

Wine Business Solutions



The Wine Paper

Issue One – August 2007

Introduction

It's been almost three years now since we started Wine Business Solutions. During that time we've run business mentoring programs and helped wine industry clients across Australia, New Zealand and South Africa. It's been a wonderful journey. We've greatly enjoyed meeting you all, getting to know you and helping you where we can.

As promised, what follows is the first half-yearly summary of some of the key research findings and market analysis that crosses our desks along with some of our own helpful tips on building a better wine business.

We hope that you find this useful.

Peter McAtamney
Principal
Wine Business Solutions

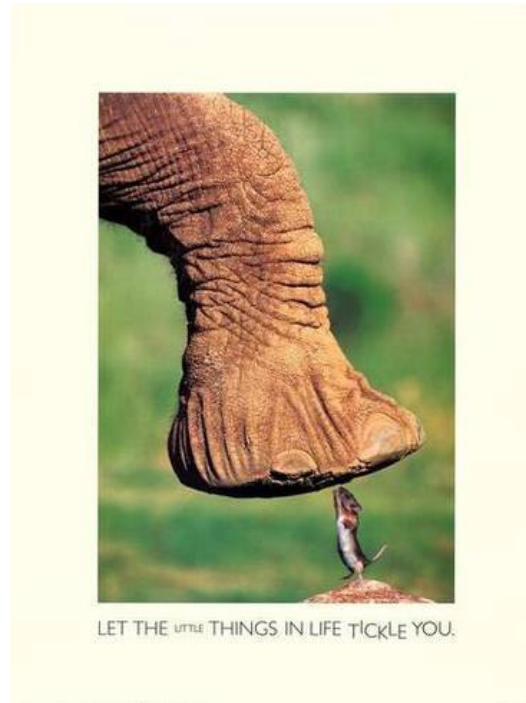
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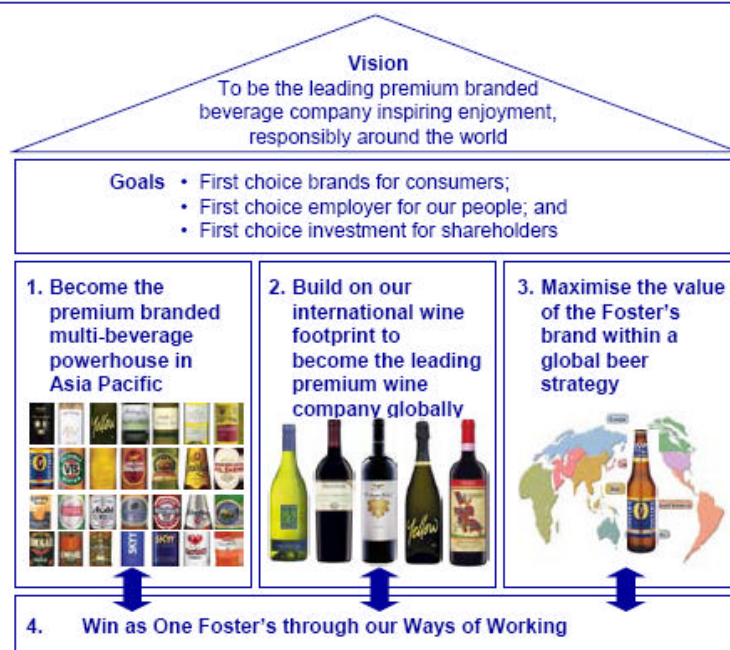
The Elephant and the Mouse.

Not so very long ago, you may remember certain industry commentators suggesting that it was a good time to be either an “elephant” or a “mouse”. In other words - medium sized companies, make sure your last will and testament are up to date...



Fosters boldly proclaimed to the world that it had a “Multi-Beverage” strategy that was going to see them become an “Asia Pacific Powerhouse”. They also said that their “International Wine Footprint” was going to result in them becoming “The Leading Premium Wine Company Globally”. Intimidating stuff...

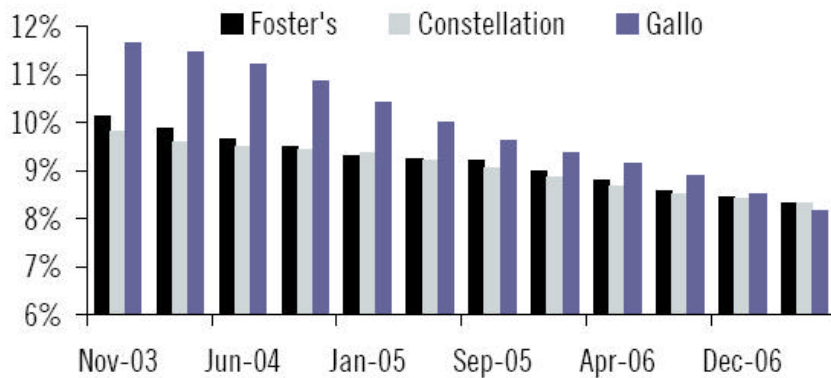
Foster's global strategy



But it hasn't actually worked out that way, has it? Far from steamrolling all before it, the new Fosters Wine Group has been "The Biggest Loser" in many respects. Its off premise volume share in the Australian market was down 10.7% YTD April 07, a far worse performance than any other top 10 company.

And it's not just in Australia that they're feeling the pinch. They've been on a long slow slide in the US. They're not on their own, however. The same has been applying to all three of the largest wine companies

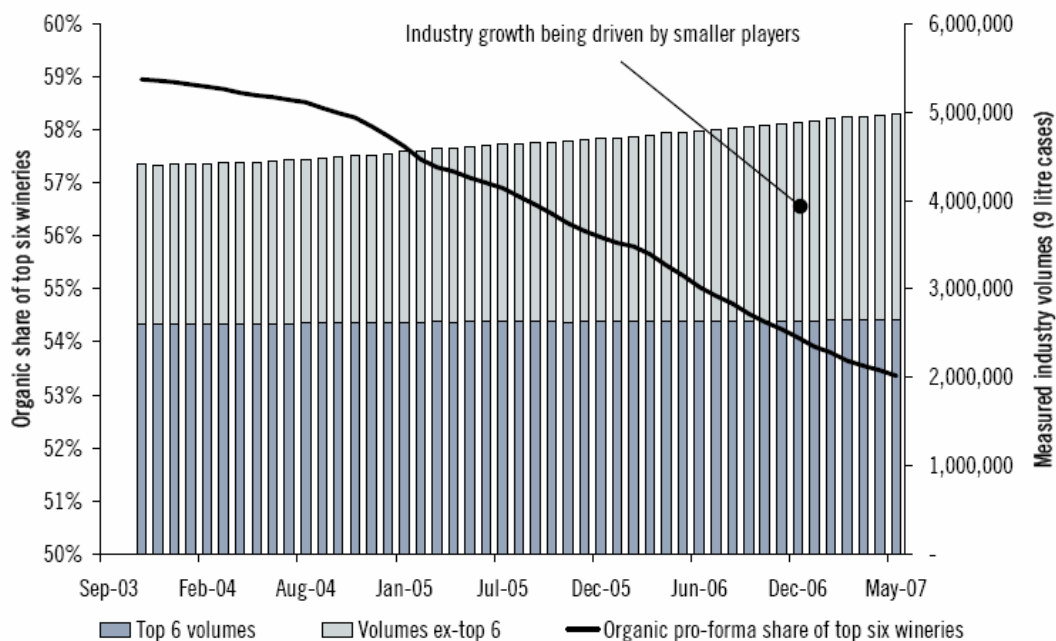
Figure 1. Top players losing pro-forma MAT value share in the US market



Source: AC Nielsen top 50 US and top 50 Australian brands, Citigroup Investment Research,

Gallo has been going downhill even faster than either Fosters or Constellation. Over the last four years, growth has been driven almost entirely by smaller players.

Figure 10. Top wineries are losing share



At the same time, the best performed firms in Australia, New Zealand and South Africa have all been medium sized ones (e.g. Brown Bros, Delegats and Fairview)

So why does this happen? Why do large companies find it so hard to turn the cost advantages of market share leadership into market share growth, enhanced profitability and ultimately - market dominance?

Firstly, several cross industry research studies have shown that industry market share leaders will lose up to 2% share per annum and their followers 1% if all other things remain equal and they don't significantly change the way they compete. This is where Fosters figured they had an advantage in that they did believe that they were becoming more competitive through their multi-beverage play.

All Fosters had to do was look at history however, to see the folly of aggregating similar sized companies with competing offerings and trying to maintain share. In 1991 Adelaide Steamships undertook arguably the most significant acquisition round in the Australian wine history when they consolidated the companies owned by Penfolds and Lindemans with Seppelt into the company soon after to be known as Southcorp. If you go back 4 years prior to this event, this vast array of famous names (many who have now sadly passed into history) represented 64% of the Australian grape crush. This became a company with a 32% market share. As we all know, Southcorp then acquired Rosemount (or, some say, it was the other way around) and was bought by Fosters to create a company with less than a 20% domestic market volume share today.

We can see that this is what has happened to Distell (who claimed an incredible 85% domestic market share at the time Distillers and SFW got rolled together) and Montana (who claimed 65% domestic share after buying Corbans).

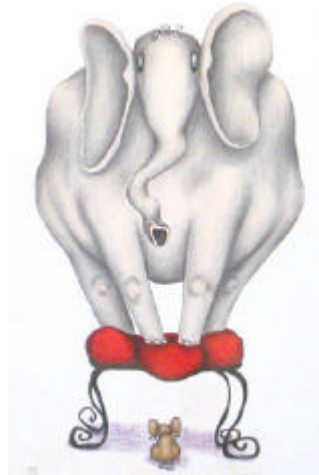
Stephen Millar (Chairman of Hardys) once told me that he fancied his chances of taking market share from Montana by acquiring its competitors far more so than holding share if they were to acquire Montana. He was right. Constellation today claims a 15.8% share of the NZ market. (NB - it should not go unnoticed, however that Constellation are about to experience their own grief as a result of their seemingly endless acquisition spree)

So why is this so? Well, there are a number of reasons

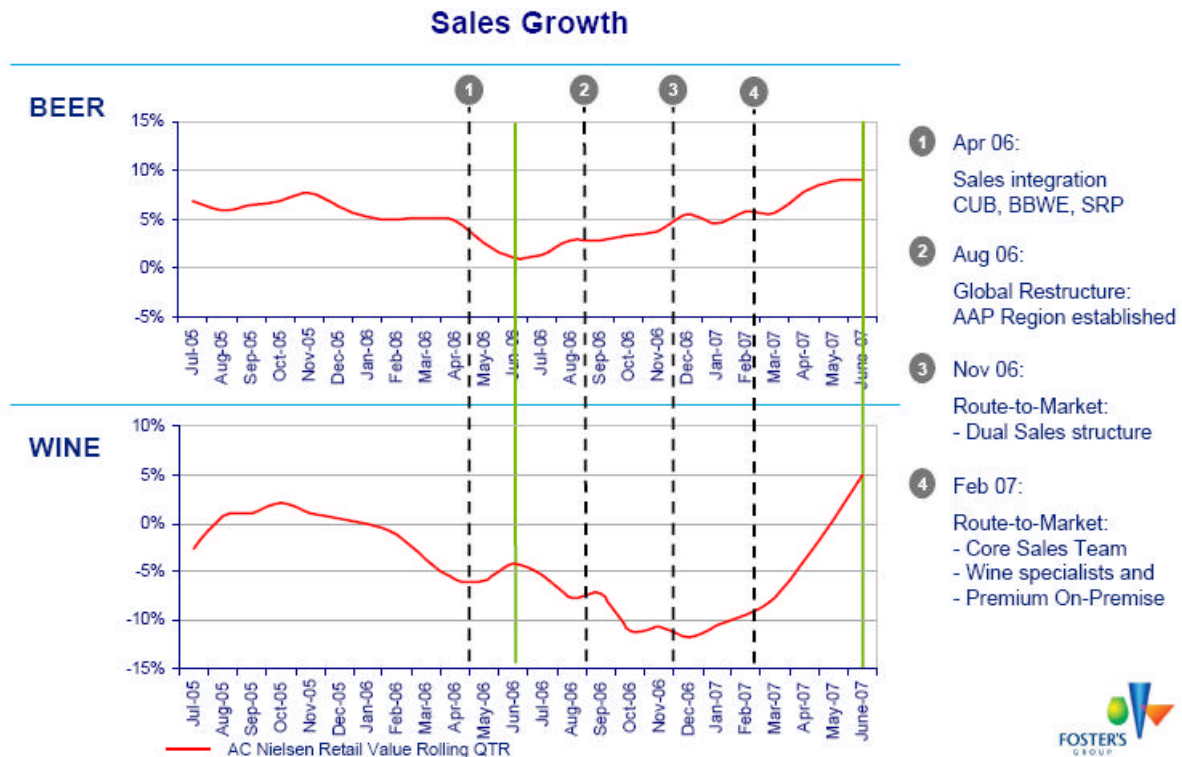
1. Complexity kills companies. Most companies have far too many line items creating way too much confusion.
2. When really big companies make really big acquisitions, there are "really big" inefficiencies and double ups. For example – when Constellation bought both Hardys and Vincor - did they really need all of those Australian and New Zealand brands?
3. When big companies talk about "synergies" after acquisition, it is well documented that these rarely work out either economically or in corporate cultural terms. It's hard to keep smiling when all your friends are being fired.
4. It's not that easy to transition out of wine industry assets once they're in place. Attacking new opportunities is therefore inherently better suited to new companies
5. But most importantly and most relevant to you – good operators tend to enter the market with an offering much better targeted at a customer group than these large incumbents generally manage.
6. These companies are given a free leg up through the turmoil that acquisitions create (e.g. [yellow tail] replacing Rosemount in US distribution and Kim Crawford opening up opportunities through departing the NZ market).

Big companies have dedicated brand managers who have very sophisticated consumer insight available to them. By the time they attempt to execute upon this in the field, however, sales representatives are simply not equipped to carry multiple, sophisticated, integrated brand stories in their heads and execute them at point of sale.

Ross Brown (CEO Brown Bros, the leading Australian wine company by domestic value share growth as at June 07) once told me that the maximum number of brands stories his sales guys could remember was one. He wasn't being unkind to his sales force, just understanding of the importance of focus and the number of different elements that have to be correctly executed in order to build a brand properly as opposed to "flogging grog".



In the end though, we should perhaps pay heed to the wise words of Tony Sernack (Marketing Manager for Lion Nathan at the time of the launch of Tooheys Blue, Tooheys Red, Tooheys Dry and Lion's first ever serious incursion into Victoria) – He once said to me in relation to Fosters - "Never underestimate the importance of size." Foster took some time to respond to Lions aggression but upon doing so have taken more than 10% of market share from them.



In their 2007 year financial results released yesterday, Fosters claim that things are turning around for them in Australia. Beer is not wine, however and I'm putting my money on history repeating.

A Bull at the Gate

Wine Business Magazine this month tells the heroic tale of Angus the Bull, a single wine with a single, simple consumer proposition – Goes well with Prime Beef. It's not the first time they've run stories about new and / or small players getting it right and winning.



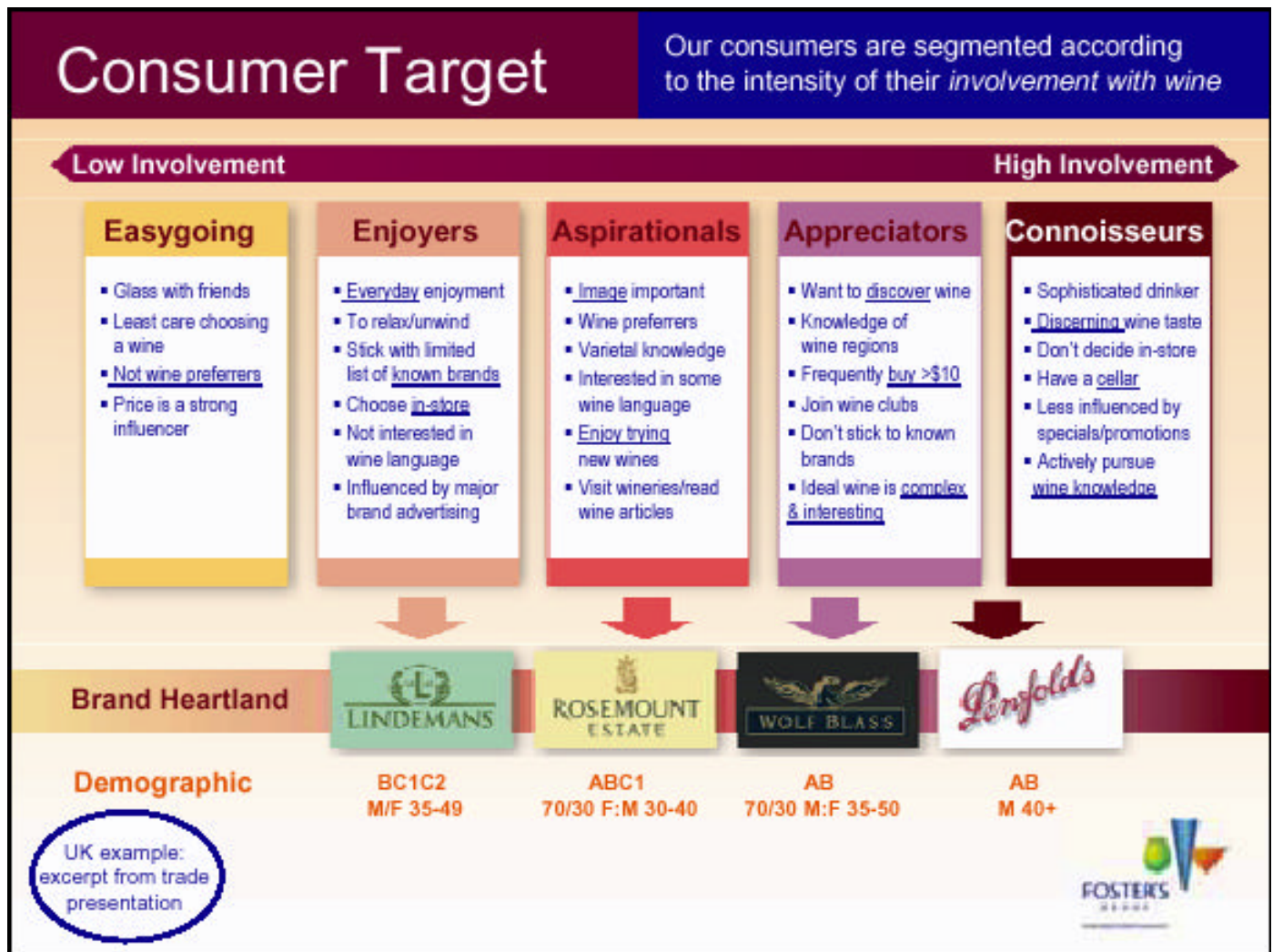
And it's not just niche players who can win in the current environment. Sometimes people come along and see the opportunity for what it is and simply put a better offering all together in front of consumers thereby stealing most of the market, [yellow tail] being perhaps the best example.

Oyster Bay did this as well. They understand the female wine consumer and they too have this strong and easily understood connection to a wine and food. Likewise - Fairview and cheese.



You may recall how in the late 1990s several “futurist” were claiming that world was about to be dominated by 5-6 huge corporations? Today, more that 65% of the market capitalisation of the New York Stock exchange comprises companies that didn’t exist in the year 2000.

So what are these companies getting right that the big established companies are missing? For a start, in our industry, they’re recognising that there are a least five big ideas of wine that really have nothing to do with one another. As below, Fosters do get this.



The problem is that Fosters have stretched their brands across these consumer segments to the point where it’s unclear as to what brand really is for whom? They don’t fit neatly into the pigeonholes they’ve put them in above.

Using one brand to cover multiple price points and consumer categories was a tactic that worked in the 1990s when competition wasn’t so hot and people simply wanted a brand name they could trust. As you can see from Fosters demographic profiles, the Aspirant group and the Appreciator group, for example, have almost nothing to do with one another. The 30 year-old, urbane women who is buying a bottle of Oyster Bay to drink with her girlfriends is probably going to want to break it over the head of the “Appreciator” type who insists on talking about wine over dinner. When wine industry newcomers came along and said to consumers - “we understand who you are and what you want and we’ve got a brand that’s just for you” the “one brand fits all” approach just wasn’t going to be good enough.

Consumer Target

Our consumers are segmented according to the intensity of their *involvement with wine*

Low Involvement

High Involvement

Easygoing

- Glass with friends
- Least care choosing a wine
- Not wine preferers
- Price is a strong influencer

Enjoyers

- Everyday enjoyment
- To relax/unwind
- Stick with limited list of known brands
- Choose in-store
- Not interested in wine language
- Influenced by major brand advertising

Aspirational

- Image important
- Wine preferers
- Varietal knowledge
- Interested in some wine language
- Enjoy trying new wines
- Visit wineries/read wine articles

Appreciators

- Want to discover wine
- Knowledge of wine regions
- Frequently buy >\$10
- Join wine clubs
- Don't stick to known brands
- Ideal wine is complex & interesting

Connoisseurs

- Sophisticated drinker
- Discerning wine taste
- Don't decide in-store
- Have a cellar
- Less influenced by specials/promotions
- Actively pursue wine knowledge

Brand Heartland

[yellow tail]

Oyster Bay

Brown Bros

Torbreck

Demographic

BC1C2
M/F 35-49

ABC1
70/30 F:M 30-40

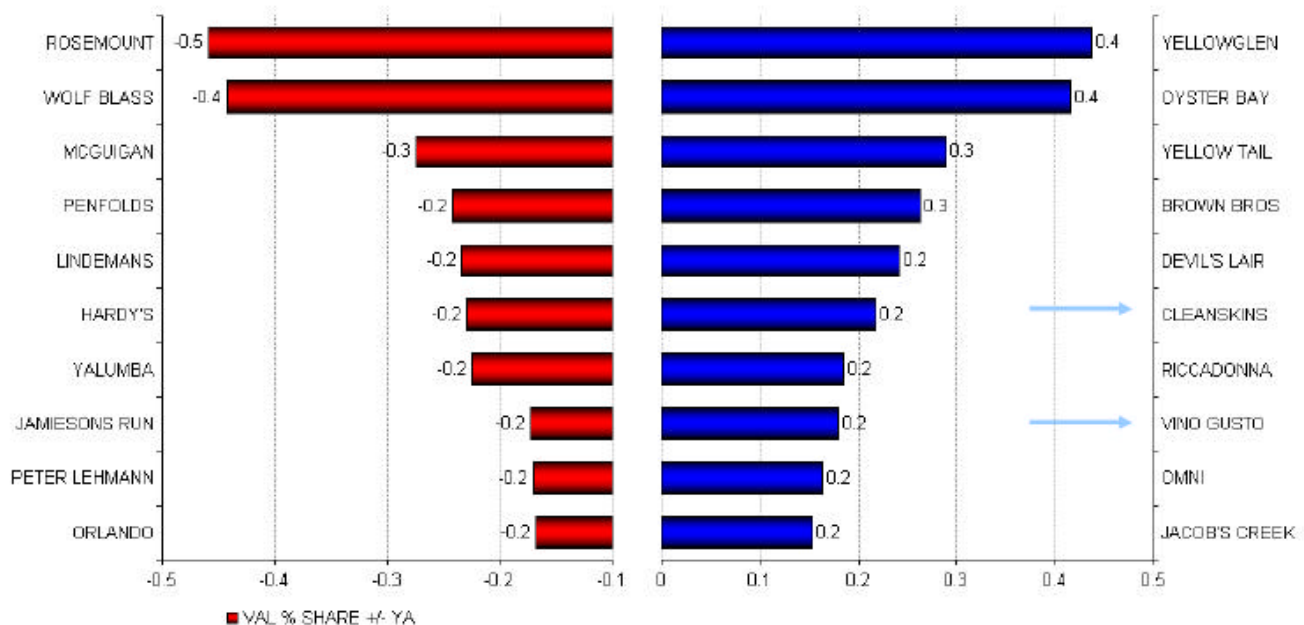
AB
70/30 M:F 35-50

AB
M 40+

UK example:
excerpt from trade
presentation



TOTAL WINE | Share Winners & Losers
AUSTRALIA - MAT TO 30/04/2006 | Unit of Measure: Value - \$(000'S)



Source AC Nielsen

So just how exactly are these brands targeting what consumers want more effectively? Work on understanding these “five big wine ideas” – the key wine consumer groups – began in Australia as long ago as 1986 and culminated in research by Hall and Winchester into the ultimate end values sought by each group.

Brand	Target Customer	Benefits Sought	End Values Sought
Vergelegen Dry River Torbreck	Connoisseurs	Discernable quality and Brand Association	Sense of accomplishment Comfortable Life Social Recognition World at peace Equality
D'Arenburg Spice Route Trinity Hill	Appreciators	Discovery and learning	Social Recognition * Exciting life Sense of Accomplishment
Oyster Bay Porcupine Ridge Innocent Bystander	Aspirants	Enhanced Social Status and Self Image	World at peace Social Recognition True Friendship Exciting life Sense of Accomplishment
Graca [yellow tail]	Enjoyment Orientated	Special to share, Easy to drink	True Friendship
Chateau Libertas Black Box Wines	Beverage Wine Drinkers	Recommended Reliability	Inner Harmony

Hall, J., & Winchester, M.K., (2000). What's really driving wine consumers? Australian and New Zealand Wine Industry Journal, Vol 15(4), 68-72.

**Added in. Not proven by this research*

End values are the underlying motivators of consumer action and are enormously important. Oyster Bay and Banrock Station are great examples of brands that tapped into this “World at Peace” consumer end value. Oyster Bay ended up there almost accidentally through choosing a name designed to be even more appealing than Cloudy Bay. Banrock Station worked off this understanding most deliberately.

Fosters research in the UK picked up a vital consumer segment that Hall and Winchester misses – Appreciators. It would be great if someone were to carry out publicly available research into their end values and close this gap but no one seems prepared to fund it at this point in time.

Having had quite a lot to do with this group over the last 20 years or so as most of you will have also – I'm willing to wager that one of the drivers for them will be “social recognition”. For this group, talking about and collecting wine is a bit like a competitive sport. This is what Stormhoek have recognised and they've created a major brand through giving their wine to bloggers and getting them to blog about it.

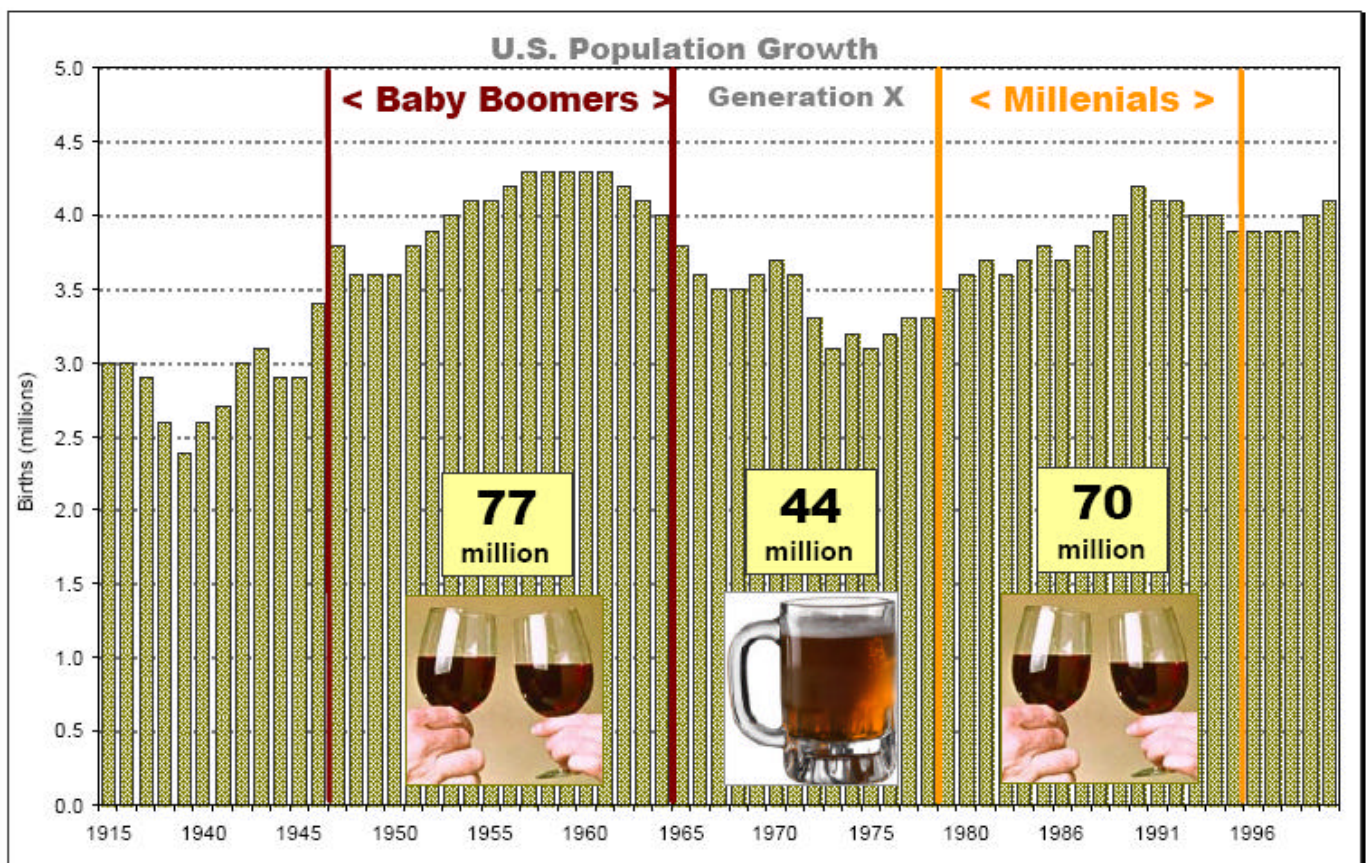
Stormhoek.
The best
South African
wine for the
money, end of
story.



www.stormhoek.com

©hugh

If you're interested in using new technologies to reach new wine consumers, the Stormhoek site has a lot of interesting links that talk about ways to do this. Being well connected to Millennial wine consumers as their interest peaks is going to be critical for wineries.



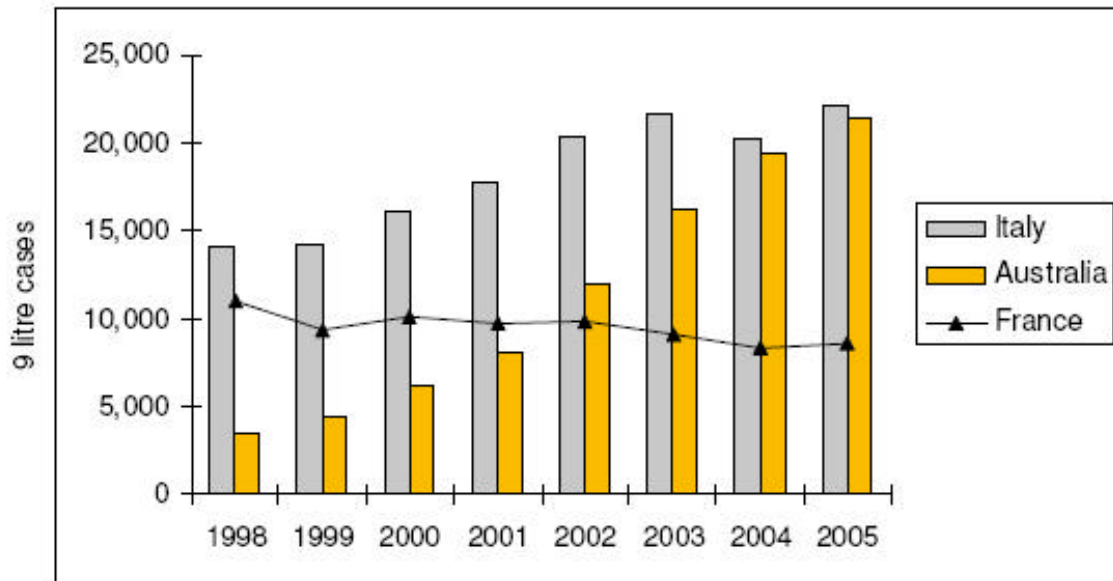
Source MKF Research, US Census Bureau

Working on every aspect of your brand to accurately reflect what your customer wants out of the experience of it will generate a lot more opportunity yet.

Something to Chew On...

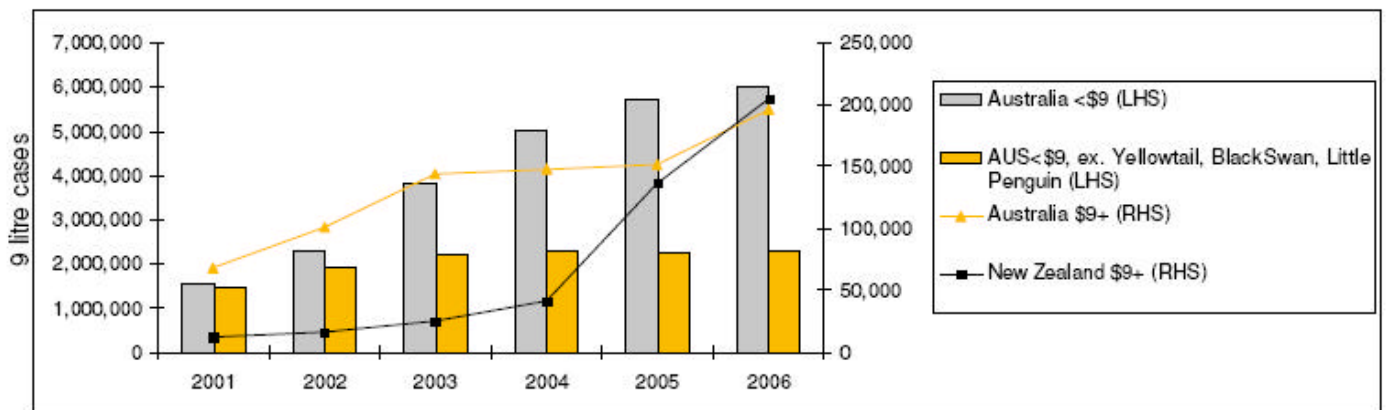
The following slides are from Lion Nathan's Anthony Robert's June 07 analyst briefing talking about the US market...

Australia has experienced almost 30% annual growth for the last decade, catapulting it past France in total sales, and poised to challenge Italy



Source: Impact 2006

- While Australia has grown 30% annually since 2001, it has been driven primarily by three brands, Yellowtail, Black Swan, and Little Penguin
- Excluding these three brands, sub-\$9 AUS wines have only grown 10%
- Conversely, \$9+ AUS wines are up 23% annually and NZ is up an astonishing 76% annually



Source: Source: IRI

The “Top Ten Tips” for Building Better Wine Businesses.

(from Wine Business Solutions article published in Wine Business Magazine, March 2007)

One - Start by understanding your customer value proposition. Only part of this stems from your company's unique heritage and / or personality. To be successful, this needs to be strongly linked to what your customers ultimately want from the experience of your brands. There is some excellent research on this that is publicly available. Getting it right is therefore not out of the reach of small companies.

Two - Once you understand what customers value most, you can then remove what they don't want (thereby reducing costs and freeing up cash), focus your communication on what they do want (often at no additional cost), differentiate your company on the basis of fulfilling customer needs more accurately than any competitor (again often at no extra cost) and raise prices (because your offering is more highly valued)

Three - Always be asking the question – “If I could start with a blank canvass today – what would our wine business look like?” It's all too easy to let existing assets, existing product lines and existing ways of doing things blind us to what it is that our consumers value most. Often it's simplicity. Complexity usually adds to costs and often only serves to confuse customers. Retaining unnecessary or irrelevant product lines, assets or business processes is the worst contributor.

Four - Make everyone in the company accountable for securing customer preference. This is not just the job of marketing but of everyone in the company, the owner most particularly. Make this the focus of the way every employee innovates their job processes on a daily basis.

Five - Invest in relationships. This is particularly so with major distribution partners. Make sure sufficient time and money is invested before demanding results. Be prepared to invest up front in bringing them to your home base and entertaining them in order to build enduring friendships.

Six - Make all employees champions for profit. Develop a culture of honesty around net revenue. Make sure everyone knows the actual price achieved net of all discounts, rebates, bonus stock and anything else that might otherwise cloud the true profit picture. Keep them focused on reducing costs but let them know that a percentage increase in wine company revenue is, on average, twice as effective as the same percentage decrease in the cost of goods sold and 3-4 times as effective as the same percentage saving in operating expenses.

Seven - Optimise your pricing mix. Focus first on selling more, higher margin product in high value markets to high value customers. Beware of people in love with “big volume”. Big numbers make for big stories but often mean a lot of running around for no addition profit.

Eight - Build better business intelligence gathering systems – most companies are good at monitoring their own press. Very few have effective systems in place to monitor competitors, track changes in consumer preferences and turn customer feedback into customer value added.

Nine - Build 5-10 year Strategic Plans, forecast rolling 12 month budgets link them to the most relevant KPIs and tie remuneration to these where ever possible. Everybody knows they should do this. Few do. The difference in performance of companies that do is enormous.

Ten - Watch your cashflow – building a cashflow forecast is a relatively easy exercise with the right software and some quality assistance. Some people survive years of losses but you can only run out of cash once. In a cash hungry business like wine – Cashflow is King.