Wine Business Solutions

The Wine Paper 21

June 2012

Coming of Age

After a period of tumultuous change, the On-Premise wine market in Australia seems to be stabilising. From our Wine On-Premise Australia 2012 research just released, the amount of imported wine on Australian wine lists has actually decreased slightly (from 26 to 24%). As you would expect, those wines that are produced locally that represent fair competition to European styles are starting to shine through.

The most innovative Australian red wine makers, for example, have succeeded in taking away over 10% of what was imported wine list territory through creating innovative blends and understanding better, the regions best suited to key varietals. New Zealand has still managed to improve its position against this backdrop.

Some of the more progressive Australian regions, like McLaren Vale and Mornington Peninsula, have inspired consumers with their creativity and restaurateurs with their good commercial sense. They have accordingly, reclaimed lost ground. Rather than give up and walk away, 2012 has also been the year that the "big boys bounce back". People are returning to brands and Treasury Wine Estate (TWE) has been the biggest beneficiary.

Altogether, the Australian wine offer On-Premise looks more self-assured this year. With the push to get back to drinking more locally produced product finally starting to take hold, things are looking a little better both for progressive premium producers and major brand owners alike than they did a year ago.

Figure One – Percentage Share of On-Premise Wine Listings for States and Countries

Source	Share 2012	Share 2011	Chg.
SA	31.5%	31.0%	2%
VIC	16.4%	16.6%	-1%
WA	13.4%	12.6%	6%
New Zealand	9.9%	9.7%	2%
France	9.2%	9.7%	-5%
NSW/ACT	8.6%	9.0%	-4%
TAS	3.9%	4.2%	-7%
Italy	3.4%	3.5%	-3%
Other Imports	1.8%	1.8%	0%
Spain	1.3%	1.7%	-24%
QLD	0.6%	0.2%	200%

(Note – excludes Australian wine without regional designation from total in each year)

Sales above $15 per bottle in the Australian Off-Premise were up 13% by both volume and value MAT March 2012 according to Nielsen. We therefore thought we should carry out some further analysis to see how the various regions are performing in that context. *Note – Zero share change equals 13% growth.*

Figure Two – Share of $15 plus Category in Off Premise of Leading Regions

Region	$Share Mar 2012	$Share Mar 2011	Change	Vol Share 2012	Vol Share 2011	Change
Marlborough	36.0%	36.2%	**0%**	39.6%	39.6%	**0%**
Non or Multi Regional	15.0%	16.3%	**-8%**	13.2%	13.7%	**-4%**
Clare Valley	9.3%	9.2%	**0%**	10.9%	11.2%	**-2%**
Barossa	8.7%	7.8%	**12%**	8.4%	7.6%	**10%**
Coonawarra	7.7%	7.7%	**1%**	5.9%	6.2%	**-4%**
Margaret River	5.1%	5.5%	**-8%**	4.5%	4.8%	**-7%**
Orange	2.9%	3.3%	**-11%**	3.3%	3.8%	**-12%**
McLaren Vale	2.4%	2.2%	**8%**	2.6%	2.4%	**7%**
Mornington Peninsula	2.3%	2.0%	**16%**	2.1%	1.8%	**17%**
Adelaide Hills	2.1%	2.4%	**-12%**	1.5%	1.8%	**-17%**
Tasmania	2.0%	1.8%	**9%**	1.9%	1.7%	**9%**
Yarra Valley	1.7%	1.4%	**20%**	1.7%	1.4%	**23%**
Hunter Valley	0.9%	0.8%	**5%**	0.8%	0.7%	**4%**
King Valley	0.6%	0.6%	**6%**	0.6%	0.6%	**6%**
Central Otago	0.5%	0.3%	**100%**	0.4%	0.2%	**100%**
Other Regions	2.8%	2.5%	**13%**	2.6%	2.4%	**10%**

The first thing to notice is that the volume share of Marlborough is still 40%. Those that thought that price discounting would destroy the Marlborough brand may still be proven correct but there is no evidence that that is happening now. As in Figure One, New Zealand, collectively, have only 10% of On-Premise listings but managed to grow that over the last year as well.

The amount of non or multi-regional wine sold Off-Premise reflects the extent to which the major brands buy shelf space. The proportion of these wines On-Premise, according to our research, is less than 5%.

The increase in "Other Regions" in the Off-Trade is reflected On-Premise as Australians become more comfortable with Shiraz and Cabernet in particular, from a wide range of sources.

The growth in Central Otago's share is almost entirely driven by Chard Farm's "Rabbit Ranch" which looks like becoming that region's first hard brand in retail.

Our customers always like to run us through a few hoops before purchasing our research and rightly so. Some of the most asked questions include – Just where are you getting your lists from? Is it truly random? Are you giving fair representation to all types of outlets?

One of our largest customers was so keen to be sure about this that we spent two days together going through our research and theirs. The issue for them internally was – "Just how do you classify outlets?"

They had already been through the exercise of giving different types of outlets names but quickly found this to be useless. Terms like "up market" or "casual" are highly subjective. Good (or bad) food and accompanying wine can happen just about anywhere today in Australia.

My wife (I have to give her the credit) then came up with the ingenious idea of classifying outlets based upon their average price of a main course plate. This, after all, is how most of us typically choose a restaurant. This works fairly well except that some of the best food in Australia is now sold as small inexpensive plates. The Wine Library's Truffle Quesadilla, for example, will be my last meal before I die…

The most reliable answer, in the end, turned out to be something much simpler. The average price of wine listed by-the-bottle is a very good proxy for class of restaurant. If our proportion of wine at key price points matched that of our distributor client's read of total market, we would both be happy. And it did.

That then begs the question – just what are those key price points?

If we just look at total listings this year as in Figure Two, less than 10% of bottle listings today are at less than \$30, around 50% are between \$30-50, another 25% between \$50-80 and the remaining 15% of listing opportunities are at above \$80.

This on its own doesn't tell us very much but what happens when we look at how the Top 10 national distributors cover these price points?

This should give prospective Brand Principals the opportunity to evaluate fit as well as identifying any possible weaknesses / opportunities for distributors.

Figure Three – Proportion of On-Premise Listings at Key Price Breaks

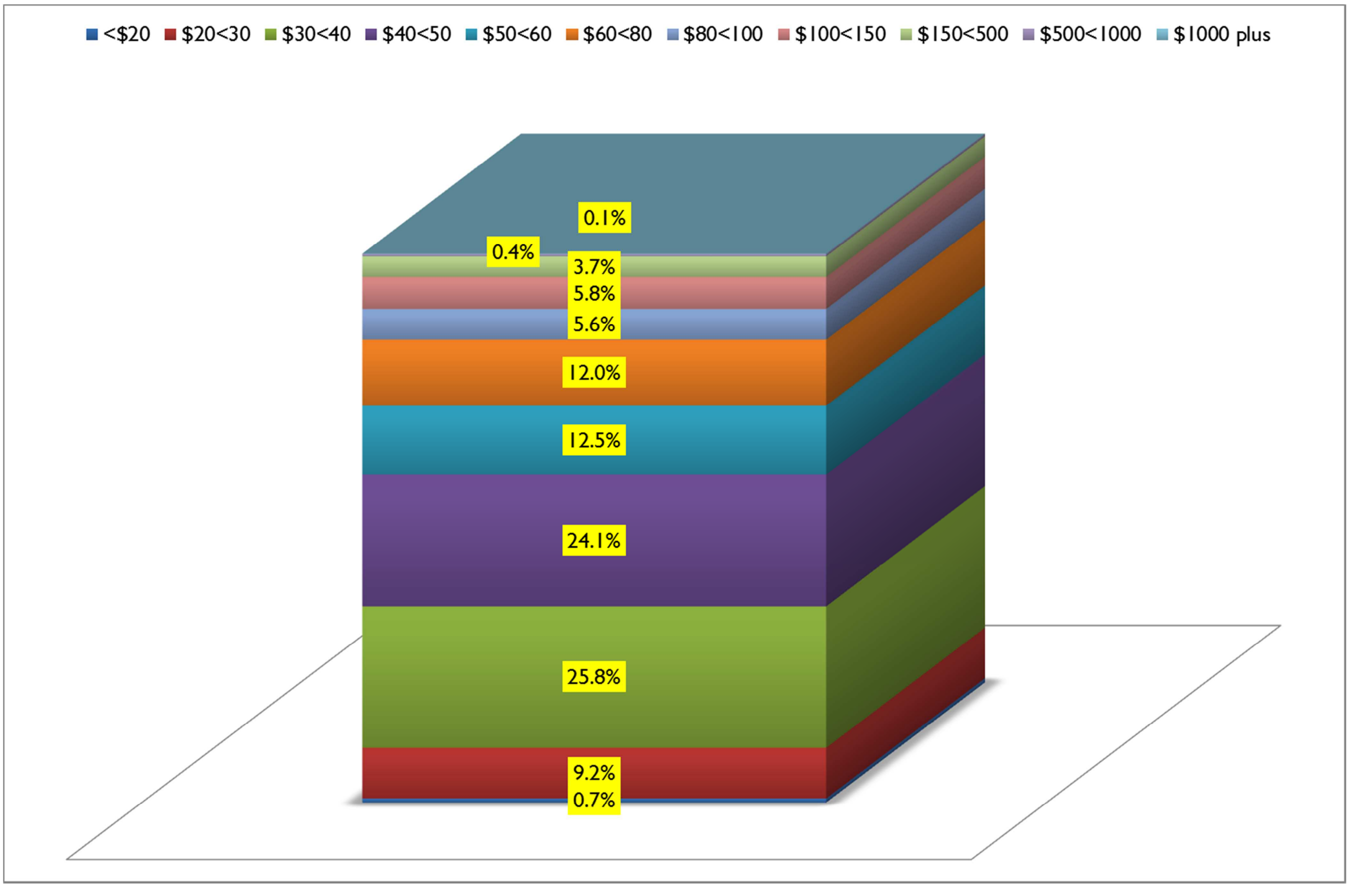

Figure Three – Proportion of On-Premise Listings at Key Price Breaks for Top 10 Distributors

Distributor	<$20	$20<30	$30<40	$40<50	$50<60	$60<80	$80<100	$100<150	$150<500	$500<1000	>S1000
FWP	2%	8%	6%	8%	9%	10%	9%	8%	10%	23%	13%
Negociants	0%	8%	6%	6%	7%	7%	8%	9%	7%	5%	37%
TWE	32%	27%	6%	4%	4%	4%	5%	5%	7%	37%	12%
Red & White	2%	4%	6%	6%	7%	9%	8%	6%	7%	8%	0%
Moet Hennessy	0%	0%	1%	3%	6%	6%	7%	19%	23%	16%	0%
S Smith & Sons	6%	5%	5%	5%	4%	4%	7%	1%	3%	0%	0%
Mezzanine	0%	2%	3%	3%	3%	5%	2%	2%	2%	0%	0%
DWS	1%	3%	2%	3%	2%	1%	1%	3%	2%	0%	0%
Young & Rashleigh	0%	2%	2%	3%	2%	1%	1%	0%	0%	0%	0%
Nelson	0%	1%	1%	2%	2%	3%	3%	3%	2%	0%	0%
Others	56%	39%	60%	57%	54%	51%	47%	42%	37%	12%	38%
Dollars	**0%**	**2%**	**15%**	**17%**	**11%**	**13%**	**8%**	**11%**	**14%**	**5%**	**2%**

The companies above had the highest total listings in our 2012 survey.

The "Dollars" figures above are the sum of all prices of bottle listings in each price band expressed as a percentage of the total. The percentage figures for each distributor are drawn from the sum of the dollar value of all their listings in each price band.

You can see that Fine Wine Partners (FWP) cover the market well and increase in strength as they head up the price scale. This really is the model, I believe, for effective long term brand building.

Negociants appear fairly similar at first, just not quite as strong in the ultrahigh priced area. This is because they are the masters of having the conversation with the sophisticated sommelier and fine wine fanatic more so than they are pure luxury brand builders in the mould of Moet Hennesy. There is nothing wrong with that but you have only to look at the imported portfolio of FWP and that of Negociants to see how fundamentally different their approaches are.

Treasury Wine Estates (TWE) is a totally different beast altogether. They are overweight at the top and the bottom with not so much in the middle these days. This is because their business today is about the branded wine drinker and their aspirational moments. Do brand led companies need wine engaged consumers? After years of working at Freixenet and [yellow tail] etc, despite world renown wine journalists' insistence otherwise, I am almost certain that the answer is "no". The drinkers of those products are more or less unconscious and uncaring where the entire "wine world" is concerned. Can country brands survive without wine lovers? I'm utterly convinced that the answer there again is "no". Can a business as big as TWE survive without effectively nurturing that part of the market? There's the question, I think…

Red & White is solid all the way through but sister company Mezzanine is more of a force at commercial price points. Can it be possible that Moet Hennessy has such a strong hold on the ultrahigh priced sector? We undertook that same exercise last year and came up with the same sort of numbers. To me this demonstrates that what Moet Hennessy believes to be a fair price for a world class bottle of wine and what most competitors believe the market will pay are two totally different ideas. This points to significant opportunity for "premiumisation". So far, TWE seem to be the only ones catching on.

S Smith and Sons is clearly the more commercial arm of the Yalumba wine distribution empire. Whether they need to have quite so much business below $30 a bottle is a question they'll no doubt be asking themselves. Domaine Wine Shippers (DWS), on the other hand, is strong at commercial price points with domestic brands and has an extensive list of imported wine. There could be an opportunity to build domestic business at more premium price points.

Young and Rashleigh is the most successful single State wine distributor in Australia and ranked No.2 in NSW this year in terms of listings, a remarkable achievement. They've done this by focusing entirely upon more commercial price points and without any real specialisation in imported wine (other than New Zealand). Perhaps this is a good strategy. Perhaps there is a significant opportunity. The Nelson Wine Company, who are Victoria's finest, haven't missed that one. As a group, those wineries doing their own distribution or with the 213 other smaller distributors caught by our survey may have done.

Where it gets really interesting is when you start to look at what are now that most popular On-Premise price points based upon number of times they appear in our 2012 Survey.

Figure Four – Most popular Price Points On-Premise 2012 and Number of Times Listed

$	45	528
$	38	496
$	42	450
$	40	392
$	36	378
$	32	360
$	48	338
$	35	333
$	39	294
$	55	288
$	50	264
$	34	259
$	30	254
$	28	220
$	49	219
$	52	217
$	60	215
$	44	210
$	65	195
$	46	187

The first thing to notice is that there no unrounded prices in our list. Restaurants like neat numbers. This flies in the face a bit of recently release research that showed that people actually prefer pricing that ends in $X.99 or $X.95. This wasn't because any deception is actually taking place anymore. It was because people didn't trust companies that used round numbers. It was felt that they weren't trying hard enough! Clearly though, in that dim light of restaurants that challenges the eyesight of aging wealthier patrons battling to decipher the small print, round numbers work best, particularly after a glass or two of wine...

From our research, the most popular price point on a wine list in 2012 is $45. In 2008, when we started doing this, it was $32. This doesn't mean that the average listed price had risen nearly 50% but as you can see, there are some very good price points to target in this most frequently listed list.

Figure Five – Anticipated Returns at the Most Listed Price Point.

Mark Up X 2.5	**$45.00**	60%
LUC incl WET	$18.00	29%
Wholesale Margin	$13.96	30%
Price per bottle	$9.80	
Revenue Per Case	**$117.60**	
COGS	$58.80	50%
Admin	$23.52	20%
Sales & Marketing	$17.64	15%
EBITDA	$17.64	15%

The third real standout, for me, is the way in which the "mid-points" ($35, $45, $55, $65) are all there. More importantly though, those price points that are just above the ten dollar price breaks ($32, $42, $52) appear to be just as valid as those just below ($28, $38, $48). Getting that wrong could cost you everything.

Figure Five – The Same Wine as in Figure Four Discounted to meet $38 Price Point

Mark Up X 2.5	**$38.00**	60%
LUC incl WET	$15.20	29%
Wholesale Margin	$11.78	30%
Price per bottle	$8.20	
Revenue Per Case	**$98.40**	40%
COGS	$58.80	
Admin	$23.52	
Sales & Marketing	$17.64	
EBITDA	-$1.56	-2%

Wine On-Premise Australia 2012 can be purchased from our web site by following this link. It provides the complete guide to doing On-Premise business in Australia including who the best distributors are both nationally and by State as well as what the most listed brands, wine styles, regions and countries are, again, both nationally and by State.

Nine out of the Top Ten national distributors have bought the research prior to publication so don't be missing out…

When I reflect upon the last ten years and think about what was our best work, it probably was one of the first projects we were involved with. It was a strategic review of a failing company.

We started by using a simple analytical framework that all of you will be familiar with to ask that same set of questions of all key stakeholders and staff.

When you hear enough versions of what people believe to be the truth told in confidence, you very quickly get to the heart of the problem.

We then reviewed findings with the owners.

The next step involved repeating back to the team, including the owners, the most common themes. Great care was taken to keep the sources of feedback in absolute confidence.

We then asked the team what they thought they should do to make things better. From this we were able to construct an action plan to take the business forward.

As a result of a successful but not always easy implementation, that business now operates with a positive cashflow and has returned to consistent profit.

After taking a further step and appointing a consulting winemaker who is one of our associates, they have reshaped their working culture and improved their wines out of sight.

This process is not easy. It's not for everyone either. The only real project failure we've had in ten years resulted from the same process. Sometimes people just don't want to take the medicine.

But executed in good faith, this approach can have a profound effect changing struggling businesses into profitable and sustainable ones.

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 wherever possible. Everybody knows they should do this. Few do. The difference in the 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.