

Wine Business Solutions



The Wine Paper 18

November 2011



Sink or Swim Time

Page 3 – Export or Die?

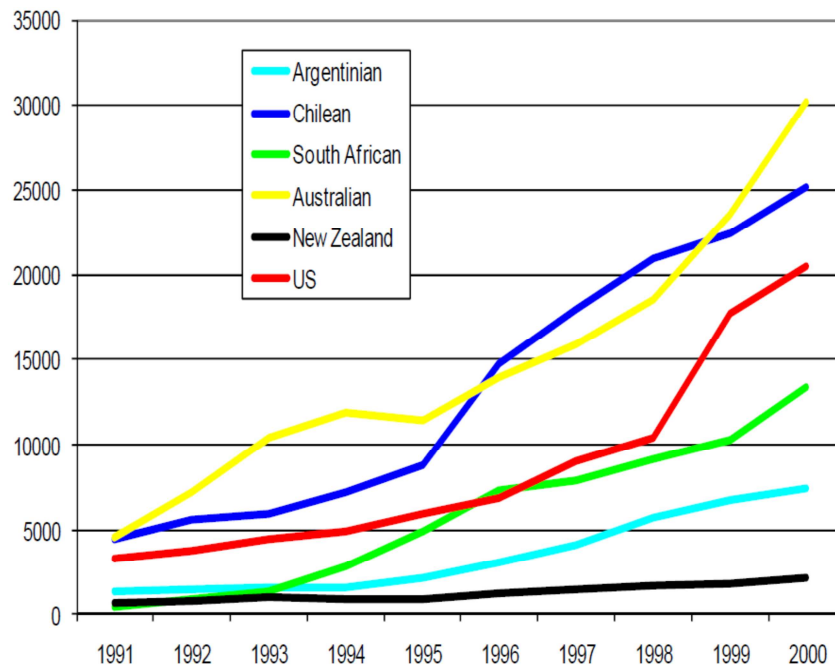
Page 4 – Selling to the Home Market

Page 6 - Protecting Premium Wine Brands

Page 11 – The Top Ten Tips for Building a Better Wine Business

“Export or Die !” was Brian Croser’s catch cry as he led the fearless charge of the New World onto the global stage. Ah, yes - those were heady days weren’t they? Forget J curves – Australia’s trajectory looked more like an out of control skyrocket being chased by Chile. South Africa burst back onto the international stage like a rampaging rhino. New Zealand took an extra decade to get organised but when it did, was like Richie McCaw after a loose ball...

Figure One – New World Wine Exports ‘000 9 Litres Cases – Source IWSR



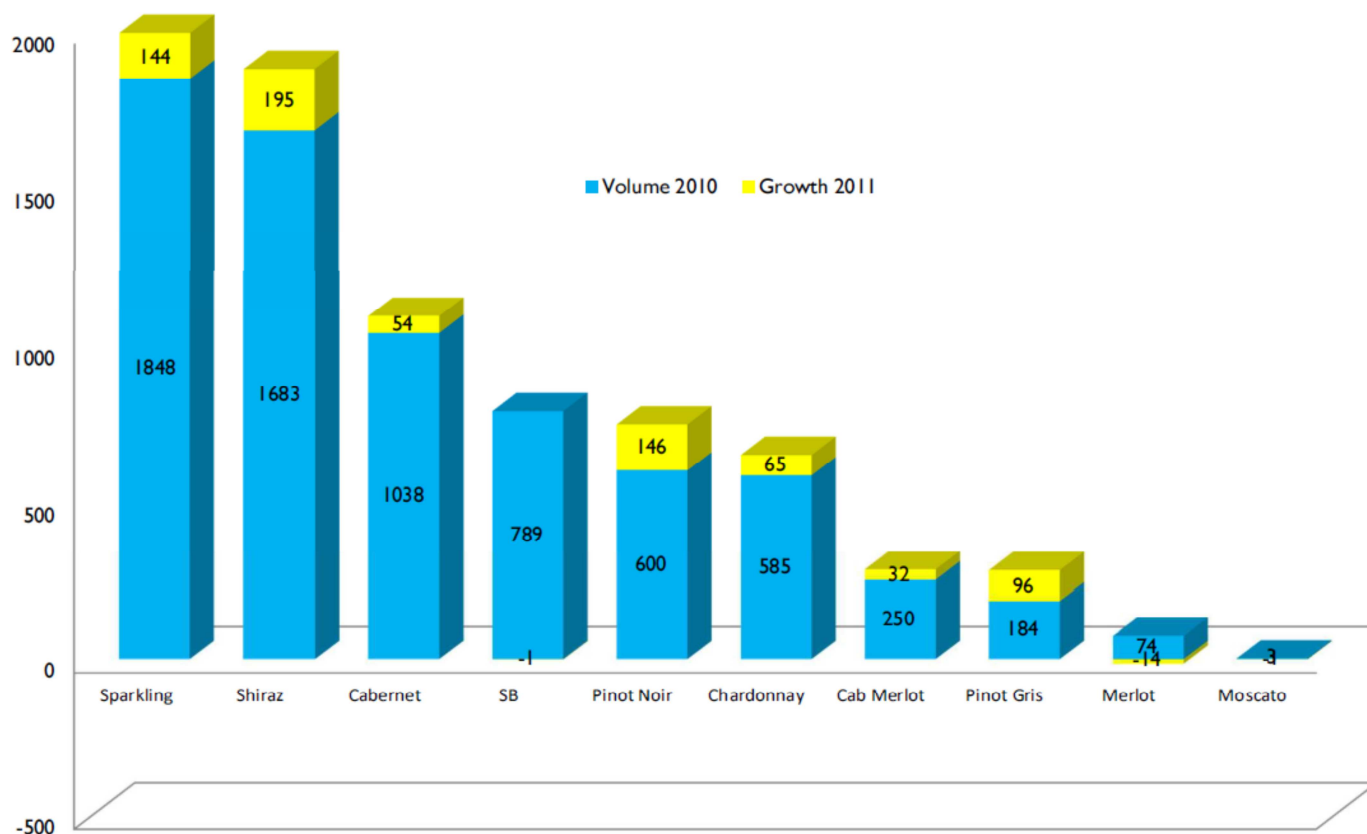
Export really was the saviour for rapidly growing New World wine producing countries but with exchange rates working against Australia, New Zealand and South Africa recently, global oversupply and toughening international competition, the future viability of those exports is now coming into question. Should individual producers persist?

Certainly direct to consumer is where the margins are but most will ultimately need to seek out other channels if they want to continue to grow their business.

South African domestic demand has been flat for a decade at around the 39 million case mark. New Zealand has grown from around 5 to 7 Million cases in the last 5 years but against a production of around 25 Million cases, total domestic consumption is not making a big contribution to reducing oversupply. Australia also looks less inviting now that imports have slowed and total domestic demand appears to be peaking. Sometimes, however, when working out where to go, it pays to dig deeper...

Wine Australia's principle promotional program during the early part of next year will involve selling Australian wine to the Australian public. Who would have thought? Altogether, over 30 regions are now involved in the largest series of events of this type ever undertaken. On the basis of the latest Nielsen data to September, this would seem to make some sense for small to medium producers. Whilst the overall market may be flat, there is significant growth in premium wine sales.

Figure Two – Sales volume ('000s litre) of \$20 plus wine sales as measured by Nielsen.



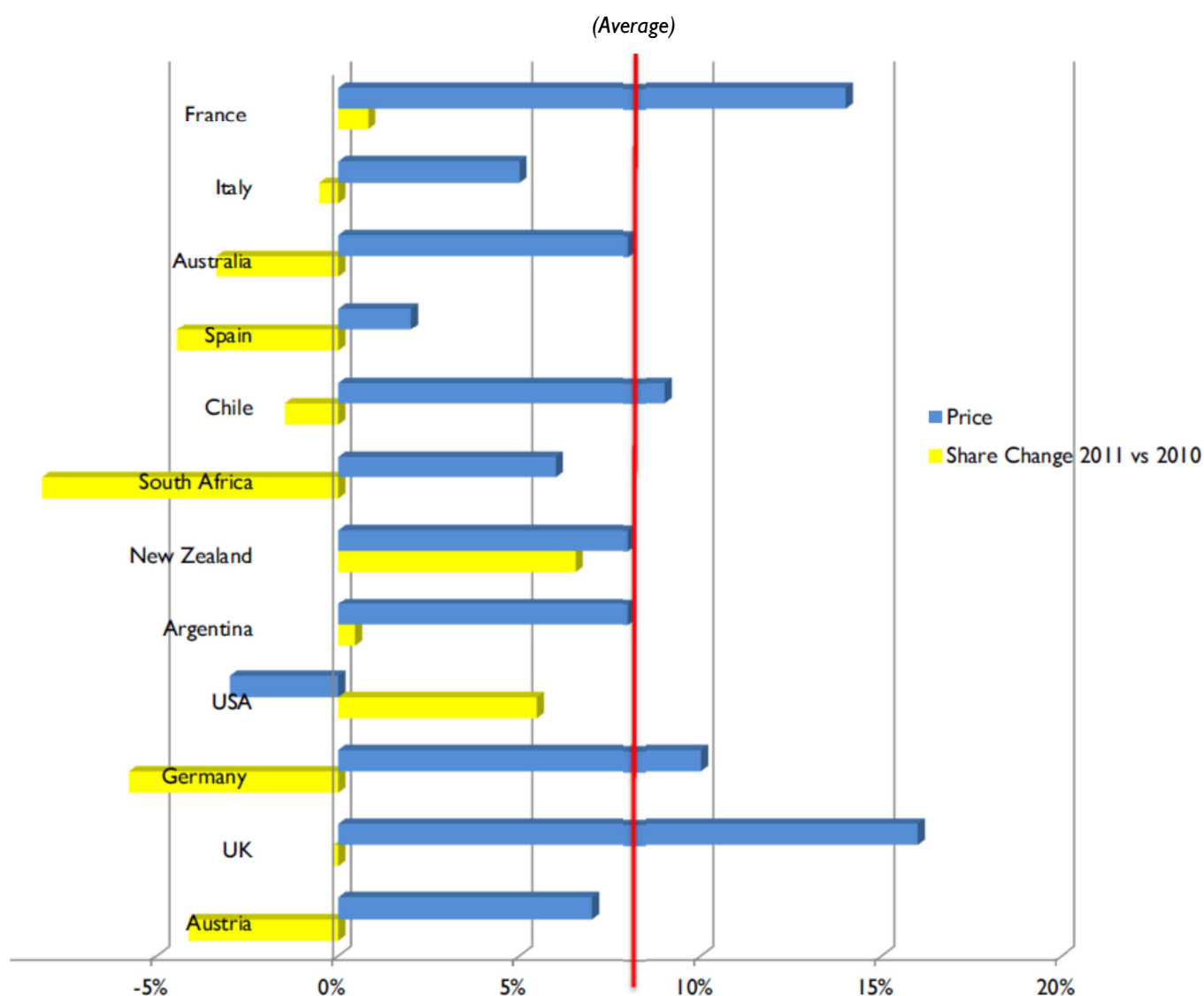
According to Nielsen, wine sales volumes at over \$20 per bottle are up 12% MAT. Pinot Gris is up over 50% (as it was last year) and Pinot Noir 24%. Chardonnay and Shiraz are both up 11%. Sauvignon Blanc is flat but that is almost entirely due to the non-performance of leading Australian brands rather than any slowdown in the sales momentum of premium Marlborough product.

With a 29% tax rebate thrown in on top, why would small to medium Australasian producers look outside the home markets? The simple answer is that as Australia exports over 60% of its production, South Africa over half and New Zealand over 70% this is simply not an option. It still is “export or die”, I’m afraid otherwise this ocean of wine will wash back over us like a tsunami. And if Australia’s best brands continue not to make their presence sufficiently felt in premium channels in key export markets, the whole house of cards could come crashing down. Here’s why.

Our third [WINE ON-PREMISE UK](#) report is just hot off the press and we've found compelling evidence that reducing prices and/or average quality levels not only damages brand image in the long run, it can almost immediately lead to a drop in sales, dashing profits.

For example - In 4 out of 5 cases when countries failed to match or bettered the average increase in listed price On-Premise in the UK during the last year, they lost market share. Only the US grew. In 4 out of 7 cases, those countries that matched or bettered the market average increase in price increased their share. The French, who understand this better than anybody, lifted their total share of listing to over 40% again this year whilst raising their average listed price by 14 %.

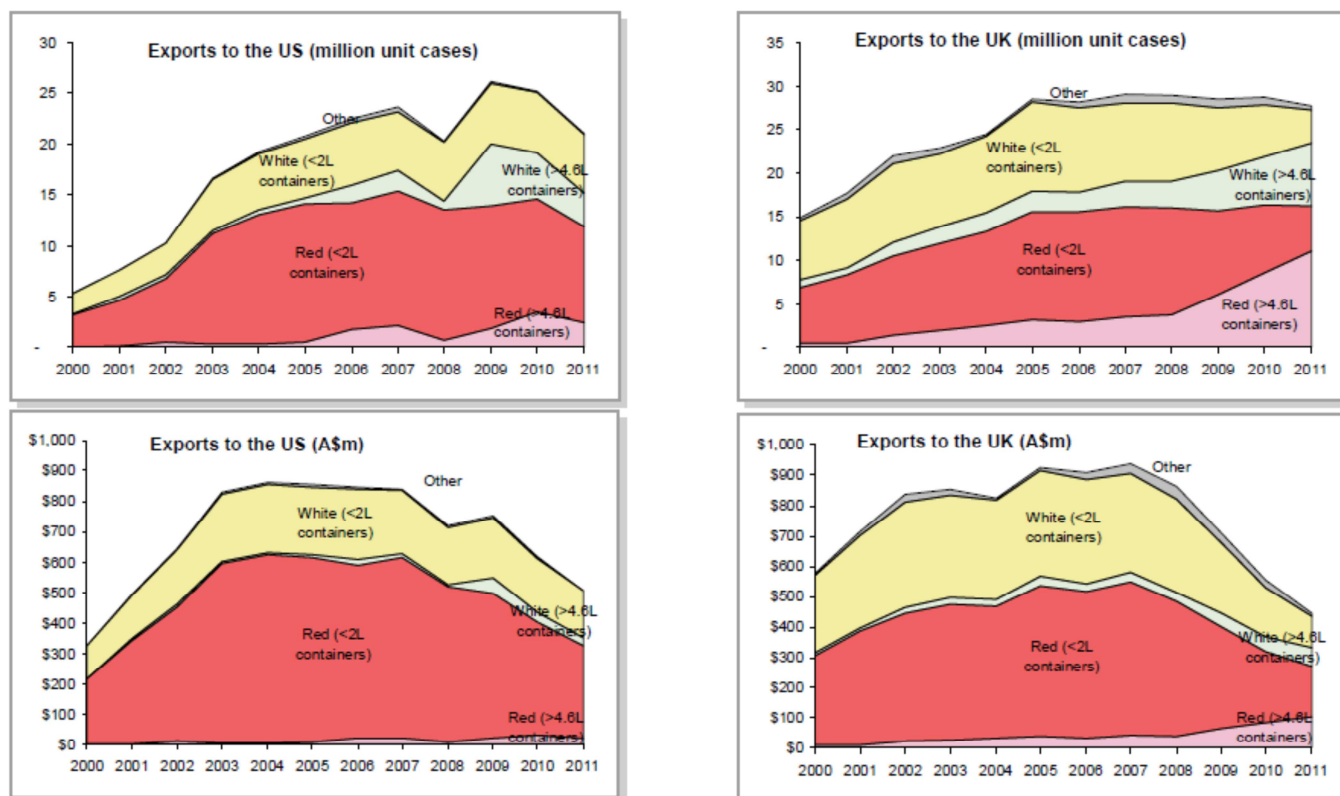
Figure Three – Increase in Average Listed Price and change in Share of Listing for Leading Countries.



This was a theme that we encountered throughout the report. It is also something we have seen before as markets move out of recession, Moët Hennessey being the classic example of how to play. Those brands that do not discount and those categories that hold or build their prices outperform those that cave in.

With the advent of bulk wine shipments for in-market bottling, working out exactly what is going on in export markets as a whole has become increasingly challenging. You need to be able to view quite a bit of data on one page in order to make a proper assessment. In the US each time Australia has turned on the bulk wine “tap” in recent years, this has been followed by a slowdown in sales across the board. Declining bottle wine sales, a higher percentage of bulk shipments and unfavourable currency movement has slashed the value of exports. In the UK, in-market bottling may have largely substituted bottled wine shipments volumetrically but exporter profits have been decimated.

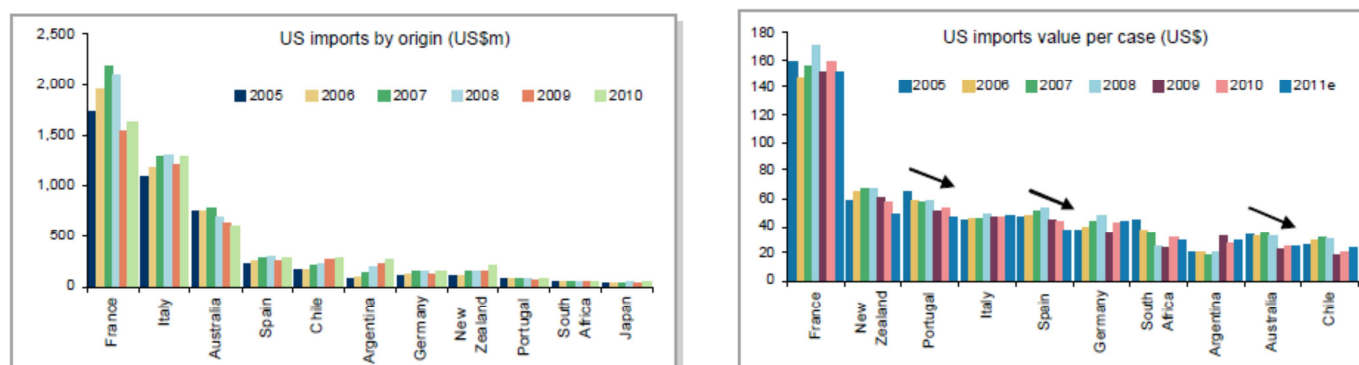
Figure Four – Australian Wine Exports to the US and UK - Value and Volume.



Source – ABS, Morgan Stanley Research

We found the same when we looked at Morgan Stanley analysis of the US market. The harder Australia, Spain and Portugal attack price, the worse their sales performance.

Figure Five – US Imports Volume and Value – Source – Morgan Stanley

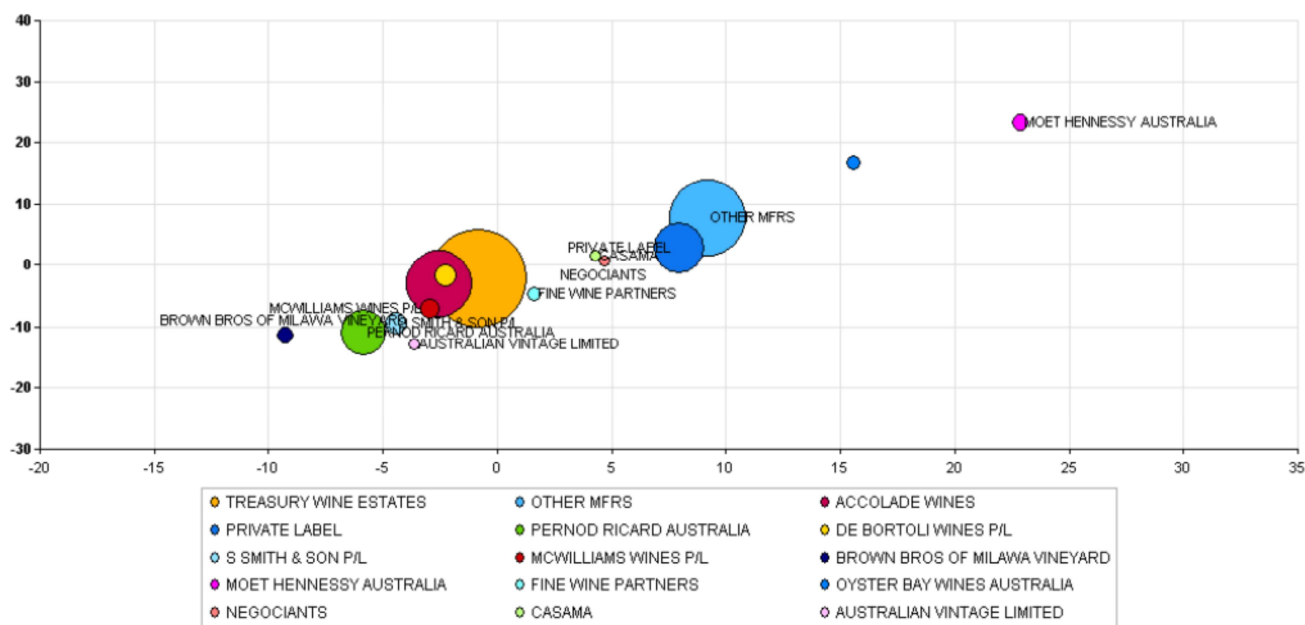


When we look at the Australian Off-Premise sector, you can see the principle operating in reverse. The leading company is French and it is increasing the value of its sales faster than volume. Moet Hennessy wins hands down just as they do in the Australian On-Premise.

Figure Six – Performance of leading Australian companies in the Australia Off-Premise

MANUFACTURER SIZE & GROWTH

AUSTRALIA - MAT TO 31/08/2011 • Period Ending AUGUST 2011 • X Axis = Val % Chg YA | Y Axis = Vol % Chg YA | Bubble Size = Val Sales



Country: Australia Total Market: AUSTRALIA Total Product: TOTAL WINE Source: Nielsen ScanTrack [LWINSMI]
Fact Basis: \$(000'S), LITRES(000'S), UNITS(000'S) Retrieval Condition: Top 'X' in defined Market & Period

Australia has over 2600 estate wine producers, 8-9 world class wine producing regions amongst over 60 appellations and the full pallet of food friendly wines across every wine style. It is the outright leader in the UK Off-Trade with over 20% share. The country brand could not be more familiar. With the advantage of common language, Australia is perfectly placed to be a world class competitor in the UK, the world's largest On-Premise market.

Instead it has a meagre 8% share and has been on a continuous slide since we started researching our Wine On-Premise UK report. Why is this so? For a start, wines from South Eastern Australia (a place that doesn't actually exist let alone provide any quality assurance to the consumer) now accounts for 41% of listings up from 37% in 2010. And it's not the listed companies that are to blame. They have long since given up on the On-Premise. In Australia, SEA wines account for less than 2% of listings. If Australians will not drink these wines in a restaurant, you would have to ask why UK consumers should be expected to. If you think about it, it is the exact opposite of what Chile did. In the early days, they had to create a whole new wine offer at a higher quality level for the export market.

The Australian “First Families of Wine” group which includes Peter Lehmann, dArenburg, Yalumba, Brown Bros. and de Bortoli are hanging in there providing the backbone of the Australian effort in the UK.

The runaway success of Berton Vineyards, who are little known in Australia, will be great for them and for part owners Hallgarten Druitt but, just like [yellow tail] in the US, not so great for the category.

Figure 7 - Top Twenty Most Listed Australian Wine Brands in the UK On-Premise – WBS Research

Brand	Share 2011	Share 2010	Change
Berton Vineyards	3.3%	0.6%	422.8%
Little Yering	3.0%	0.0%	-
Peter Lehmann	2.8%	1.8%	56.4%
de Bortoli	2.4%	2.1%	14.6%
Yalumba	2.2%	2.4%	-8.3%
d'Arenberg	1.9%	2.1%	-6.7%
Cape Mentelle	1.6%	1.3%	18.1%
One Chain Vineyards	1.3%	1.9%	-30.3%
Opal Ridge	1.3%	0.6%	127.0%
Pitchfork	1.2%	0.0%	-
Trentham Estate	1.2%	0.4%	201.1%
Warburn Estate	1.2%	0.2%	652.8%
McHenry Hohnen	1.1%	0.8%	42.2%
Grant Burge	1.1%	1.3%	-16.4%
Berri Estates	1.0%	0.9%	14.1%
Jim Barry	1.0%	0.8%	25.5%
Mount Langhi Ghiran	1.0%	1.5%	-34.0%
Brown Brothers	0.9%	2.1%	-55.0%
Innocent Bystander	0.9%	1.2%	-21.9%
Branch Creek	0.9%	0.0%	-

You can never blame lack of performance on someone else’s success, however and the key the health of any country category is quality producers turning up to play. France also supplies a lot of cheap wines to restaurants from the Languedoc and South West etc., but 45% of its listings are at over £40 per bottle and as earlier mentioned, they hold 40% of the market. Herein lies the opportunity.

For example, if your goal is to make \$200,000 profit @ £26 per bottle (the average listed price of an Australian bottle of wine On-Premise back in 2009) then using a gross margin figure of 45% and an operating expense margin of, let’s say 30%, you would need to sell nearly 22,000 cases of wine to achieve your objective at today’s exchange rates.

Too many small to medium producers listened to importers who told them that that was the price they had to be at and of course they ran a mile. Too many people still talk about wine as one idea instead of looking at the segments.

If you thought a small parcel of that wine was exceptionally good and might actually justify selling for today's average listed price of £44.47 a bottle, you would only have to sell 2300 cases or 1/10th the volume to produce the same profit result.

Why is this so? Cost components like excise duty, warehousing and freight are fixed costs per case and don't change with your selling price. The leverage effect of a small percentage change in retail price has a huge effect on profits and, therefore, the number of cases you need to produce to have a viable business.

Figure 8 – Volume of Case Sales Required to Make a \$A200,000 Profit at Given Margins

Number of cases needed to make \$A200,000		21,858		2,254	
EBITDA	15%	\$9.15		\$ 88.75	
Op EX	30%	\$18.30		\$18.30	
COGS	55%	\$33.55		\$33.55	
Ex cellar price - \$A		\$ 61.00		\$ 140.60	
Exchange rate	1.56	£39.10	1.56	£90.13	
Freight	£1.80	£40.90	£1.80	£91.93	
Warehousing	£2.40	£43.30	£2.40	£94.33	
Freight out	£3.00	£46.30	£3.00	£97.33	
Duty	£20.28	£66.58	£20.28	£117.61	
Agent Margin @ 20%	22%	£85.00	20%	£147.00	
Wholesaler Margin @ 20%	20%	£106.20	20%	£183.00	
Price per bottle		£8.85		£15.25	
Restaurant Margin @ 60%		£22.13		£38.13	
Value added tax @ 17.5%	0.175	£3.87	0.175	£6.67	
List price		£26.00		£44.47	

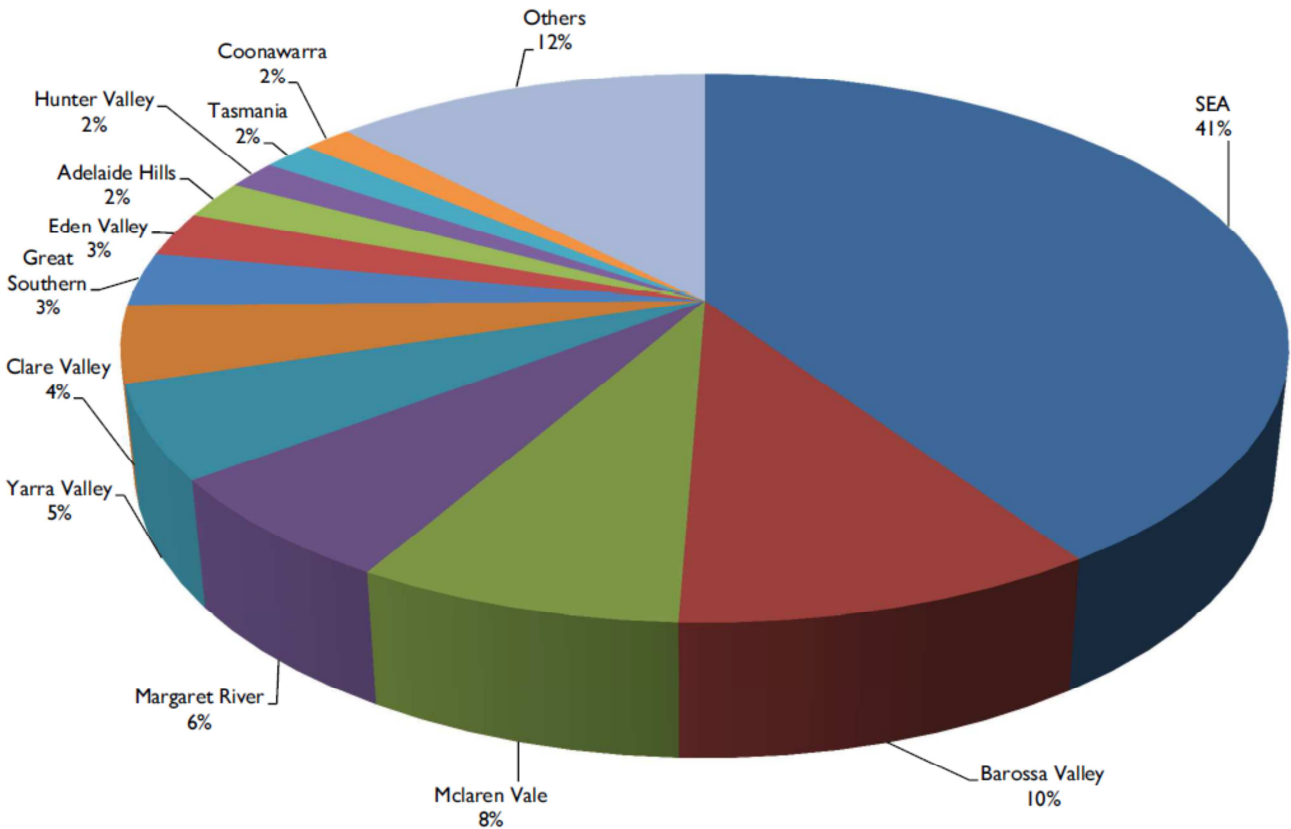
Now of course better wines have a higher cost. The model above only works if you average your costs across your production. That average price of £44.47 will net you over \$140 as an FOB price regardless and there is not a quality estate producer anywhere in the world that could not make money at those prices. It is simply a question of getting the right wine and the story in front of the right audience and finding the right distribution partners (one that understands the estate wine model) to support.

Quoting Frank Zappa RIP – “you are what you is”. Your country’s brand image will not change until the wine we sell does.

You can help, strengthen the offer and build your business by participating. We can help, we hope, by shining light on who the best distributors are and where the best growth opportunities lie. That is what our [WINE ON-PREMISE](#) series is designed to do. As well as the UK and Australian reports, we’re also commissioning a study into the Canadian market which should be available early next year.

I’d like to take this oppourtunity to wish you all the best for the coming selling season. If there is anything we can do to help, please don’t hesitate to be in touch.

Figure 9 - Source of Australian Wine by Region listing in the UK On-Premise – Share of Category



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.