

Wine Business Solutions



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# **The Wine Paper 17**

**August 2011**

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## ***Choosing your Channels***

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## CHOOSING YOUR CHANNELS

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Channel strategy is arguably the single most important set of decisions any wine business makes.

Critical questions include;

- Which partners are the best match for my brand and audience?
- Can they tell my story with as much passion and enthusiasm as I do?
- Do they understand brand building and can they stick to a strategy?

The channels that you choose to pursue and the extent that you are prepared to rely upon any one of them will depend upon a number of things.

- Do we have a database, the customer relationship management (CRM) skills and the dedicated resources to execute a direct to consumer strategy effectively?
- Am I a better brand principal than a sales force manager? Am I clear about what skill set is required for each task?
- Do I have the stamina necessary to support brand building in far flung markets?
- Am I more comfortable working in certain channels than others?
- What other skills and resources do I need / can I access and leverage?
- What will mitigate my risk in terms of exposure to different markets, routes to market and channels of distribution?

Ultimately, your channel strategy has to support the physical distribution of your wine, your communication strategy and generate required sales revenue.

As a starting point, I thought it timely to look at the current state of each of the five main paths to market:

1. On-Premise
2. Chain Retail
3. Independent Retail
4. On Line Retail and
5. Direct to Consumer

WBS has just completed its 3<sup>rd</sup> [Wine On-Premise Australia](#) report. The report covers who the best distributors are on a National and State by State basis along with major market trends and opportunities.

There have been some big changes in the last 12 months that reflect the natural evolution happening in all markets.

Most dramatic has been the demise of big name traditional brands that are heavily promoted through supermarket-owned retail. These are being roundly rejected by restaurants, far more so than they were a year ago.

It's not all about lack of effective strategy either. In the case of some of the largest companies, there has been a conscious decision to abandon the on-trade in favour of servicing those channels where they have a cost advantage and can deliver more competitively – chain retail, in other words. Viewing their brands as unit commodities, they feel that the on-trade is expensive to service compared to multiple retailers.

Is it a good long term play by these companies? I would argue strongly that it is not. Organising Australia's largest wine businesses around the Branded wine consumer, competing on cost and abandoning premium price segments has and will further weaken the Australian wine brand globally whilst ensuring that those same company's trade customers continue to amass market power driving down supplier profitability.

It does, however open up huge opportunity for well organised medium sized companies who understand brand building in premium segments. Image driven brands such as Cape Mentelle, Leeuwin Estate and Cloudy Bay, by stark contrast, have never had it better.

It's not at all necessary for listed companies to simply give up this ground. Fine Wine Partners and Moët Hennessy are, after all, large public companies. FWP now leads the On-Premise sector with one in every 10 listings. LVMH brands can be found on 56% of Australian wine lists, according to our research.

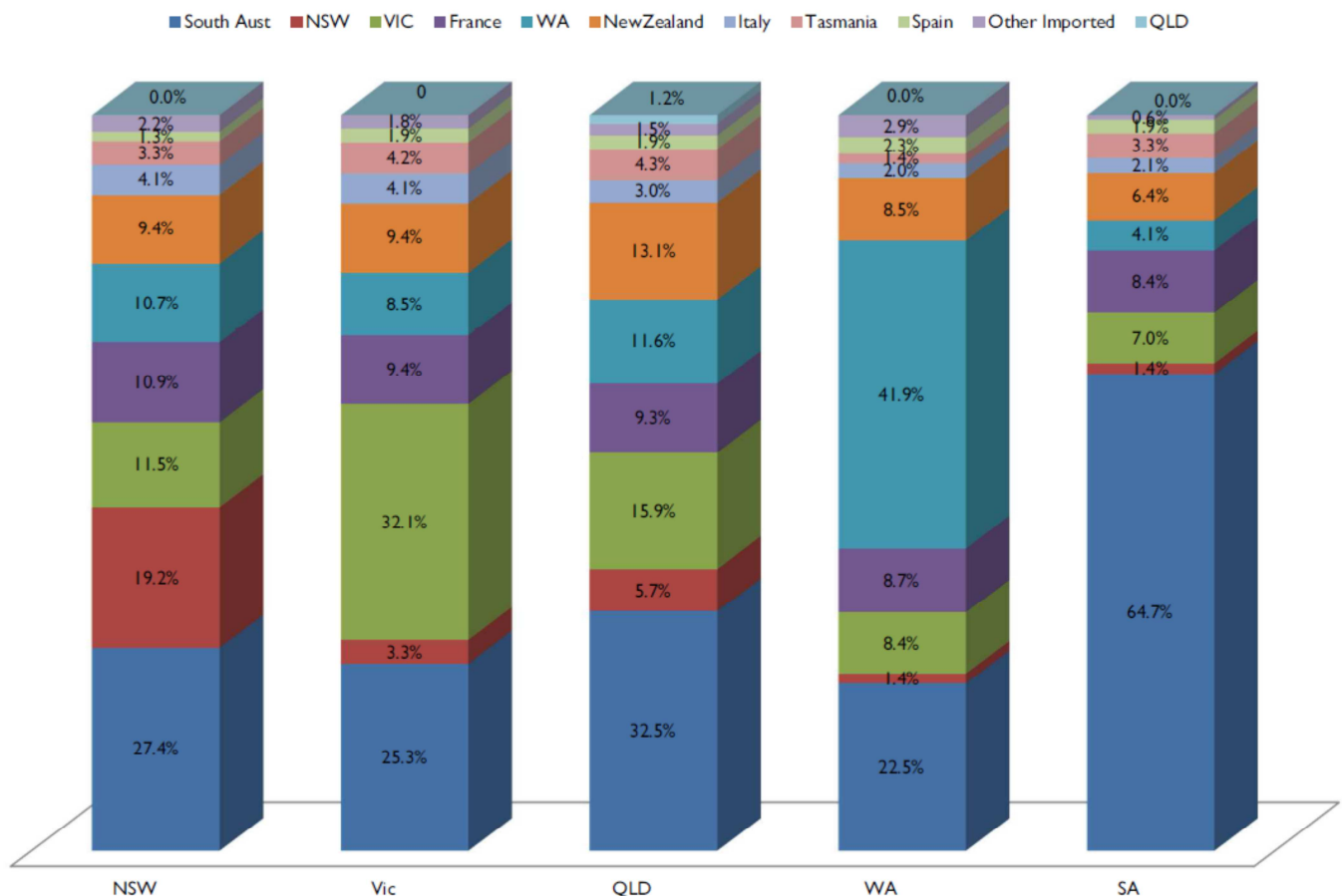
Some of our clients like Grant Burge, for example, have managed to have it both ways through developing innovative hybrid models that address changes in all channels. This is always a bit of a tight rope walk, it has to be said.

Why are On-Premise listings so important when building premium brands?

- People buy what they try. There are very few other trial opportunities for wine.
- It's a chance for your wine to be seen and consumed in the best possible surroundings.
- It's a chance for you to be shared, remembered, recommended and bought again later.
- It's one of the only true 'brand building' opportunities many wines will ever experience.

Imports are now up to 26% of listings spawning the raft of new distributors. In a market that is becoming rapidly more sophisticated, there are opportunities aplenty for smaller producers with a unique offer who place themselves amongst the more “interesting” portfolios.

All of Australia's States with the exception of NSW have less share of wine listings than they did a year ago. NSW wines are receiving strong support from NSW government in their home state and it is starting to yield results. Listing of NSW /ACT wines in NSW / ACT restaurants are up 22% year on year.



Percentage Share of Wine Listings (for States and Countries) by State

The biggest winners amongst the Australian regions are those located in mainland cool climate zones. Orange, Adelaide Hills and Canberra are all up over 60% in terms of their share of listings when compared to a year ago.

Wine On-Premise Australia 2011 can be purchased from our web site.

<http://www.winebusinesssolutions.com.au/research>

## DANCING WITH GORILLAS

I recently had the pleasure of meeting Joe and Renato Berardo. Joe (pictured below) is the majority shareholder of Cumulus wines of Orange - NSW, a major shareholder in Chateau Laffite, the largest shareholder in Sogrape (makers of Mateus Rose) and owns the largest wine distributor business in Portugal. Two supermarkets they sell to there have over 75% market share. The only way that they hold their number one slot is through razor sharp cost and inventory management. This is where it ultimately gets to with duopolies. As a supplier, it is not a race you want to come 2<sup>nd</sup> in.

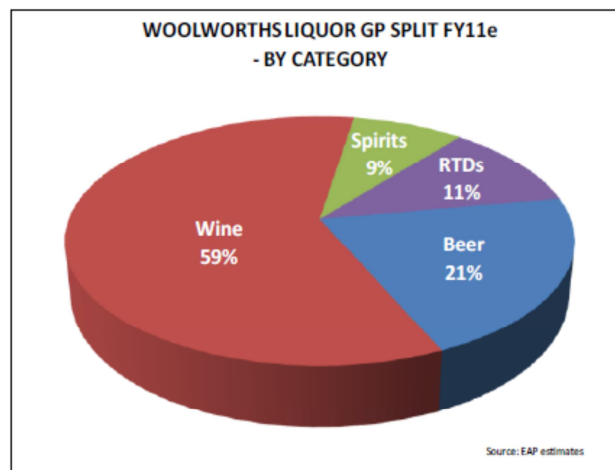
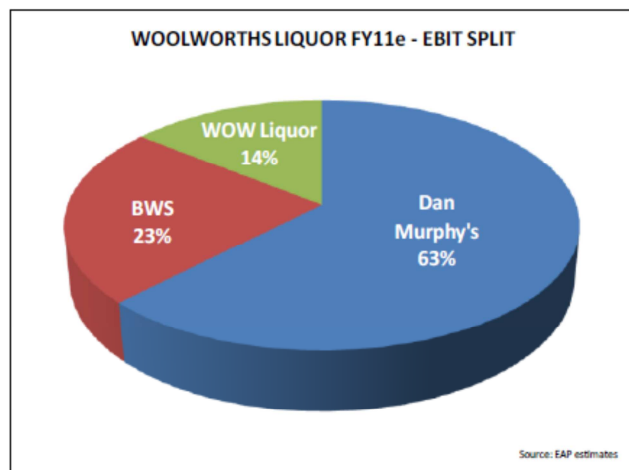
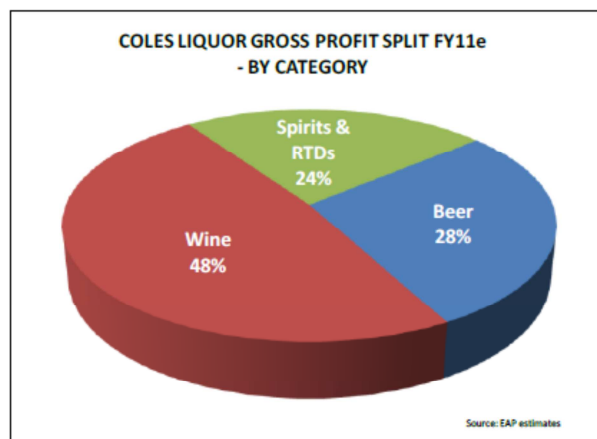
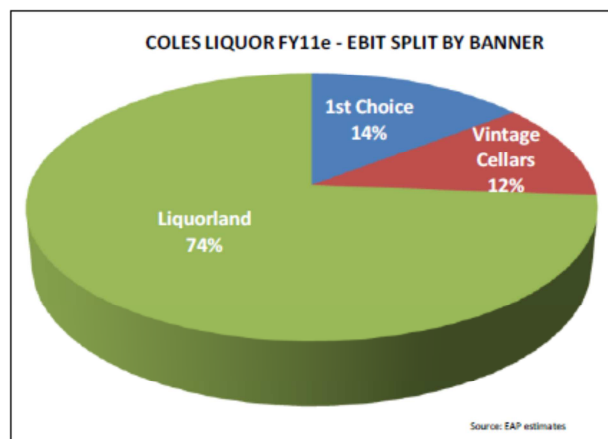


Evans and Partners recently published a most enlightening analysis of liquor retail in Australia. If you were tossing up between the two large format retailers - Dan Murphys (Woolworths) and 1<sup>st</sup> Choice (Coles) then that race has already been run and won. Dan's smashes Coles on practically every score.

	Average market	Dan Murphy's	1st Choice	Comments
Stores (no.)		133	82	DM store rollout = 15-20 p.a.; 1C store rollout = 8-10 p.a.
Sales per m <sup>2</sup> (\$'000's)	7 - 12	13.5	10	DM at the top end, 1C struggling to get value and volume.
Average store size (m <sup>2</sup> )	750 - 2000	1600	1300	Very similar, 1C new stores getting larger but DM still overall a touch above.
Sales per store (\$m)		21.6	13.0	
TOTAL SALES (\$m)		2,873	1,066	
Sales composition:				
Beer	35-60%	35%	50%	1C locations weighted to areas of high beer consumption.
Wine	25-55%	50%	35%	DM's premium store positioning supports higher % of wine sales.
Spirits	5-10%	7.5%	7.5%	
RTDs	10%	7.5%	7.5%	Higher convenience style formats have higher RTD skew.
Gross Margins:				
Beer	3-7%	6.5%	6.5%	On promo beer margins avg ~0-3% = 60-70% of sales. Off promo = 10-12%.
Wine	25-35%	28.0%	27.0%	On promo wine margins 17-27% = 50% of sales. Private label margins ~40%.
Spirits	5-6%	9.0%	9.0%	Choose not to compete aggressively in this category.
RTDs	5-10%	7.5%	7.5%	Choose not to compete aggressively in this category.
TOTAL GROSS MARGIN	10-14%	17.5%	13.9%	General industry perception (10-14%) different to our DM estimates.
TOTAL GROSS PROFIT (\$m)		503.1	148.6	
Cost of doing business (%)	10-11%	10.0%	12.5%	More a fixed cost rather than % of sales. Dan's scale gives it advantage.
Cost of doing business (\$m)		287	133	
Cost of doing business (\$m per store)		2.2	1.6	DM marginally higher given higher turnover and store footprint.
EBIT Margins	3-4%	7.5%	1.4%	General industry perception (3-4%) different to our DM estimates.
Operating Profits (\$m)		215.8	15.3	

Source: EAP estimates

NB. All estimates are made having regard to "back margin" and other rebates from suppliers.



## Total Woolworths

Stores (no.)	1257
Selling area (000's m <sup>2</sup> )	334
Average sales / m <sup>2</sup>	16

Beer	1,888
Wine	2,152
Spirits	642
RTDs	605
<b>TOTAL SALES REVENUE</b>	<b>5,272</b>

Beer	226
Wine	634
Spirits	90
RTDs	121
<b>GROSS PROFIT</b>	<b>1,070</b>

Beer	12%
Wine	29%
Spirits	14%
RTDs	20%
<b>GROSS PROFIT MARGIN</b>	<b>20%</b>

<i>Cost of doing business (%)</i>	14%
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<b>EBIT</b>	<b>346</b>
<b>EBIT margins</b>	<b>6.6%</b>

## Total Coles

Stores (no.)	892
Selling area (000's m <sup>2</sup> )	254
Average sales / m <sup>2</sup>	11

Beer	1139
Wine	902
Spirits & RTDs	709
<b>TOTAL SALES REVENUE</b>	<b>2749</b>

Beer	156
Wine	267
Spirits & RTDs	130
<b>GROSS PROFIT</b>	<b>554</b>

Beer	14%
Wine	30%
Spirits & RTDs	18%
<b>GROSS PROFIT MARGIN</b>	<b>20%</b>

<i>Cost of doing business (%)</i>	16%
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<b>EBIT</b>	<b>106</b>
<b>EBIT margins</b>	<b>3.9%</b>

“Big Box” stores (Dan Murphys and 1<sup>st</sup> Choice) are taking share from their own convenience stores (BWS, Liquorland, Woolworth Liquor etc.). Independents are suffering but not disappearing as some commentators would have you believe. There are still around 15,000 of them at last count. Whilst they have only 40% share in Victoria, they have more than 60% in the other States.

Where will it all end ? Without government intervention and a lot of industry support, Evans and Partners back Joe Berardo’s view that the duopoly will end up with around 75% of off-trade sales just as in Portugal. That sort of market power and continued global oversupply will ensure that dealing with them remains unprofitable for all but the biggest.

In New Zealand and South Africa, things are very similar in terms of the supermarkets controlling the market. The big difference for Australia is that wine is not actually sold in the supermarket isles. For that reason alone, I doubt that Australia will get to a situation where there are only 5 specialist wine stores for 4 Million people as in New Zealand. The premium wine sector is robust in Australia and total consumption has just broken through 30 litres per head for the first time.

Is it game over then for Woolworths? I’ve just visited the Sydney Costco store for the first time recently. Those of you in other parts of the world may have trouble understanding the excitement but Australasia has been waiting to 30 years for the Hypermarkets the rest of you enjoy and we’ve gone a little bit crazy.

Australian stores are immediately outperforming those in the US on a turnover basis. Half kilometre queues of people wait for the doors to open into a building that occupies a block that Australia’s largest electronics store occupies a fraction of on the opposite side of the road. Inside is mayhem. The profile of the average Costco store customer is interesting. Male, average age 50, educated, high income. Hmmm.

Their wine offer contains a lot of parallel imports but is almost all high-end. As well as familiar local brands at good prices for the suppliers, there are incredible bargains on wines from the most famous European appellations. As you would expect, it is all being ‘hoovered’ up. At this early stage, it is a great and unexpected opportunity even for some of the smaller brands we work with. My expectation is that they will be extremely successful as they build their offer and that Dan Murphys will lose a lot of their direct to trade market.

Quoting their Auburn liquor manager – “Dans will turn away customers they know to be trade. We don’t care. I sold a pallet of Chivas Regals to a customer yesterday.”

Perhaps it is not getting any easier in retail but it certainly is getting more interesting...



## INDEPENDENTS

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As earlier mentioned, the independent retail sector is still alive and well in Australia if coming under increasing pressure from large format retail. Larger companies have a propensity to confuse convenience retail with fine wine specialists. Convenience on a one store or chain basis has little hope against the supermarkets. Fine wine specialists still have a world of possibility in terms of providing a better experience and a more interesting offer.

Our clients who have formulated strategies to target independents have achieved phenomenal growth in the last 12 months. Fosters encouraging their trade customers to buy at Dan Murphys rather than their own representatives has created a legacy of resentment for Treasury Wine Estates opening up opportunity for competitors.

Again, those companies with an offer that is not heavily promoted through the chains do well here. Grant Burge, Tyrrells, Beelgara and others have developed innovative strategies to avoid upsetting this valuable client base. Beelgara have again announced a \$2Million plus EBITDA result this financial year which is largely the result of a well thought through channel strategy.

## ONLINE RETAIL

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On line retail is now thought to be around 9% of the market for wine in Australia so no serious wine player can afford not to have a strategy. [Grays On-Line](#) still lead the way selling around 800,000 cases annually. Their auction offer has been affected somewhat by the drying up of excess inventory but this has been countered by the huge range of “buy now” wines the site now offers.

[Cracka](#), with its innovative reverse auction system and Cellarmaster's [Zimi](#) are two new players battling it out to become the wine portal in the same way that car sales and real estate sites become the ‘go to’ place to buy. Millions are being invested but no one seems to have the model perfected as yet. Part of the problem is that most of the players are targeting retail type margins leaving no way to affect true ‘disintermediation’. They need these margins to cover high fixed overheads and marketing spend.

The winning model, I believe, will be a small player working of a very low cost base offering a single portal for wine producers to sell direct charging a very low margin. Watch this space...

This remains the number one opportunity for profitable growth for small to medium wine businesses in our view. Returns from direct to consumer sales are typically 8-10 times higher than working through 3 or more tiers of distributions in export markets.

So why is there not a mad rush resulting in the opportunity being nullified through excess competition? The answer, I believe, is that the key elements require focused, sustained effort. US research confirms that wineries with dedicated resources dramatically outperform those where the job of “club manager” (the person who is responsible for the direct to consumer effort) is also the cellar door manager, local area sales manager and event co-ordinator etc.

The sector is most evolved and alive in the US. According to VinQuest™, in the year to Dec. 2010 -

- *Total direct sales by U.S. wineries: \$3.4 Billion*
- *Overall direct sales growth: 12%*
- *Tasting room sales growth: 2%*
- *Wine club sales growth: 19%*
- *Online wine sales growth: 38%*
- *Mail order sales: 12%*
- *Phone order sales decline: -9%*
- *Event sales growth: 37%*
- *U.S. wineries projecting consumer direct as their fastest growing sales channel in 2011: 62%*

If you fancy going direct to consumer in the US, you can anticipate 2-3 times the profit of working through importers and distributors. As there are always places where your distributors don't reach, this can be a nice supplement to your business. We have contacts who can help you set this up.

In Australia, the phone really has been the way to go. A number of companies including [Cellar Force](#) and [United Cellars](#) have been achieving phenomenal results for our clients not by managing primary customer contact but by following up club members after campaigns via phone. Response rates can be over 30% and we know of a number of cases where 2-3 follow up campaigns have added over \$1Million to the revenue of relatively small wine businesses. Yes, they charge a good margin and you need to watch what they are doing with your database. It is a highly specialised skill, however, and the majority of clients who try to manage direct sales themselves end up back with specialist providers. This is inviting competition.

What am I doing when not writing these newsletters?

**Oppourtunity Analysis** – I've just given a key note speech at the Bragato Conference in New Zealand on the Global Supply and Demand situation and opportunities for the New Zealand wine industry going forward. As well as aggregating information from our extensive research database we, of course, were able to incorporate insights from our own On-Premise and other research. ([See Blog Post](#))

**Regional Brand Strategy** – In the last year, WBS has worked with Mudgee on regional brand strategy (Mudgee increased Off-Premise sales by 41% in the year since, according to Nielsen – their hard work, not ours), we've recently finished a Marketing Plan for the Coonawarra Vignerons Association and we're working with the NSW Government on improving On-Premise distribution of NSW wines.

We'd of course love to help your region if we can.

**Mergers and Acquisition Activity** – WBS is currently project managing the part sale of major Western Australian wine business to foreign investors. The sale is near to completion.

WBS some time ago advised on the merger of two 10,000 tonne plus wineries in the Wellington Region of South Africa. The merger has recently been successfully completed. We helped facilitate the sale of Wine Inc. to the Foley Group creating a 700,000 plus case Australasian wine company.

We are pleased to welcome Adam Parkinson to the WBS team as an Affiliate. Adam has considerable skills in the areas of Information Memoranda preparation and Due Diligence support etc.

### **CRM and Club Management**

WBS is pleased to welcome Michael van der Sommen as an affiliate. Michael was Constellation's cellar door chief managing 7 different sites. Michael has a comprehensive understanding of available software, its integration into a variety of systems. Michael can help you understand how to get the most from your database and CRM processes.

**OH & S** - WBS has commenced it OH & S consulting with a leading Victorian winemaker.

If you are concerned about the effects of the new national legislation should contact John Tregambe on 0408 337 326

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

*(From a Wine Business Solutions article published in Wine Business Magazine)*

**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 canvas 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 additional 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 not just King but Oxygen.