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Summer, New Brands to Give Beer Market Boost

By Roland Oliphant

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There's a hiss, a rush of bubbles, golden liquid fills up the glass, and a good head of foam forms.

"This was made just two days ago. It's fresh," says Masaru Hemmi, chief brewer of Japan's Kirin Ichiban, checking the side of the bottle and proffering the glass.

Hemmi was pouring at the Moscow Beer Company's factory in Mytishchi, and the occasion was last month's start of licensed local production of Ichiban.

Both sides feel justified in pouring a few well-earned drinks.

The Moscow Beer Company reckons it can sell Ichiban, which is one of the most popular beers in its home country, to Japanese restaurants and food enthusiasts. Ichiban is confident it has secured its foothold on the $20 billion Russian beer market, after moving production

from Kaliningrad.

Despite the free-flowing optimism, these are not easy times to be a Russian brewer.

Though over the past decade the beer market surged 40 percent, growth peaked in 2008 at 110 million hectoliters — the standard for beer measurement equaling about 100 liters.

Then the global economic crisis, increased taxes on alcohol and saturation depressed the market by as much as 15 percent and saw the country slip from third to fourth place worldwide for total consumption.

"Russia has lost 12 [million] to 15 million hectoliters. That means that approximately five or six breweries like us should be closed. And it is happening — a lot of breweries have been closed and will be closed," said Igor Dementyev, general director of midsized brewer the Moscow Beer Company, during an interview at his company's headquarters in northern Moscow.

Foreign Branding

Domestically produced beers, like cars, carry a certain amount of stigma. Even foreign brands produced under license are widely considered to be inferior to genuine imports. Specifically, this is linked to an alleged preponderance to cause headaches.

"Abroad, drinking a six-pack of Heineken is no problem. Here, two bottles will give me a headache," complains one beer aficionado.

One urban legend links the mysterious headaches to extra alcohol — or more sinister chemicals — added to popular brands to keep the population docile.

Another rumor has it that in a bid to save money, local breweries only change their yeast filters once in a blue moon — meaning fermentation continues long after it should have stopped.

Unlike cars, however, there's not much choice but to buy Russian.

High import tariffs mean that imported beers make up just 0.5 percent of the market — compared with about 15 percent in the United States.

In Russia, that segment is replaced by licensed domestic production. There are more than 40 foreign brands now produced locally — ranging from classic Czech lagers like Pilsner Urquell (produced by SABMiller in Kaluga) to iconic Irish stout Guinness (produced by Heineken in St. Petersburg). Together they account for about 13 percent of nationwide sales, but represent 29 percent of market share in Moscow.

The Moscow Beer Company has seven licenses on the books, including a 40-year contract to produce German Oettinger and a 25-year contract with Denmark's Faxe, as well as its new deal with Kirin.

Dementyev said Ichiban would be a niche beer, appealing particularly to aficionados of Japanese food or foreign beers. Retailing at about 55 rubles ($2) for a half-liter bottle —

relatively expensive — it will not be elbowing out either Pilsner Urquell or local Zolotaya Bochka.

"We don't consider ourselves as competing with the giants. We have a unique choice of products in our portfolio, and each of those is a leader in its niche," Dementyev said.

That may explain why Kirin, whose Ichiban brand is high-end even in Japan, chose to partner with Dementyev's company.

Giant Players and Taxes

The local beer market is a battlefield of giants with little room for small independent breweries. Carlsberg Group, AB InBev, Efes Breweries International, Heineken and SABMiller together control more than 85 percent of the market.

Baltika, which is the biggest brand and part of the Carlsberg Group, has a total brewing capacity of 5.2 million hectoliters a month.

The Moscow Beer Company, which started out as an importer of beers and soft drinks in 1994 and began producing its own brews only in 2008 — right on the cusp of the crisis, Dementyev ruefully recalls — is a minnow by comparison, turning out just 2.5 million hectoliters per year.

Market analysts now say Brazil has displaced Russia from its place as the world's third-largest beer maker, and Germany is snapping at Russia's heels to move into fourth. So what went wrong?

For a start, Russians are not really among the great beer drinking nations. Even after the rapid growth in consumption over the past decade, they consume just 66 liters of beer annually per capita, according to estimates by Baltika.

Czechs get through a staggering 151 liters, while Germans drink 108 liters annually. Neighboring Finns, Poles and Estonians consume about 90 liters per capita, according to a 2010 report by Carlsberg.

Experts put the peak down the three factors: The market was probably saturated anyway; the financial crisis of 2008 ate into disposable incomes; and the government has drastically ratcheted up taxes on beer.

The beer excise went up 200 percent from rubles per liter to 9 rubles per liter in January 2010. This year the tax is up to 11 rubles, and plans exist for further hikes. The latest proposals envision jacking it up to 18 rubles per liter by 2014 — which would amount to a sixfold increase since 2009.

Consumers quickly felt the impact. The average retail price rose from 43.99 rubles per liter in March 2009 to 57.57 per liter in March 2011, according to the State Statistics Service, an increase of more than 30 percent.

Baltika, the market leader for more than a decade, reported a 0.1 percent loss of market share on the back of the price increase and a 17.5 percent fall in profits from 23.4 billion rubles ($835

million) in 2009 to 19.2 billion rubles in 2010.

Recovery, or Calm Before the Storm?

Statistics show that beer production has marginally recovered in the first three months of 2011 compared with the same period a year before.

Carlsberg even credited Baltika's recent success in Russia with driving a 38 percent increase in worldwide first-quarter profits.

But the consensus in the industry remains cautious — not least because there is more legislation on the horizon designed to reduce domestic alcohol consumption.

Today, beer is actually not legally classified as alcohol.

That doesn't mean that it can be sold to minors or that you have a few and get behind the wheel without fear of being fined, but it does mean beer is free from the much stronger controls applied to wine and spirits.

Unlike vodka, for instance, beer brands can still advertise on television — although commercials are banned from using images of humans or animals and confined to television slots between 10 p.m. and 7 a.m.

But a new law currently being considered by the State Duma would finally classify beer as alcohol and could ban all beer advertising on television, radio and billboards.

In February the State Duma passed an early reading of the bill, which would ban the sale of strong beer — over 5 percent — altogether from outdoor kiosks, airports and train stations. Shops would have to stop selling it between 11 p.m. and 8 a.m.

Beer producers' spending on television advertising soared to 1.22 billion rubles in the first quarter of 2011, up 141 percent on a year earlier, Kommersant reported last month.

The paper linked the hike to an anticipated ban, although representatives of Baltika and SUN InBev both told the paper that there had been no change in policy and credited the increased spend on rising advertising costs.

Meanwhile, export markets like Ukraine, Kazakhstan and Belarus have begun to dry up as they open their own licensed brewing of Russian and Western brands, said Yevgeny Filimonov, editor of the Ukraine-based trade journal Pivnoye Delo.

So the feeling in the industry is that the heady days have gone for good, and the best-case scenario is that the market will remain stable — provided personal incomes remain stable and inflation under control — Dementyev said.

Local Power

The real heavy hitters are the Russian brands, which account for the remaining 85 percent of the market.

The biggest selling local brand — and the jewel in Carlsberg's Russian crown — is the Baltika product line, which accounts for 40 percent of all beer sales in Russia. Other premium segment brands include Zolotaya Bochka (SABMiller) and Stary Melnik (Efes).

The Moscow Brewing Company's champion, Zhiguli Barnoye, is a lager that is matured for 21 days — unique in Russia, Dementyev claims — and trades on nostalgia for the Soviet 1960s.

The new version, as well as the classic Soviet Zhigulyovskoye brew — which is now in the discount segment of Carlsberg's portfolio and ubiquitously available at kiosks — get their name from the same region as the automobile.

Zhiguli Barnoye was launched in 2008 as the house brew for the legendary Zhiguli bar on Novy Arbat. Since then it has flown off the shelves as a middle-segment lager and kept the Moscow Beer Company expanding, though the overall market shrunk.

In the late Soviet period, the Zhiguli bar was one of very few drinking dens in the city. Back in 1987 its only rival was a large corrugated metal hangar with long wooden tables inside behind the Kievskaya metro station. Hopefuls had to stand in line for hours for both venues.

Zhiguli Barnoye's branding could best be described as Soviet retro; it is sold in old-fashioned green bottles with a sepia label evoking images of the 1960s. It does, however, have easy-open tops, tastes much more like a decent lager than its notorious Soviet-era namesake and is targeted at the "middle" segment of the beer market — comparable to Baltika's No. 3.

And it is also distinctly and recognizably Russian — as opposed to mainstream brands that have adopted Western-style labels with Cyrillic writing, Dementyev says. "If you look at the market, you understand that Zhiguli Barnoye is in fact the only truly Russian brand," he said.

The marriage of nostalgia with modern quality has paid off. It won the brand of the year at the Russian EFFIE awards in 2010, and in the same year sold more 0.5 liter bottles in Moscow than any other brand, according to data by research company AC Nielsen.

Though there is no stated desire to take on the leaders, it's clear that Zhiguli Barnoye's local success has given the company a certain giant-slaying confidence.

"One day, we hope to be the No. 1 brand in greater Moscow," Dementyev said. "We're going to grow, and we're doing a lot of enlargements to achieve that growth. That's the plan."

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