

Wine Business Solutions



The Wine Paper

Issue Three - May 2008

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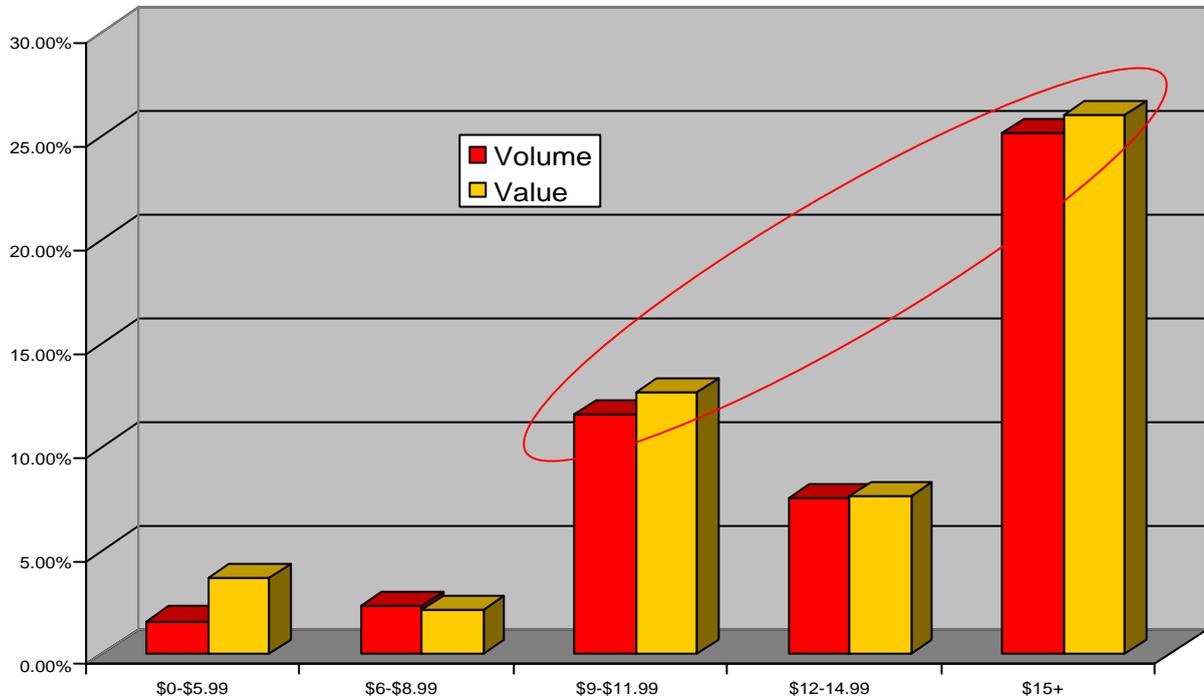
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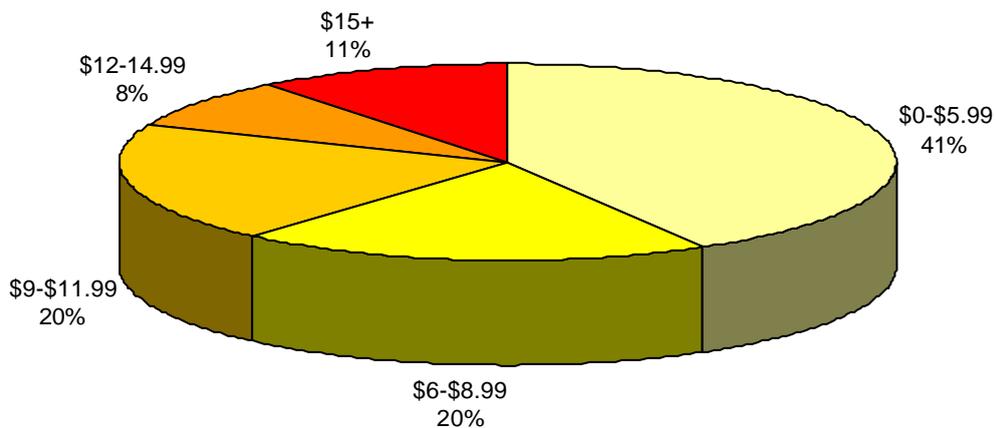
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Selling your wine in the US

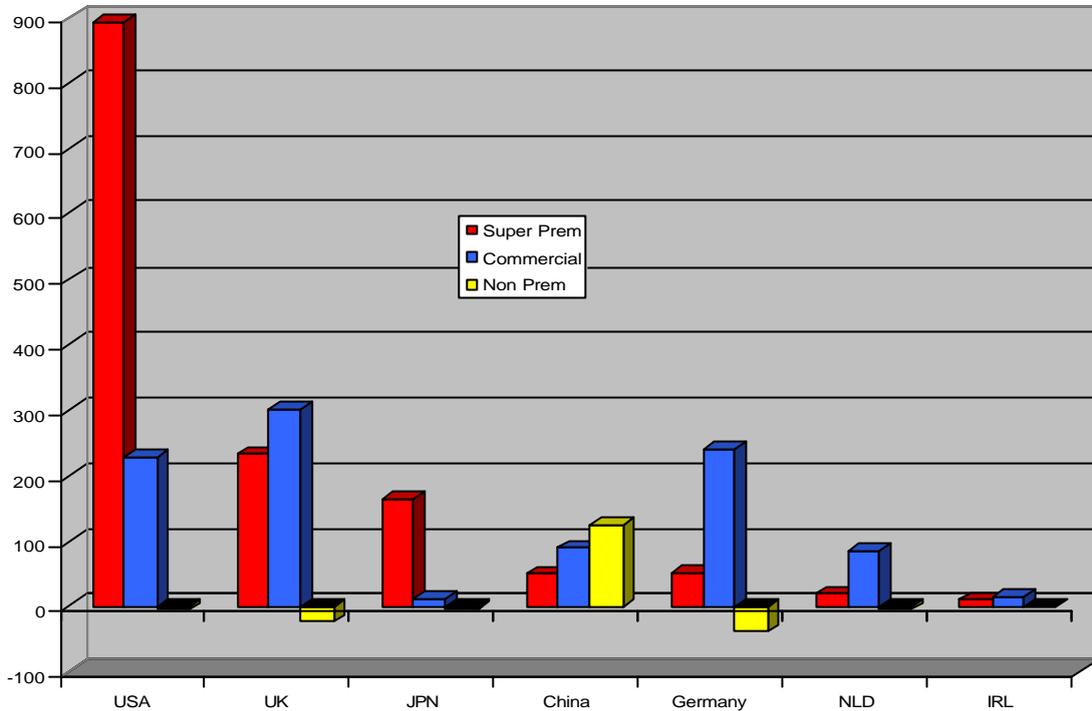
According to the latest Nielsen data for the 12 months to February 08, the US market is still showing strong growth in all premium price categories.



Almost 40% of sales are now above \$9.00 per bottle. Sale above \$15 are now 11% of the total.



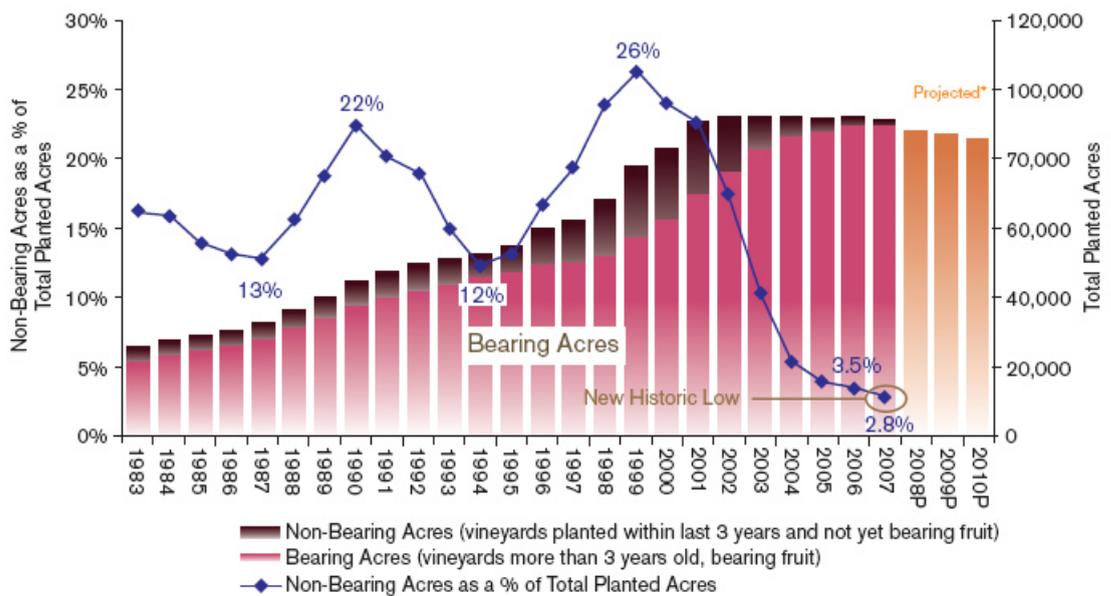
Looking at projections for growth in the \$US Million value of Imports from 2005-2015, it should be clear where your biggest opportunity lies.



(Note - "Super Premium" means wine with an FOB value of more the \$4.50 per bottle. Source Global Wine Market in the Decade to 2015 with a Focus on Australia and Chile – Glyn Witwhet)

And there is little chance that the US is going to fill the gap using its own resources...

Historical Bearing & Non-Bearing Acres



Includes: Napa Cabernet Sauvignon, Napa Merlot, Napa Cabernet Franc, Sonoma Cabernet Sauvignon, Sonoma Chardonnay, Sonoma Merlot Sonoma Pinot Noir, Mendocino Pinot Noir, Santa Barbara & San Luis Obispo (District 8) Chardonnay and Santa Barbara & San Luis Obispo (District 8) Pinot Noir.
 Source: California Agricultural Statistics Service.
 * Projected bearing acres based on 2007 non-bearing acres maturing into bearing acres, less 2% annual replacement of old vines (assumes 50 year average life of vines).

The market has undergone a massive transformation during the first six years of this century and the number of core wine drinkers in the US has almost doubled. This is the time during which half of the 77 million strong Millennial generation have commenced setting their preferences. What New World wine producers do next will play a major role in determining what the remaining 38 million who are yet to reach legal drinking age choose to drink.

5 Wine drinking frequency		
Core wine drinkers	2000	2006
daily	7	11
more than once a week	22	24
once a week	17	16
Marginal wine drinkers	2000	2006
2 or 3 times a month	28	20
once a month	16	13
once every 2 or 3 months	10	16

SOURCE: WINE MARKET REPORT, 2008

Table 5 shows compares wine drinking frequency in 2000 with 2006. Of an estimated 70 million total wine drinkers, 51 percent (36.7 million) are considered core wine drinkers, described as drinking at least once a week. 49 percent (34.3 million) are marginal drinkers.



■ 2000 ■ 2006

Table 6 shows that while the number of pure beer and spirits drinkers is decreasing, the number of wine consumer is on the rise, especially among core drinkers.

*Although core wine drinkers represent only 17 percent of all adults, they consume 92 percent of all wine.

Whilst retailers don't have anything like the same dominance that they do in our home markets and the UK, it is projected that sales in multiples will almost double during this decade. Wal-Mart aims to increase their wine sales by more than 3 times during that period.

7 USA, market shares: top retailers 2007						
Company	2000		2006		2010	
	GRBS (USD mn) ²⁾	MS (%) ³⁾	GRBS (USD mn) ¹⁾	MS (%) ²⁾	GRBS (USD mn) ¹⁾	MS (%) ²⁾
1 Wal-Mart	57,562	7.0	124,837	11.2	178,973	12.7
6 Kroger	36,123	4.4	45,596	4.1	52,682	3.7
4 Costco	16,519	2.0	31,435	2.8	50,823	3.6
8 Ahold	21,514	2.6	36,118	3.2	42,980	3.0
9 SuperValu	9,869	1.2	20,769	1.9	33,893	2.4
2 Target	8,835	1.1	18,714	1.7	30,331	2.1
3 Walgreens	9,550	1.2	17,731	1.6	30,129	2.1
10 Safeway	22,569	2.7	26,915	2.4	28,704	2.0
12 Publix	12,287	1.5	18,718	1.7	23,813	1.7
7 CVS	7,883	1.0	13,828	1.2	20,380	1.4
13 Delhaize Group	10,203	1.2	13,554	1.2	17,020	1.2
15 Whole Foods Market	1,740	0.2	5,196	0.5	15,363	1.1
Total MGD Sales	822,078	100.0	1,116,774	100.0	1,413,534	100.0

Table 7: Although most Americans buy their wines in supermarkets, there is not the consolidation in that industry that you see in countries such as England, where the top five chains account for 80% of all wine sales. The top dozen grocery retailers in the United States muster only a 33.5% market share. In fact, the 85 biggest grocery retailers together do not even reach half the market, accounting for merely 48 percent of total grocery sales.

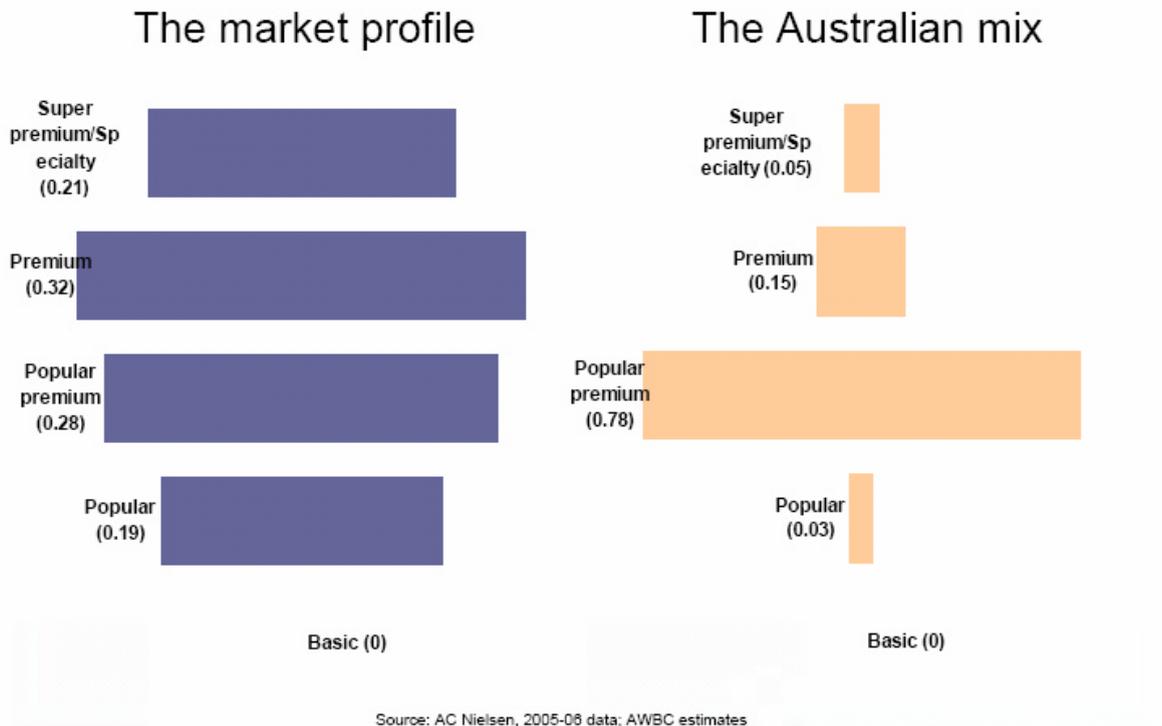
Although perhaps confusing, the rank number is their respective total retail banner sales. Some large companies like Target, though, do less grocery retail.

¹⁾ Rank in total retail banner sales
²⁾ Grocery retail banner sales in million US\$
³⁾ Market share in %

SOURCE: PLANET RETAIL

New media and social networking in particular will play an important role here. Woolworths (Australia), for example, announced yesterday that it has \$A200 Million to spend in this area. Direct Shipping is the biggest competitor for imported wineries looking to build premium and above wine business in the US. We'll all need to build better direct to consumer bridges.

Australia in particular however, remains fundamentally misaligned with the opportunity.



AWBC © November 2007

AUSTRALIAN WINE AND BRANDY CORPORATION

As per the Nielsen scan data below, with the exception of [yellow tail] and Jacobs Creek, the big Australian wine brands have hit the skids during the first quarter of this year. Not surprisingly the AWBC's Laurie Stanford has today reported a slow down in Australian shipments to the US during the last 3 months.

Figure 2. Rolling 12 week performance ending 23 Feb 2008 against pcp

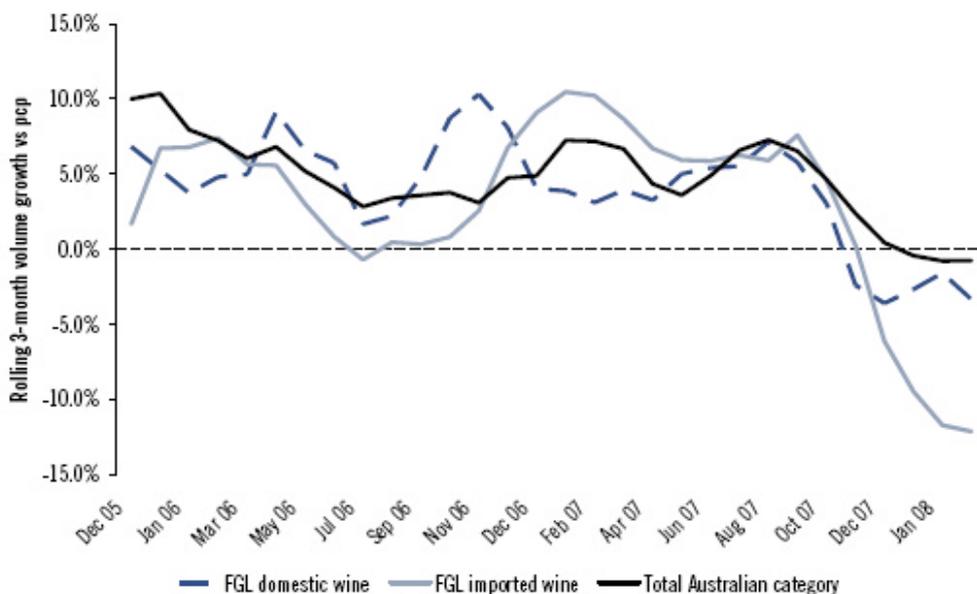
Brand	Owner	Volume Chg %	Value Change %	Price/mix	Share of Aus imports %
Yellow Tail	Casella	6.2	4.8	(1.4)	41.2
Lindemans	Foster's Group	(8.6)	(7.2)	1.4	12.6
Jacobs Creek	Pernod Ricard	6.0	5.4	(0.6)	6.4
Black Swan	Gallo	(12.0)	(13.5)	(1.5)	6.9
The Little Penguin	Foster's Group	(12.3)	(12.6)	(0.3)	5.0
Total Aust. wine (top 50)		(0.6)	(1.7)	(1.1)	100.0
Australia ex Yellow Tail		(4.5)	(5.2)	(0.7)	58.8

Source: Citi Investment Research, AC Nielsen

Disturbingly however, Fosters would appear to have been stockpiling inventory at the same time as their sales have been flagging hinting at bigger problems for them to come shortly.

Gomberg Fredrickson - US wine shipments					
Volume	month ending (% chg YoY)			period ending...	
	Dec-07	Nov-07	Oct-07	3mth	12mth
Gallo	16.6%	1.7%	20.8%	12.3%	3.8%
Constellation	44.1%	-19.8%	8.7%	-1.7%	-0.7%
Foster's	-1.3%	1.1%	11.0%	2.9%	16.3%
The Wine Group	7.2%	-14.4%	-15.7%	-8.4%	3.4%
Trincherro	-3.5%	13.2%	21.7%	11.8%	12.2%
Fetzer	-7.3%	-4.0%	-3.0%	-4.6%	-0.7%
Total	5.5%	-6.5%	5.9%	1.3%	3.6%
Bottled Imports					
Italy	0.2%	-6.3%	28.4%	6.5%	9.0%
Australia	1.0%	13.5%	9.0%	7.9%	6.5%
France	9.9%	-0.6%	14.9%	7.2%	-1.8%
Spain	-11.2%	3.0%	24.5%	4.7%	6.5%
Chile	-0.2%	0.2%	25.2%	8.1%	7.8%
New Zealand	-2.2%	43.3%	-8.2%	9.5%	34.7%
Total	-89.8%	3.4%	21.3%	-19.0%	5.1%
Bulk Imports					
Italy	1222.7%	-15.3%	-61.0%	114.3%	297.0%
Australia	-86.1%	-62.8%	-68.6%	-68.3%	-43.6%
France	-26.7%	22.4%	-88.8%	-30.2%	32.2%
Total	49.6%	-16.3%	-28.7%	-7.6%	21.7%

You can also see that the drop in bulk sales to the US has been particular to Australia with Italy and France more than picking up the difference. Italy, Chile and New Zealand especially are all growing faster than Australia on an annualized basis.



Source Clitigourp – Nielsen

13 Top 10 wine brands off-trade			
Rank	Brand	Sales ¹⁾	Origin
1	Yellow Tail	182,408	AUSTRALIA
2	Franzia	160,136	CALIFORNIA
3	Sutter Home	153,455	CALIFORNIA
4	Woodbridge	140,152	CALIFORNIA
5	K-J Vintners Reserve	135,182	CALIFORNIA
6	Beringer	107,200	CALIFORNIA
7	Carlo Rossi	106,717	CALIFORNIA
8	Livingston Cellars	103,878	CALIFORNIA
9	EJ Gallo Twin Valley	85,362	CALIFORNIA
10	Almaden	81,265	CALIFORNIA

Table 13: Although America has become an enormous importer of wine, brands from California still control the volume. Yellow Tail, that only first came onto the market in 2001, is the notable exception.

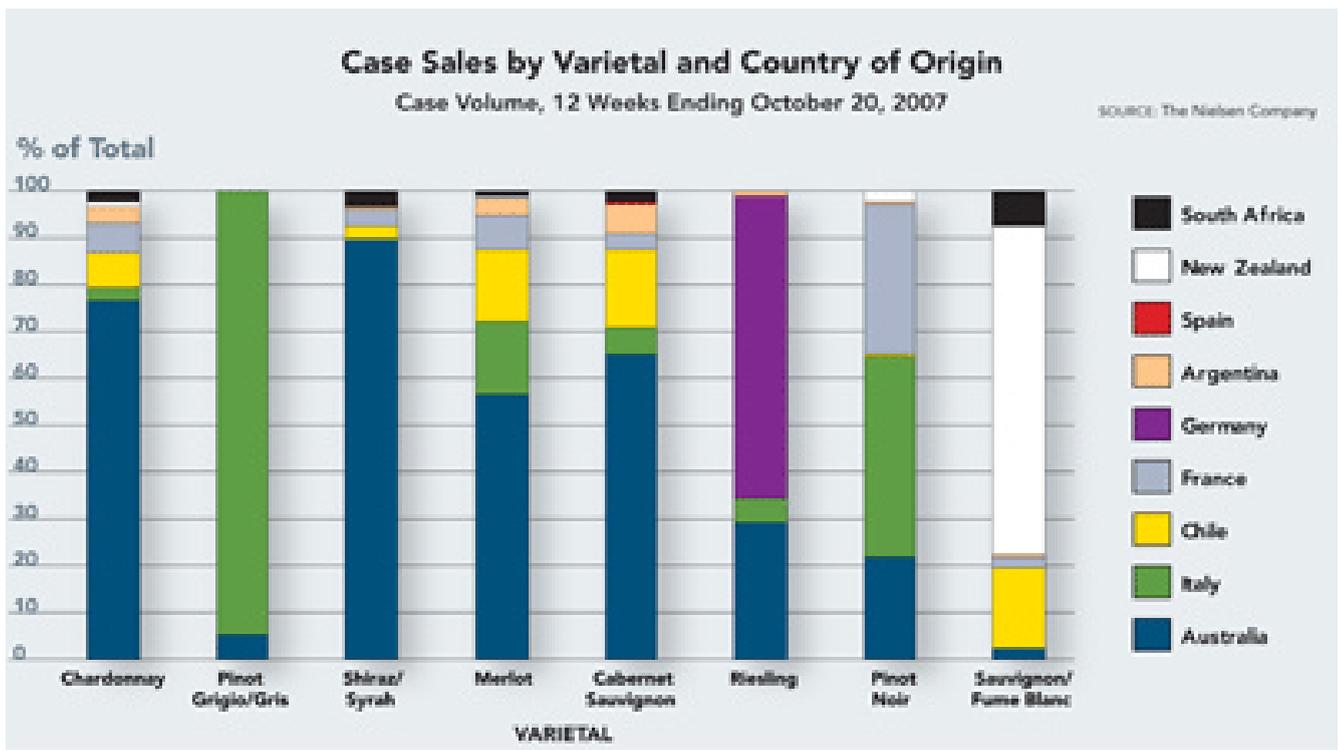
¹⁾ in '000 US\$

14 Top 10 wine brands on-trade				
Rank	Brand	Origin	Owner or Importer	sales ¹⁾
1	Beringer Vineyards	USA	Foster's Wine Estates America	1,520
2	Franzia Winetaps	USA	The Wine Group	1,400
3	Kendall-Jackson	USA	Kendall-Jackson Wine Estates	1,155
4	Yellow Tail	Australia	W.J. Deutsch & Sons, Ltd.	1,125
5	Inglenook	USA	Centerra Wine Co. (Constellation)	1,100
6	Copperidge	USA	E. & J. Gallo Winery	1,090
7	Sutter Home	USA	Trinchero Family Estates	1,000
8	Woodbridge	USA	Centerra Wine Co. (Constellation)	865
9	Cavit	Italy	Palm Bay Imports	700
10	Foxhorn Vineyards	USA	The Wine Group	460

Table 14: Although the distinction between on- and off-trade sales is not so profound as in other markets, some brands have focused on restaurant exposure. Given the rise in the number of Italian establishments, it is not surprising that one Italian brand is on these charts.

¹⁾ On-trade sales in 2005 in '000 of 9-litre-cases.

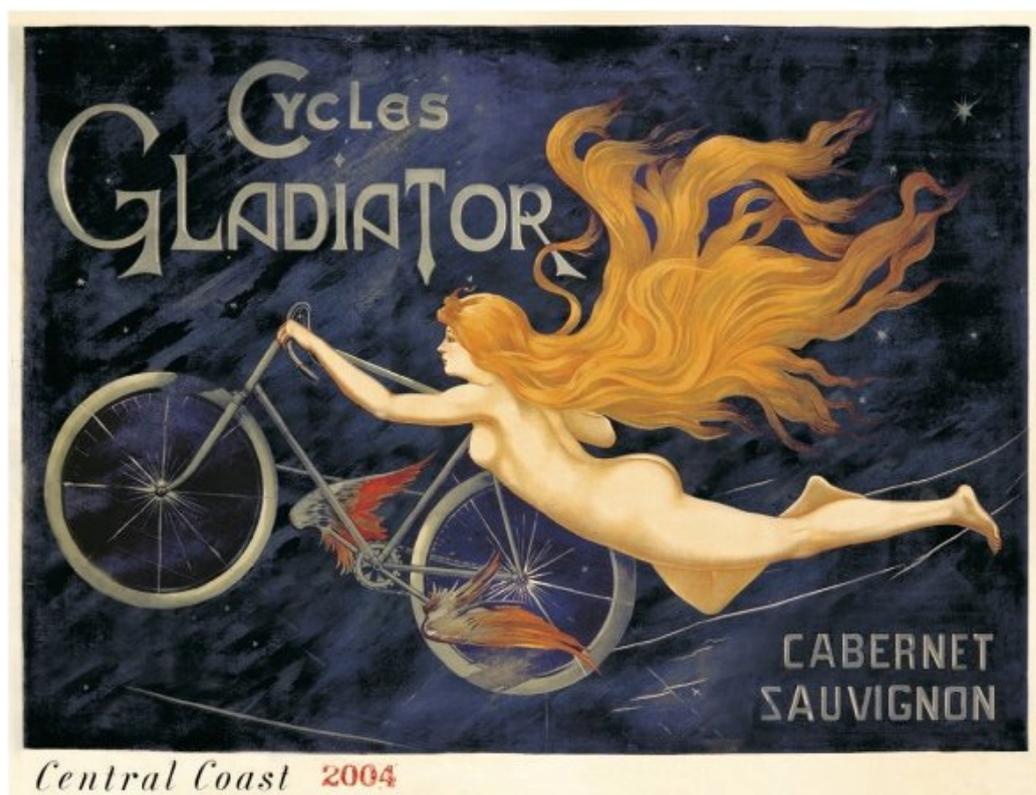
[yellow tail] may be the outright leading brand in the US now but looks rather lonely in terms of imported "friends" in the Top 10 off and on premise wine brands.



According to the CIVC, Champagne sales were down 30% during the first quarter of 2008 a clear sign that recession is starting to bite. Sub \$50 looks to be where the action will be this year.

So if the New World imported wine category in the US is to be something more than "a very large kangaroo and a generic sea of (Marlborough) Sauv", what must we do to gain a larger share of the \$14.99 and \$19.99 critical price point opportunities? How do we successfully capture the imagination of the key Aspirational and Appreciator segments described in Wine Papers 1 & 2?

WBS has taken the last 5 years Wine Business Monthly's Hottest Small Brands and analysed their success factors. Each year, this publication celebrates those brands that have managed to stand out in the world's most crowded wine marketplace and gather a faithful following. Some, like Cycles Gladiator and HRM Rex Goliath have gone on to sell hundreds of thousands of cases.



Others have simply won their battle for consumer hearts and minds in their comparatively small market space...

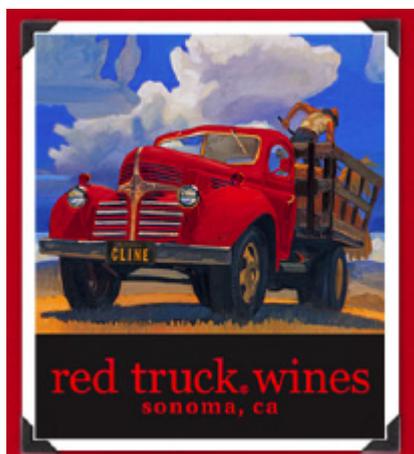
In 2003 – a time not dissimilar to now in terms of the economic cycle – many brands struck success just by being “value for money” and having a catchy name. Indeed, this was the inspiration for so many Australian wine producers rushing to the market with “concept brands”. Exchange rates were good, wine was in relative oversupply and a number of people made a lot of money relatively quickly.



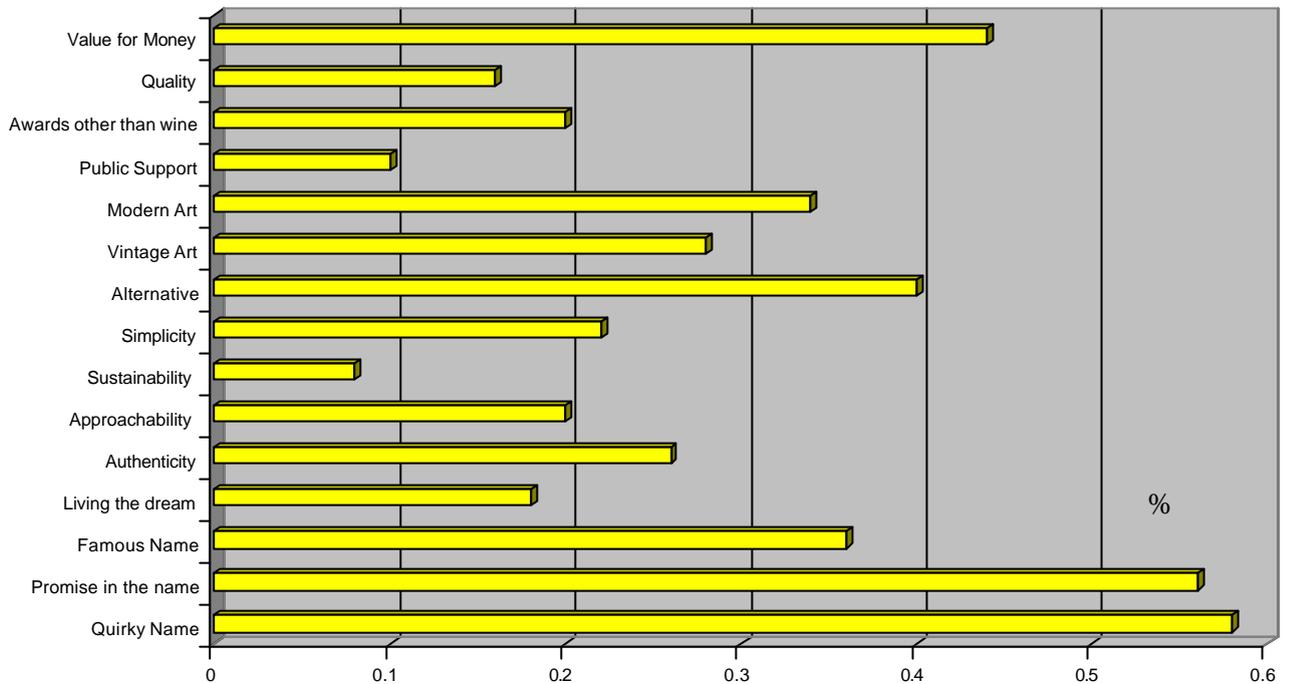
Hottest Small Brands of 2006	Hottest Small Brands of 2005	Hottest Small Brands of 2004	Hottest Small Brands of 2003
1. A TO Z WINEWORKS Oregon	1. PARDUCCI WINE CELLARS Mendocino Wine Company (Ukiah, California)	1. RED TRUCK Cline Cellars (Sonoma, California)	1. HRM REX-GOLIATH Smith & Hook and Hahn Estates Winery (Solodad, California)
2. HOUSE WINE Magnificent Wine Company, Walla Walla, Washington	2. SOLO ROSA Soloflora Wines (St. Helena, California)	2. CARTLIDGE & BROWNE Greenfield Wine Company (American Canyon, CA)	2. MCMANIS FAMILY VINEYARDS River Junction AWA, Ripon, California
3. LIBERTY SCHOOL (Troona Winery), Paso Robles, California	3. CHEAPSKATE WineSmith (Napa, California)	3. SEVEN DEADLY ZINS Michael David Winery (Lodi, California)	3. SEBASTIANI VINEYARDS & WINERY (Sonoma, California)
4. SHANNON RIDGE High Valley, Lake County, California	4. VELVET RED St. James Winery (St. James, Missouri)	4. OLIVER WINERY Oliver Winery (Bloomington, Indiana)	4. CASTLE ROCK WINERY (Palos Verdes Estates, California)
5. TWENTY BENCH Nise North Wine Company, Napa, California	5. INCREDIBLE RED Peachy Canyon Winery (Paso Robles, California)	5. ANGELINE WINES Martin Ray Winery (Santa Rosa, California)	5. BLACK OAK Chateau Diana (Healdsburg, California)
6. CYCLES GLADIATOR Wimbleton Wine Company, Napa, California	6. HARD CORE Core Wine Company (Santa Maria, California)	6. ROCK RABBIT Purple Wine Company (Graton, California)	6. JEWEL COLLECTION Jewel Wine Company (Lodi, California)
7. BEDPELL CELLARS Catsogue, New York (Long Island)	7. KUNDE ESTATE Kunde Estate Winery & Vineyards (Kenswood, CA)	7. THREE THIEVES BANDIT Three Thieves (Lodi, California)	7. TIN ROOF Murphy-Goodie Winery (Geyserville, California)
8. ARTESA VINEYARDS & WINERY Napa, California	8. HITCHING POST Hartley Oates Hitching Post Winery (Burling, CA)	8. SOFIA MINI Niebaum-Coppola (Rutherford, California)	8. THREE THIEVES Lodi, California
9. BLACK STAR FARMS Suttons Bay, Michigan	9. ANDRETTI WINERY Andretti Wine Group (Napa, California)	9. SCREW KAPPA NAPA Don Sebastiani & Sons (Sonoma, California)	9. JEST RED Hambrecht Vineyards and Winery (Healdsburg, CA)
10. BUENA VISTA CARNEROS Sonoma, California	10. ESSER VINEYARDS Esser Vineyards (Napa Valley, California)	10. GRACELAND CELLARS Signature Wines (Oakland, California)	10. J GARCIA WINES Allied Domercq (Geyserville, California)

Five years later and the market is markedly more sophisticated, has traded up to a certain extent and the approach required to win has changed. We've identified 15 factors that these 50 successful brands incorporated into their value proposition. As time's gone on, successful brands have had to leverage more of these in order to be noticed above the 100,000 plus other contenders. So what are they?

1. The label. 62% used either modern or vintage art. The most successful themes seem to be those that make heroic, a quaint aspirational version of the past. This approach bespeaks heritage but in a fun, unthreatening way to new wine drinkers



- The brand name. Nearly 60% had a quirky / catchy and or otherwise stand out name that people would likely tell one another about. Over 50% of brand names (from 7 Deadly Zins to the Hitching Post) carried some sort of implied promise about what the wine would do for you...



- A Point of Difference. Around 40% emphasized a point of difference such as alternate grape varieties, closures, pack types etc. One, Clos du Val, even managed to spin mechanical harvesting as a point of comparative advantage.
- A Famous Name. Having found fame and fortune elsewhere certainly helps. Not a lot you can do if you don't have that already. A good number, however, had managed to rise above the pack utilising their positions in industry representative bodies to the fullest. The Wine Industry Leadership program running around Australia currently has been designed specifically to help people learn how to be more effective in this area.
- Authenticity. Around a quarter of people put major emphasis on the authenticity of their story and /or their approach to the business. Nearly 20% had had successful lives already are now "living the dream". Whilst not everyone relates to rich stock brokers having a crack at the wine game, American idol producers Nigel Lythgoe and Ken Warwick managed to create a top rating television series about their experiences, for example.

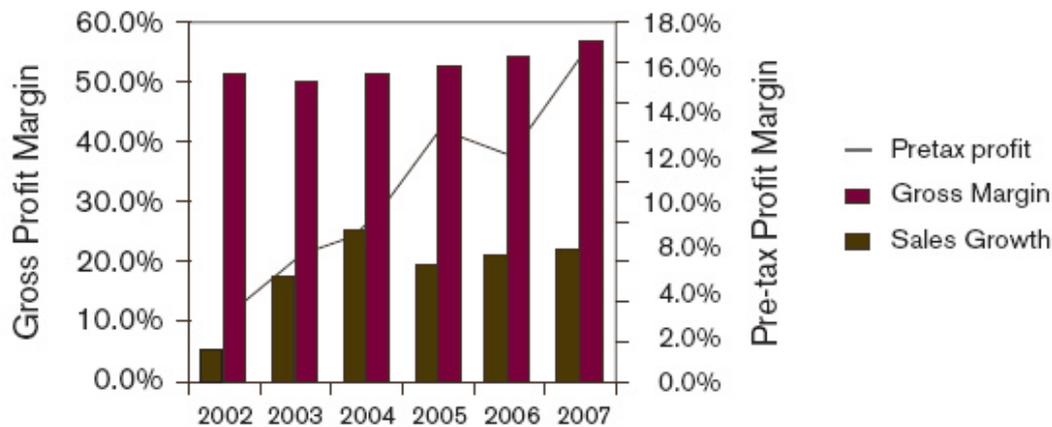
6. Enlisting Public Support. Getting customers actively involved in your business through finding ways to engage them in activities complimenting but not always directly related to wine such as sponsorships and investing was another key success factor for a number of wineries.

7. Accessibility. Approachability and simplicity were more common claims than out right quality in the value propositions of this winning group. Some spoke about sustainability but it is not the driving factor in this market yet that it is in the UK, for example. Watch this space though.

And are they making any money?

Silicon Valley Bank each year survey over 100 of its wine industry clients. From 2003 to 2007, margins have climbed 8% to 57% average. Consistent with discussions re pricing in Wine Paper 2, all of this has found its way directly to the bottom line giving US wineries a healthy 16% average before tax profit. 16% is the number used by Westfarmers and a number of other Australian industrial companies as the benchmark needed to cover tax and cost of capital. It's also in line with those Delliote numbers for a sustainable small wine business.

High-End Industry Profitability



Source: SVB Peer Group Analysis

The Grass is Browner?

With the \$A looking like it's about to blow through the \$US equivalence stratosphere and global recession starting to bite, the Australian Wine Market perhaps warrants a closer look. According to Nielsen – for the year to Dec 2007 total bottled wine value grew 7.1%, with all categories contributing to the growth.

The mining boom economies of Queensland (11.4%) and WA (9.1%) grew most strongly.

- **White Wine is growing at +8.9%.**

- Growth continues to be driven by Sauvignon Blanc (44%) and Sem Sauv Blanc Blends (22%), with growth also in wines classified as Dry Whites. All other major varietals are in decline, led by Chardonnay on MAT. No surprises there, I guess...
- The \$15 -20 price segment continues to drive White Wine growth (22.5%), with all price segments now in growth. Whites over \$30 grew a staggering 29%. This is consistent with Langtons' claim that their auction average sales value in 2007 was up by 22% versus YE06 compared with a usual 6-7% increase.

- **Red Wine is showing growth of +5.1%.**

- Shiraz (8.5%) and Cab/Sauv (6.1%) have achieved good growth, with strong growth in Pinot Noir (20.9%) continuing. Shiraz Blends are still experiencing some declines on MAT.
- All price segments are now contributing to the growth of Red Wine, with the \$15-20 segment (16%) contributing the most to this growth.

What Australia Drinks On- Premise

WBS will shortly be releasing the first comprehensive study into what Australians are drinking On Premise. Amongst other things you'll be able to learn which brands are the most listed, who are the most successful on premise distributors, what the average price achieved by glass and by bottle is for individual brands, varietals and regions. In Summary – You'll get a comprehensive picture of the On Premise landscape in Australia today.

Getting more from your Cellar Door

Recent research made available by Morton Blackatar from their Cellar Door Metrics program www.cellardoormetrics.com show significant differences between regions in terms of winery's ability to remove money from visitor's wallets.

Rank	State	Region	Per visitor spend – reported in multiple currencies		
			AUD	NZD	ZAR
1	SA	Adelaide Hills	52.45	59.98	321.27
3	NS W	Mudgee / Orange / Bathurst	42.88	49.45	268.62
2	VIC	Macedon / Sunbury	42.57	47.84	314.37
4	QLD	Southern Downs / Granite Belt	42.31	48.36	259.47
7	VIC	Grampians / Pyrenees / Ballarat	40.87	46.87	254.98
5	VIC	Mornington Peninsula	40.81	47.11	259.03
8	SA	Limestone Coast	40.53	46.37	250.20
6	ACT	Canberra District	40.34	46.09	262.37
9	VIC	North East Valleys / Rutherglen	38.18	43.82	233.74
10	SA	McLaren Vale	35.83	40.92	218.71

Interestingly, the Adelaide Hills achieved 50% more sales per customer than its neighbours, McLaren Vale. The Hunter ranked 13th with a per visitor spend of less than half the Adelaide Hills. So when next planning a visit to another wine region, it might be worth taking a few notes on what they do differently...

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 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.