal service: at Mackmyra customers can create a single malt of their own

made from Swedish oak. The result was Mackmyra's personal cask service, where customers can create a single malt of their own, and are invited to annual tastings over the three-year maturing process.

"Our customers come first," says Ms Collins. "We listen very carefully to what they want."

In 2008, the first regular bottled whisky, "The First Edition" was launched, and since then the company has grown into an international whisky brand. Two years ago, it was named the European Spirits producer of the Year at the IWSC, with the First Edition gaining a gold award. The company has also been financially successful — sales for the 2013 calendar year were £7m.

Mackmyra has had success in nearby countries, but last year attempted to expand into North America. In its 2013 annual report, chief executive Magnus Dandanell said the expansion had been too fast, and that the company had "spread our resources too thin and lost focus on neighbouring markets".

The company has now returned to its original strategy of focusing on its local

'Sweden produces some of the best-tasting barley — Scottish distilleries even import it from us'

customer base, although this has not tamed the company's ambitions to export.

"Sweden is our main market," says Ms Collins, "but we have also had 100 per cent growth in both Belgium and the UK over the past year. In 2015 and onwards, we will be looking to focus more on our overseas markets."

There is some debate as to what the future holds for the Swedish whisky industry.

"I get the impression that the Swedes are primarily interested in the domestic market, and are tailoring the style of their whiskies to suit Swedish palates," says Gavin Smith, a Scottish whisky writer who recently visited Sweden's 13 distilleries.

Tommy Andersen, managing director at Eldvatten, has a more global outlook: "Swedish whisky has a big potential to become one of Sweden's [leading] exports. Even if the whiskies from the top distilleries Box, Smögen and Hven are only four to seven years old, they are well in line with the best Japanese or Scottish single malts when it comes to quality."

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Collectable malts may be in 'bubble' territory

Investment

There is already evidence of a slump in the retail market, and rare whiskies could follow, says *John Kenchington*

Today's rain is tomorrow's whisky, goes the old Scottish proverb. But after a remarkable boom in the value of single malts in recent years, economic factors may now point to stormier days ahead.

Collectable whiskies have emerged as the latest beneficiary of the global boom in demand for luxury goods.

The clamour by international investors hit the headlines this January, when a custom-made Lalique crystal decanter of Macallan single malt fetched \$628,000 at a charity auction at Sotheby's Hong Kong.

"The market is very, very buoyant," says Martin Green, head of whisky at Bonhams, the auctioneers. "It has been over the past few years. Interest from the Far East certainly has been rising and we have huge interest from Asia."

According to the Apex 1000 index, run by consultancy Rare Whisky 101,

the prices of the 1,000 most collectable bottles of Scotch single malt rose by 219 per cent between 2008 and the end of November 2014.

Famous names such as Macallan, Port Ellen, Brora, Dalmore and Bowmore have risen the most and the Apex 100 index of the most desirable expressions (versions of different whiskies) has rocketed by 473.5 per cent since 2008.

The boom has been driven by a scarcity of sufficiently aged stock. Whisky distillers 50 or 60 years ago did not foresee the vast scale of demand that exists today, and much of the stock they did put into barrels back then has been bottled and drunk already.

Only recently have the distillers been investing in sufficient quantities to reflect the surge in demand, with up to £2bn put by producers into expanding production capacity, according to the Scotch Whisky Association (SWA). But with a turnaround time in the decades, there will be a long wait before they can deliver whiskies that command strong prices. In the meantime, high-end producers have been keen to promote the explosion in prices for their rare old expressions, hoping to benefit from the resulting interest when they price their

more affordable mass-market offerings.

But now some experts are warning that collectable whisky prices look to have hit "bubble" territory, in spite of the combination of supply constraints and booming demand.

Ian Buxton, whisky consultant and author of the bestselling *101 Whiskies to Try Before You Die*, says the fine wine investing market has already come off the boil in recent months and whisky is set to follow.

"[Rare whisky prices are] classic bubble stuff and it's run up by a really small number of purchasers," he says.

Headline figures for whisky returns often fail to factor in the high transactional costs involved in buying and selling such items, creating the impression that returns are higher than they really are, he warns.

Auctioneers will typically charge up to 25 per cent of the value of whiskies in order to sell them. Online auction houses may be cheaper — often closer to 10 per cent — but could fail to attract the same attention. Meanwhile, whisky transportation and storage costs can also be high.

Mr Buxton says claims by promoters that if you invest and prices collapse

then you can, at least, drink the whisky are a "fig leaf of a get-out clause" for those quoting the very highest prices.

There is evidence that a slump is already taking place in the retail whisky market. In September, the SWA revealed that whisky exports had taken a hit in the first half of 2014, with a flurry of markets reporting double-digit falls. Exports to the biggest Scotch market, the US, fell by 16 per cent compared with the first half of 2013. Exports to Singapore, another big market, fell by 46 per cent.

But amid the broader gloom, the market for rare whiskies does not appear to be suffering yet. The Apex 1000 index has risen by 16.7 per cent in the past 12 months. In the past three months it grew by 3.1 per cent, and in November it fell by just 0.2 per cent. The more volatile Apex 100 index fell by 1.3 per cent in November, a negative — but by no means disastrous — result.

Whether the prices of rare whiskies are set to suffer a spectacular collapse in the future remains to be seen. But what is certain is that investors who misjudge the timing of acquisitions or sales in this market could find themselves with a very nasty hangover.

1963

Year Glenfiddich was actively marketed internationally

1m

Current annual sales of 9-litre cases of single malt Glenfiddich

category will ever rival single malts, saying grain's relatively restricted range of flavours renders it much less interesting.

It is a charge grain advocates are keen to reject. Rather than new drinkers, William Grant is targeting whisky enthusiasts as its primary market for what Mr Abrook calls the "crème brûlée" flavours of Girvan single grain.

One tool of conversion is a sample set that allows them to compare the light and fruity spirit that emerges from a grain still with the more complicated flavours that come from later exposure to American oak casks.

Previous efforts to promote grain whiskies in the mass market have had little lasting impact, however. William Grant's own Black Barrel brand, launched in 1995, was not a success. "It just didn't catch on," admits Mr Abrook.

Still, Mr Abrook is sure the market has changed, and Nick Morgan, Diageo head of whisky outreach, agrees. There is a buzz around single grain among bartenders and enthusiasts that was lacking even a few years ago, Mr Morgan says. "What's different now is there appears to be real interest out there."

The Business of Whisky

Building brands bar by bar and street by street

Interview Diageo's David Gates talks to *Liz Bolshaw* about the challenges of marketing whiskies to a global customer base.

When I first joined Diageo in 1991, I didn't join the pension plan because I didn't expect to be here long enough," recalls David Gates, global director of premium core brands for Diageo, as he looks back over his 23-year career with the drinks company. "Then I fell in love with our brands and the culture of our business."

Mr Gates' career with Diageo has taken him round the globe with long stints in Brazil, Japan, Singapore and the Netherlands before returning to the UK. "That's kept it exciting," he says.

Before taking on responsibility for all Diageo's premium spirit brands last year, his career focused on the company's 100 whiskies, which include Irish whiskies and blended Scotch brands such as Bell's, Famous Grouse, J&B and Buchanan's.

Diageo also provides single malts such as Lagavulin and Talisker, and the world's best-selling blended Scotch: Johnnie Walker. Diageo brands account for 44 per cent of Scotch sold globally. Whiskies of all origins account for a third of Diageo's £10.3bn net sales.

A pivotal moment in Mr Gates' early career was a business trip to Recife in northeastern Brazil. "I went into bar after bar and saw hundreds of bottles of Johnnie Walker on the tables," he recalls. "They poured me a glass over ice, topped it up with soda water and I thought, 'Holy smoly, this is delicious!'"

Everyone involved in Diageo's whisky brands, he says, has "to understand what we've come from as well as where we are going". Respect for the heritage that underpins many of the company's best-known brands is key, Mr Gates adds. "We seek to write the next chapter in brands that have 200 years of history and I hope that the work I produce will



David Gates: 'They poured me a glass [of Johnnie Walker] over ice, topped it up with soda water and I thought, "Holy smoly, this is delicious!"'

be good enough so that when people in 50 or 100 years' time look back . . . they don't hold their heads in their hands."

Strong brand associations with heritage and tradition can have a downside. "Whisky is still strongly a male category in the developed world – less so in places like Thailand or South America," Mr Gates says.

However, appointing Christina Hendricks – the American actress who made her name in the US TV series *Mad Men* – as brand ambassador for Johnnie Walker and the launch earlier this year

of Haig Club fronted by David Beckham, the footballer, are signs that Diageo is keen to take whisky out of the gentleman's club and into the cocktail bar.

The Haig family is one of the oldest families involved in whisky distilling (with roots going back to 1627), Mr Gates says.

"Even though the electric blue bottle looks incredibly contemporary," he adds – and it is true that Haig Club looks more likely to contain a liquid to splash on your skin than to pour on the rocks –

'Whisky is still strongly a male category in the developed world'

"it is based on the blue nosing glasses used by whisky blenders for hundreds of years."

While this has been a strong decade for Scotch whisky in export markets, with eight years of continuous growth, the past 12 months have seen sales internationally plateau. Sales in China have been particularly hit by the government's anti-extravagance campaign.

"Progress particularly in emerging markets is not a straight line," explains Mr Gates, unfazed by the dip.

"Volatility is very visible in short timeframes, but over a period of decades we can see sustained growth. If you take the per capita consumption of Scotch whisky in France, Spain, South Africa or Greece and you could replicate that in markets like Mexico or Brazil, the opportunity is just breathtaking."

Wherever there is a growing middle class, he argues, there is an opportunity. "There is a very high correlation between the growth of middle class per capita incomes in an emerging market and the penetration of Scotch whisky in that market," he says. People trade up from local domestic spirits to aspirational, lifestyle brands such as Johnnie Walker.

Core to the communication of such brands are Johnnie Walker Houses, Diageo's answer to the Apple Store. They were launched in China, and Beijing, Shanghai and Chengdu each offer a Johnnie Walker House as well as Seoul in South Korea.

Mr Gates sees "brand experience, both physical and virtual, where we can give [customers] exposure to the people who actually make the product, [as] incredibly powerful". (See story on page 4.)

Asia's whisky houses are the latest expression of brand immersion that started with Diageo's US programme for Johnnie Walker that Mr Gates says has driven growth of more than 100 per cent since it was initiated.

At the other end of Diageo's line-up are the small, premium brands that are enjoying strong sales. Bulleit, for example, the company's craft bourbon, "is a brand that has been built bar by bar, street by street", says Mr Gates. "It turns up in remote places all over the world, through a word-of-mouth network built by people passionate about the product."

The rookie who did not join the pension plan now directs the future of some of whisky's best-selling brands from Alaska to Zimbabwe. Mr Gates's last word is on the punitive 150 per cent import tax levelled at Scotch in India, but, characteristically, he is not so much bitter as frustrated.

"The Indian Scotch whisky market is massive," he says, "and respect for Johnnie Walker is huge."

Industry looks west again as emerging market demand dips

Future

The bourbon industry has been more innovative with flavours, writes *Rob Walker*

The big Scotch brands have binged on the emerging markets for more than a decade. From Shanghai to São Paulo, a burgeoning new generation of well-heeled drinkers was only too happy to splash out on brands such as Johnnie Walker Black Label, Chivas Regal and Ballantine's Gold Seal. It was easy money.

Aspiration was a big part of it. It still is. But, over the past 12 months, conflict in eastern Europe, and an economic slowdown in Latin America and Asia have derailed demand for whisky in many formerly fast-growing markets.

The global value of Scotch exports fell 11 per cent in the first half of this year from the same period in 2013, according

to the Scotch Whisky Association. "The export figures were a wake-up call," says Jonny Forsyth, global drinks analyst at research firm Mintel. He says the Scotch industry has been distracted by the emerging markets, and has missed opportunities in North America and western Europe as a result.

"Western markets were ignored because it was so easy in the emerging markets for such a long time," he says. "Exports sold themselves."

While the good times rolled in the emerging markets, a whisky renaissance was also under way in the US and Europe. But it was American whiskeys driving it, not Scotch.

"There's been a lot of innovation going on in bourbon, which has really appealed to people," says Mintel's Mr Forsyth. Flavour innovation has been the game-changer in the US. Jack Daniel's Tennessee Honey has grown into a 12m-litre brand in only four years. And its growth shows no sign of slowing. According to Brown-Forman, which owns Jack Daniels, underlying net sales

of this honey-flavoured tittle were up 33 per cent in the last quarter.

"People have tired of flavourless drinks," says John Hayes, managing director of Jack Daniels.

Industry regulations mean Jack Daniel's Tennessee Honey cannot be labelled as bourbon, so they call it a "liqueur". As far as the consumer is concerned, it is honey-flavoured bourbon though. And from a Scotch perspective, this is a big deal. The US is still the biggest export market for Scotch, worth more than £800m in 2013. But Mr Hayes says Americans are already knocking back more flavoured bourbon drinks than Scotch, in volume terms.

He thinks he knows why. "People think of bourbon as less formal than Scotch, and more accessible. It has a casual, down-to-earth American personality whereas Scotch tends to have more of a stuffy premium-ness to it," he says.

The Scotch industry used to shrug off those sorts of criticisms. Scotch whisky, they would argue, is a tittle you mature into.

Scotch whisky exports
% change by value, 2013



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The Business of Whisky

Austerity drive hits sales but drinkers grow more discerning

China The green-tea mixer is out and premium whiskies in specialist bars are in, write *FT* reporters

The drinks business is not the only industry affected by Beijing's anti-extravagance campaign: sales of everything from seasonal hairy crabs to the country's elaborate mooncakes, Chinese pastries baked to celebrate the mid-autumn festival, have been hit. Giving presents to officials of luxury beverages such as Moutai, a high-end Chinese spirit, as well as expensive Bordeaux wines and cognacs is virtually banned. Whisky is not black-listed in the same way, but a cut in the number of lavish banquets has weighed heavily on sales through traditional channels such as karaoke bars and nightclubs.

The UK's Scotch Whisky Association recently blamed falling demand from China as a factor in an 11 per cent decline in whisky exports by value, from nearly £2bn in the first half last year to £1.77bn in the same period this year. Exports to Singapore, which acts as a conduit to the markets of China and other Asian countries, fell 46 per cent in the first half. According to Mintel, whisky sales in China fell more than 20 per cent by value last year, after having risen 15 per cent in 2012.

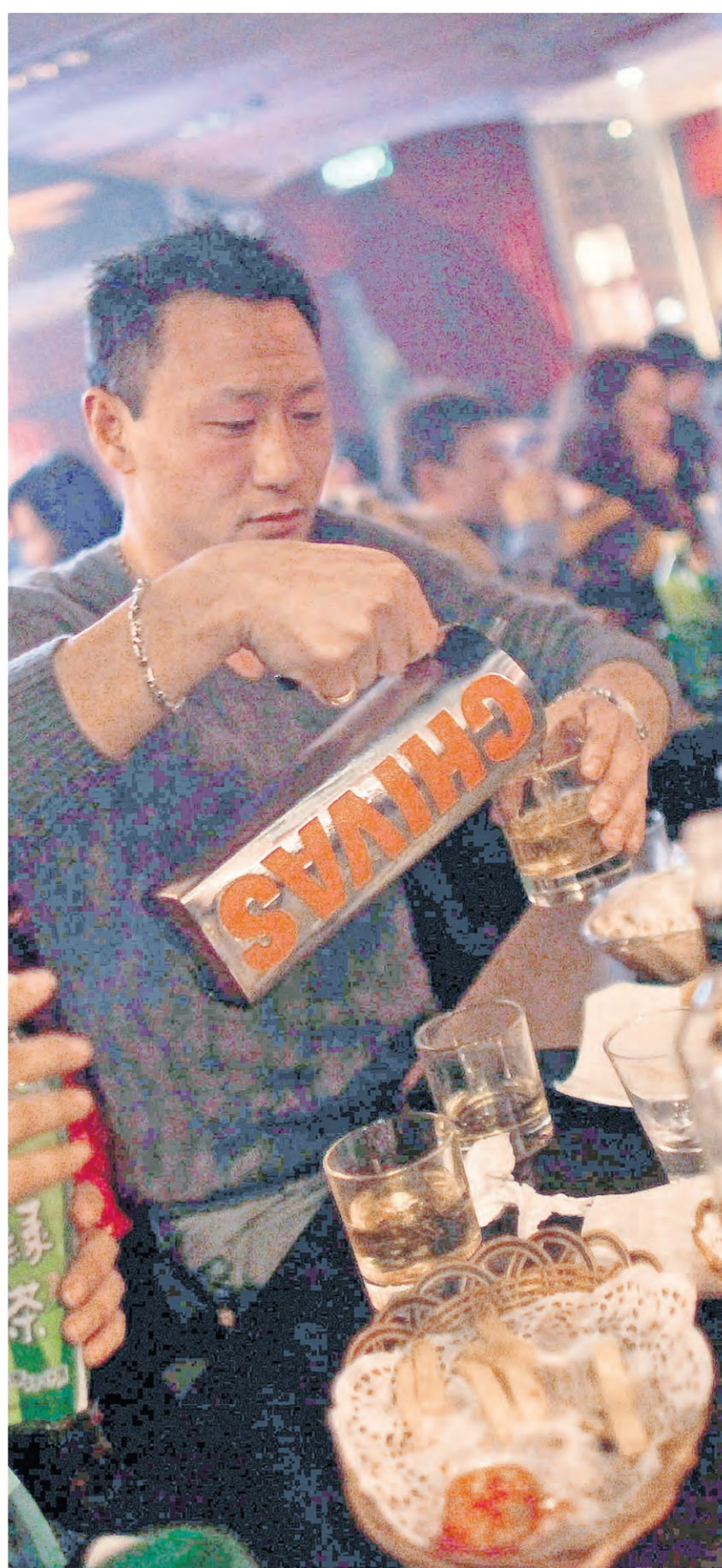
Sales volume fell by nearly 15 per cent, indicating that whisky prices have also fallen, says David Zhang, a drinks

analyst at the market research firm. "The reason the austerity ban had such a big impact is because the market structure of whisky was so distorted in China, with products highly concentrated in the premium and luxury segments, and thus at risk when policies changed," he says.

"The economic slowdown [in China] and the austerity campaign had a negative volume impact on the whisky category especially for business entertainment in the traditional KTV [karaoke] channel," says James Slack, a Pernod Ricard spokesman in China. "However, we remain optimistic and confident for the long term." The French drinks company aims to attract new consumers from the country's middle class and affluent populations, and expects their numbers to reach 440m by 2020.

Pernod Ricard dominates the highly concentrated premium whisky market in China with a 57 per cent share in 2013, according to Bernstein Research. Since it first introduced Chivas Regal 12-year-old to China more than a decade ago, mixing it with green tea has been popular in China's karaoke bars and high-energy clubs where officials and entrepreneurs used to entertain each other with excessive drinking.

But nowadays, as officials fear being seen drinking at public expense, and



Raising the bar: in larger cities such as Shanghai, urbanites are increasingly parading their taste as well as wealth by choosing premium brands — Reuters/Ally Song

Luxury Johnnie Walker Houses spread word

In China, high-end whisky is trendy, and the city of Chengdu in the middle of China is even trendier. The capital of Sichuan province, famous for its pandas and its new millionaires, has recently become a magnet for luxury brands, upmarket hotels and elite property developers. Chengdu is a symbol of how lower-tier Chinese cities have finally become wealthy enough to indulge a taste for the best — and most expensive — things in life. Diageo says the regional capital has 25,000 millionaires.

The UK drinks company wants to appeal to the new generation of affluent Chinese, so it chose Chengdu to open its latest Johnnie Walker House in China last September. The house is a cross between a museum and a bespoke blending shop, where the rich of Chengdu can learn how whisky is made — and how to drink it. The name of the game here, as at Diageo's other Johnnie Walker Houses

in Shanghai and Beijing, is exclusivity: part of the house is open to the public, but the best bits can be visited by invitation only. Diageo says that it has hosted more than 20,000 rich individuals at its houses in Shanghai, Beijing and Seoul in the past year. The houses are, the company says, "part education, part private club, part museum and part retail".

At Chengdu House, for example, local enthusiasts are offered special edition whiskies, including one engraved with the city symbol of the golden sunbird, for the elite price of Rmb3,450 (\$560) for a 1.75l bottle. Diageo says the design of the house, which includes the brand's signature "Striding Man" emerging out of water, is meant to symbolise the prowess of Chengdu. The city of 7m people is famous for its third-century BC irrigation works, which are still in use today.

Patti Waldmeir

after an anti-prostitution campaign shut down more than 200 entertainment venues in southern China, that recipe may no longer prove so popular, drinks analysts say.

"Very few people drink whisky with green tea nowadays because they all know that's a big waste. It's an outdated *tuhao* [nouveau riche] style," says the bartender at Bar Constellation in Shanghai, which features single malt selections.

Discerning whisky bars like this one have begun to emerge recently in the larger Chinese cities where urbanites are displaying a new taste for single malts as a way to show off their good taste rather than merely their wealth.

Sam Fischer, president of Diageo in China and Asia, sees it as natural for an increasingly sophisticated market such as China to shift away from an obsession with bling, and toward a true appreciation for one of the world's oldest tipples. "Chinese are increasingly interested in the craftsmanship, knowledge, not just the big fat brand."

He points out that whisky has suffered less than cognac in the current crackdown, and that super-premium brands like Diageo's Johnnie Walker Blue Label have continued to grow — with China sales up by 40 per cent year on year by value in the 12 months to

June 30 2014, and growth in low double digits expected for the current fiscal year.

"More Chinese people are consuming whisky in a different way," says Torsten Stocker, greater China retail partner at AT Kearney, the consultancy, in Hong Kong. Rather than drinking ostentatiously with officials, business partners or clients, they have begun to enjoy drinking at home with friends, family and even alone, he says. "Although these drivers are not making up for the reduction in demand, I think they will underpin a slower but ultimately more stable growth in demand," he adds.

Diageo said recently that the demographics of whisky drinking in China has started to shift: the drink previously "had mostly masculine associations, but women now account for a quarter of all whisky consumption".

Mintel's Mr Zhang also notes that some western spirits such as vodka, rum, tequila and some liqueurs gained market share in China between 2012 and 2014. "Chinese consumers are getting to know that western spirits are not limited to whisky and cognac, which makes it impossible for either cognac or whisky to resume the previous high-speed growth in China," he says.

Additional reporting by Zhang Yan and Patti Waldmeir

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Despite early year dip, US still growing market for Scotch

Exports

Higher-end producers stand to benefit from a bulge in the numbers of young people willing to experiment with their drinks, says *Aaron Stanley*

Scotch whisky exports to the US fell in the first half of 2014 but have returned strongly in the latter part of the year, assuaging fears that the spirit's largest overseas market had taken a downturn. Sales to the US plunged 16 per cent by value and 12 per cent by volume compared with the first half of 2013, according to figures collected by the Scotch Whisky Association. It was the first time since 2009 that a year-on-year decline had been recorded.

But the drop appears to have been more of a stutter than a reflection of changing US consumer tastes. Demand for Scottish malts and blends has risen since June, coinciding with an improvement in the US economy and seasonal demand as consumers sought to stock up for the summer and winter holiday seasons.

In the nine months to the end of September, imports of Scotch into the US were up 2.4 per cent year on year, and likely to surpass last year's \$1.2bn record, according to the US International Trade Commission, which tracks import data.

"Scotch whisky remains very popular in the USA, but there was a fall in the value of direct exports recorded in the first half of this year," says Rosemary Gallagher of the SWA.

"This was mainly a result of destocking after some overstocking in previous months and partly down to currency issues."

The rebound offers a reassurance that whisky consumption in the US, the world's dominant spirits market, will continue its growth trajectory. This is especially good news for the UK, which has increased whisky exports to the US by nearly 150 per cent over the past decade.

Imports from the US's two other primary suppliers, Ireland and Canada, have also performed well, posting 15.4 and 5.9 per cent growth respectively in 2013.

Sales of Irish and Canadian whiskies

in the US, however, amount to just a fraction of that of Scotch whisky in terms of volume and sales.

Further, there are several reasons for continued optimism within the US market. Whisky consumption generally is increasing, mirroring a broader trend across the spirits industry. For the first time since records began, every single category of whisky, from super-premium to low-end value brands, saw consumption growth in 2013, according to the Distilled Spirits Council (Discus).

IBISWorld, a market research firm, values the US whisky business at \$2.4bn and estimates that the industry grew at an annual rate of 3.3 per cent even during the recession years from 2009. It projects a 2.6 per cent growth rate until 2019.

In 2014, malt whiskies accounted for a 9.6 per cent segment of this market — a majority of which is Scotch, though independent craft distillers producing their own single malts have gained a foothold recently.

The underlying trend behind the US spirits market is that the country is becoming more accepting of responsible alcohol consumption.

State and local jurisdictions that have traditionally imposed restrictions on when and where alcohol can be purchased are also taking a more relaxed approach. Excise taxes, controls on Sun-

day sales and prohibitions on spirits tastings for marketing purposes are gradually being removed in states across the country.

This loosening of cultural and legal impediments has allowed for a broader base of whisky consumers, particularly among women and young people. An increase in US population growth in the early 1990s means a larger pool of young adults will reach legal drinking age in the coming years. These new consumers will have a much broader range of drinks to choose from than prior generations.

"Millennials are much more experimental than previous generations. The spirits and cocktail culture really draws them in," says Linda Montag, a beverage analyst at Moody's.

Perhaps most importantly, increased consumer confidence amid the economic recovery and a surging appetite for super-premium and ultra-premium spirits will be drivers of growth in the years to come, especially with regards to the more expensive brands.

Accordingly, higher-end Scotch brands have been able to penetrate deeper into the US market. While about 75 per cent of US Scotch imports are more traditional bottled blends, consumers are starting to show a taste for higher-end single malts (though super-premium blends have also performed well).

In 2013, imports of Scotch single malts jumped by 18 per cent, compared with just 5.4 per cent for bottled blends. Just a year earlier, those figures were the other way round, with imports of bottled blends increasing by 18.7 per cent over 12 months to 2012 against just 9.2 per cent for single malts.

Frank Coleman, senior vice-president of Discus, adds that the industry has done well for itself by investing substantial resources into promoting Scotch whisky in the US, rolling out innovative products and marketing them effectively to consumers.

"There's this dynamism that's occurring in the US market," he says. "You have the cocktail culture [and] the whole prevalence for premiumisation among a wide array of food and beverage categories."

"We're in a wonderful era, maybe the best ever for innovation in distilled spirits."

"Scotch whisky plays into that nicely because it has a charming and wonderful heritage."

Dave Broom Author of *World Atlas of Whisky*

If you are collecting, buy two bottles — one to share, one to collect/sell on. Don't buy at what looks like the top end as prices will not rise significantly. Rather, look to releases such as Glenfarclas Family Casks; Macallan's Masters of Photography; and Gordon & MacPhail limited editions. Outside Scotland there's a buzz around Karuizawa.

