Wine Business Solutions

The Wine Paper 33

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Now Let's Sell Some Wine!

That's the catch cry around which we'll be developing our workshop program for next year. Most of our clients have completely changed their business models during the last 5 years. Poor exchange rates and major markets battling to recover post GFC would have been enough of a trigger but retail consolidation, particularly in Australia and New Zealand, has been the final straw.

Our Direct to Customer benchmarking shows that for wineries producing less than 50,000 cases in Australia, New Zealand and South Africa, more than 50% of revenue comes from direct sources. Research by Silicon Valley Bank shows that the same is true for Napa wineries producing less than 10,000 cases.

And yet the most asked question during our workshops this year was – **"How do we sell more wine through distributors?"** Of course, accompanying that question were more questions about the sustainability of the current distributor model, which markets and wine styles make most sense, how do you evaluate distributors and, most importantly, how do you manage them? In the 12 years we've been doing this, that's the question that I get asked least but ultimately, it's the most important one to be asking.

The first thing to be clear on is whether or not 3rd party distribution is for you. Unless you make your own wine and have got very good control of your cost base, it gets ever more difficult for small producers to fit distributors' margins into their pricing model. Pricing correctly can be the solution but not always.

Further, our research confirms that every business we have information on still has a lot they can be doing before they are pushing the limits of what is possible with Direct to Customer sales and marketing. We've been lucky enough during the year to work with the benchmark producers in this field in each of Australia's four best-known regions. The potential upside for them and everyone else is very clear.

Overwhelming though, wine producers want to expand their business and pursue international markets. With improved exchange rates and the global economy picking up, it makes a great deal of sense to re-evaluate this opportunity. Before going into battle, however, the most important questions to be asking are – "what does that battleground look like, who are we competing against and how must we fight to win?

That is why we see the UK On-Premise as so important. It's the largest On-Premise market for premium-imported wine on earth after the US which is just slightly bigger. Unlike the US, however, domestic production is not really yet a factor. The UK therefore acts as the true 'litmus' for wine ideas globally. No other market can match it on that front. It provides the perfect lens through which to examine the way in which all the world's wine competes and how you need to play to win on the world stage.

There is a profound change taking place in the UK wine market, the same change is taking place across the wine world. People, are trading out of the bottom end but they are not returning to what they drank before. They are looking for value but they are looking for it from a more sophisticated standpoint.

Where are they finding value? In the Languedoc, in the lesser known regions of Italy, in Argentina and most of all, in Spain. Who will lose out as a result? Traditional high-end France is suffering at the moment. Bordeaux has already taken a tumble. Champagne is being affected right now, under siege from Prosecco. Burgundy (which looks to be next on the list, after Bordeaux, to become too expensive to drink) has suffered most of all this year and more delisting looks likely.

Chile, who despite the remonstrations of Oz Clark and others to get out of the bottom end of the market, are perhaps in the worst place. France will fight back as it always has but where does Chile go now that people are moving away from simple, cheap, varietal wine listed under £20 on a British wine list?

Figure 1 – Proportion of Listing in Terms of £s per Bottle (for By-The-Bottle Listings)

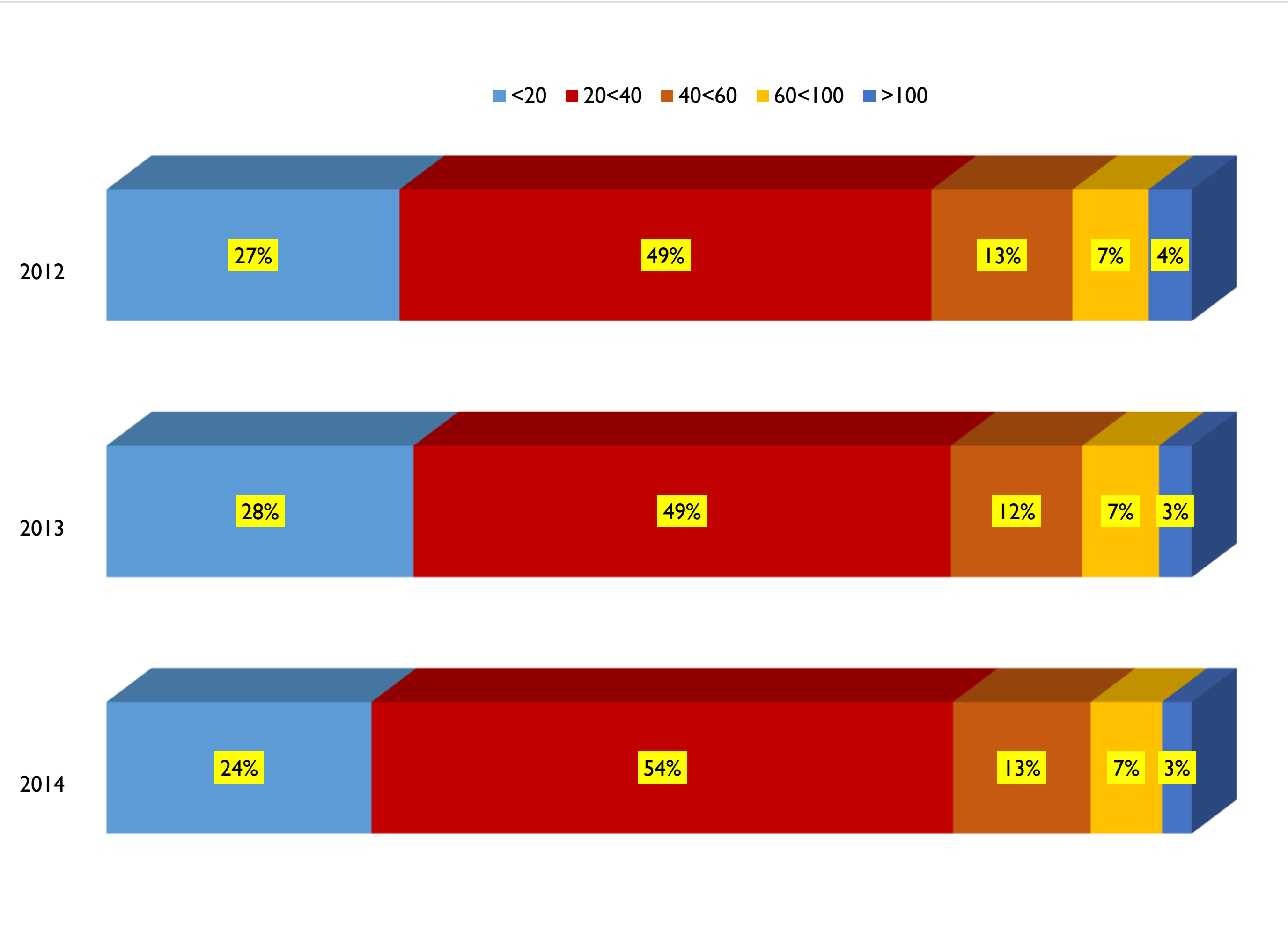


Figure 2 – Share of Total Wine Listings by Country

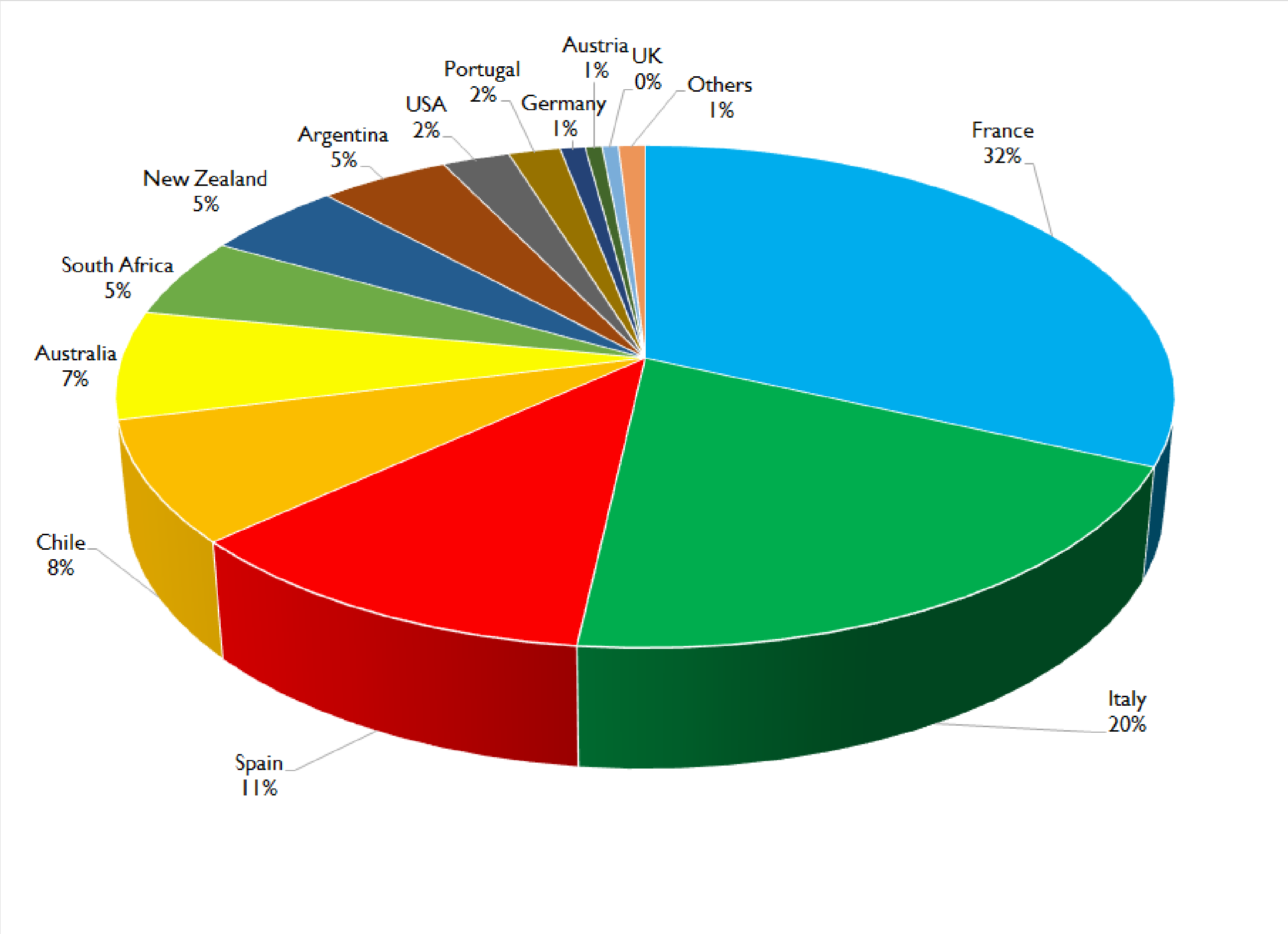
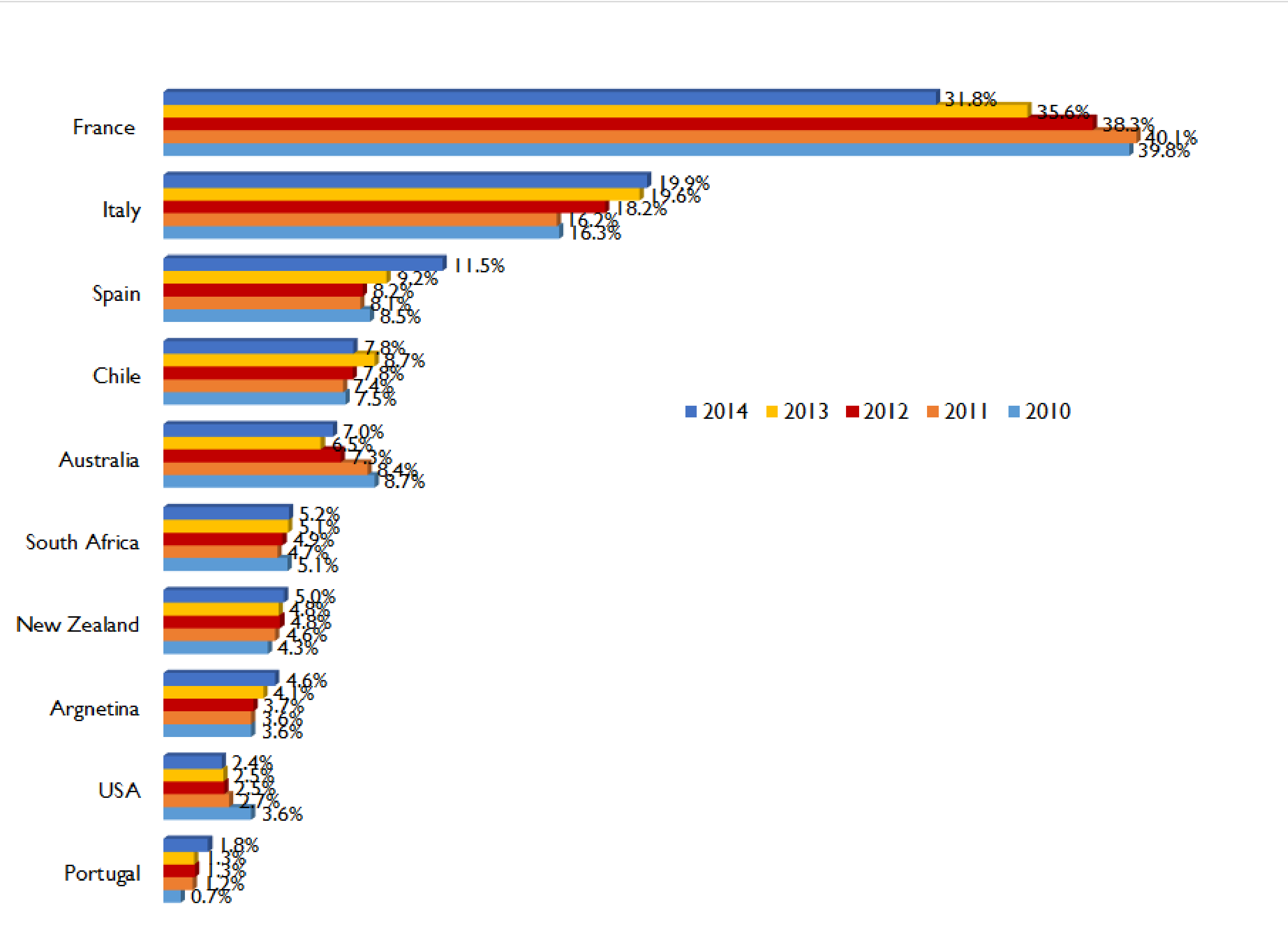


Figure 3 – Share of Total Wine Listings by Country – 2010 to 2014

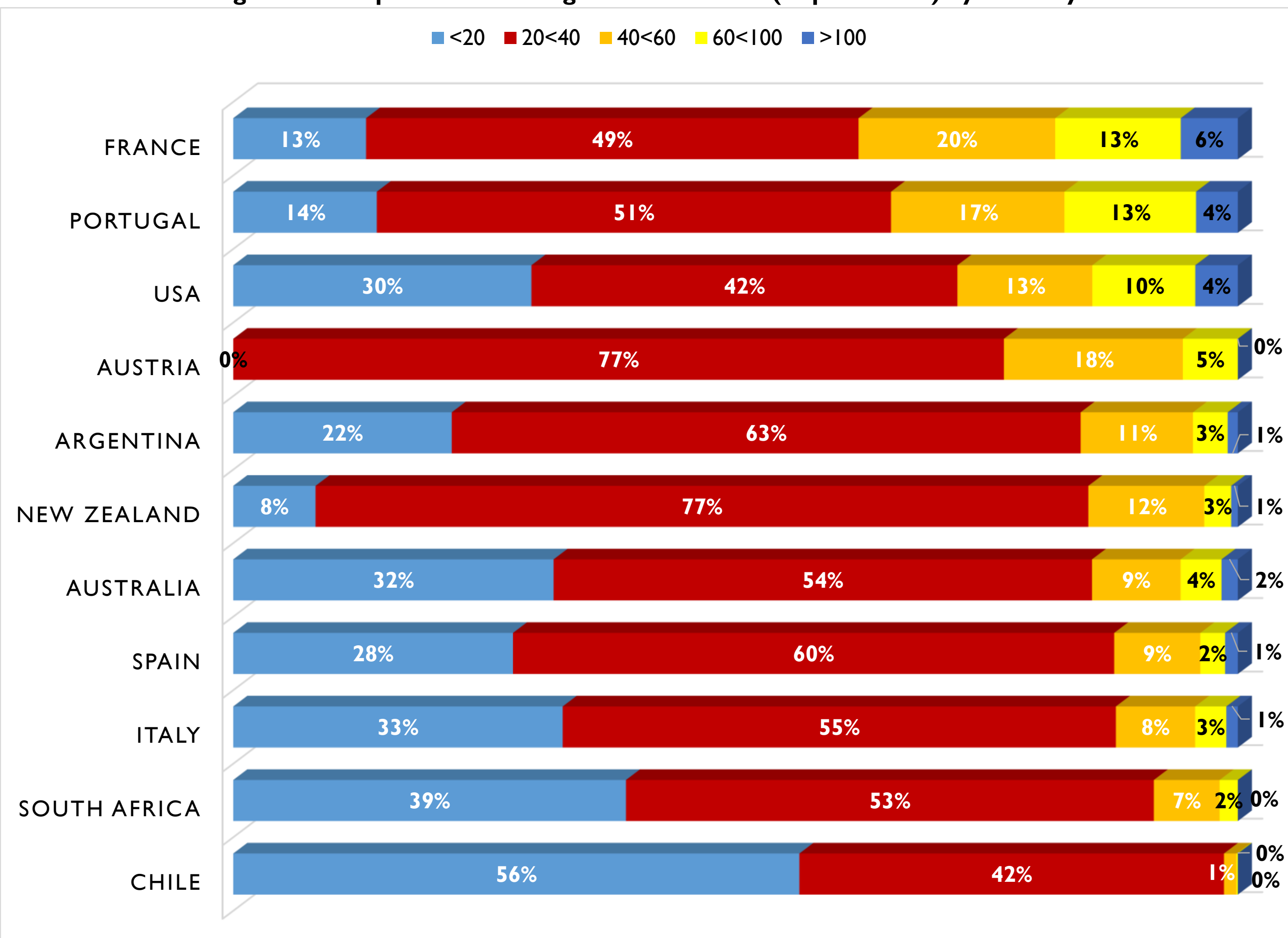


South Africa has done a better job of trading out of low price points, despite the Rand remaining at over 17 to the Pound. 60% of the SA offer was under £20 last year compared to just 39% now. If Chile really wants to look somewhere for leadership, they should watch what Argentina is doing. Not only are they moving out of the bottom end of the market, they are changing their wine and their message so as to be more of the style of those spicy Mediterranean wines, produced from old vines (i.e. they're moving away from the bigger, more extracted, over-oaked, fruit forward style that got them attention, originally).

It's the same journey that Australia has been on but the word has never really gotten out. In a strange twist of fate, Australia has kind of had the job done for it. That last gasp of crassness in the form of wines with ridiculous names from 'South Eastern Australia' has fairly much died a natural death during the last 12 months. That leaves nothing but the country's fine, regional wines to consider when looking to spend between £20-40, where over half of listings now are and where Australian wine is extremely competitive.

That doesn't mean that now that this has happened and the currency is in the right place, that Australia gets to avoid a serious rethink and remodel. What it does mean is that the best and brightest winemakers who understand what great wine is and how to sell its provenance story will once again find a keen market.

Figure 4 – Proportion of Listings at Price Points (£s per Bottle) by Country



New Zealand still needs to work on its premium game. It remains underweight above £40 per bottle and achieved the lowest average listed price increase over last year, after France and the US. A number of top quality Kiwi Pinot Noir producers, for example, are only just recovering from the hurt caused by the GFC. High exchange rates and pressure on smaller distributors leading to non-payment has put a lot of people off the UK market. They will be back, unlike many Australian producers who will never return after working out how to sell their wine direct to customer.

The fact that the average price of a bottle of wine on a UK wine list actually dropped slightly last year, reflects the overall market share that France still has. Apart from Champagne, most other major categories increased their average listed price during the last year. The large increases in the average price of Spanish, Portuguese and Argentinian wine shows both how strong the 'Iberic' brand is in the UK right now and reflects where they are going with their wine quality.

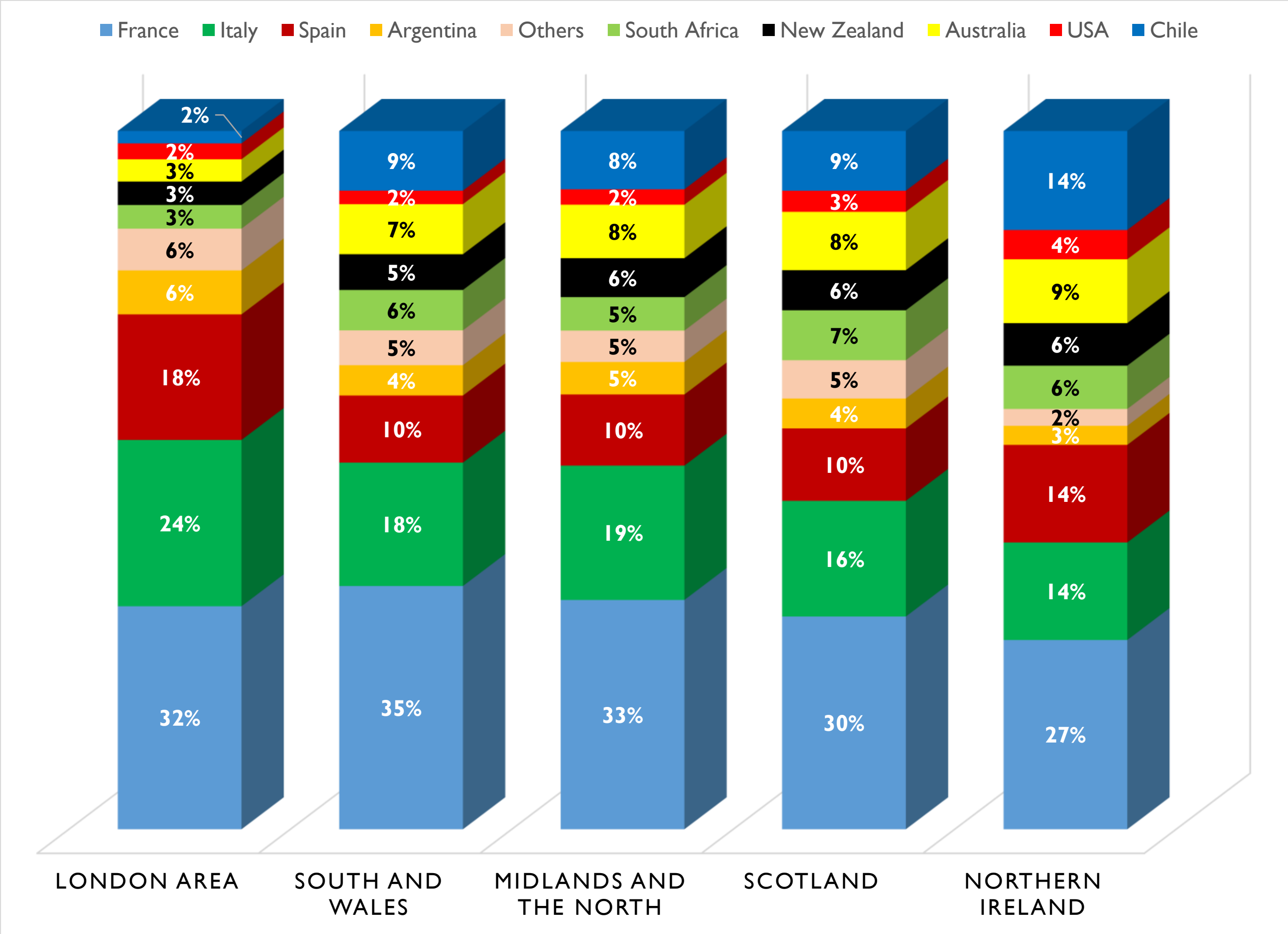
Germany made a huge improvement in listings last year (up 83%). In thinking about "where does true value in quality wine come from?", as we have been saying for years, no category is more underdone in the UK market than German Riesling. That UK restaurants are finally waking up also helps Austria (up 16%).

The US continues to oscillate wildly due to the dysfunction between its bottom end 'concept brands' and very pricy top end. As Americans understand that its wine companies make every type of wine, there is no problem in their domestic market. Once that offer gets moved off shore, however, it's very difficult for the average diner to grasp what the Californian wine brand actually means.

Figure 5 – Average Listed Price of a Bottle of Wine in 2014 vs 2013

	2014	2013	Change
France	£48.40	£50.12	-3%
Portugal	£46.27	£39.37	18%
UK	£44.47	£41.23	8%
USA	£36.62	£39.95	-8%
Austria	£36.34	£33.99	7%
Germany	£31.90	£30.52	5%
New Zealand	£31.43	£30.68	2%
Argentina	£30.10	£24.56	23%
Spain	£29.74	£25.45	17%
Australia	£29.51	£27.78	6%
Italy	£28.19	£27.20	4%
South Africa	£25.16	£22.93	10%
Chile	£20.61	£19.47	6%

Figure 6 – The Share of Listings Held by the Major Supplier Countries by Market



As with all major style preference shifts in the UK, it is London that is driving the move towards Spanish and Italian wines and away from French. In our survey last year, French wines made up 45% of all listings in the London area. How quickly things change.

Nothing has changed in the London market for Australia, however, and whilst there appears to be a recovery of sorts in the rest of the country, my point about there still being a great need for a change of image, is underlined by the fact that Australia has slipped to just 3% of London listings.

If London really does set the trends for the rest of the country, and we have seen this time and again, New Zealand and South Africa have plenty to be concerned about as well. South Africa has perhaps the lesser problem, as there is a serious push for change in the right direction as has already been undertaken by Argentina. New Zealand, having only ever done one thing, may be unaware of any need for change.

Chile has lost share in all of its UK regional markets and has very little support at all in the London On-Premise. As their exports of supermarket wine keep growing, they may not yet see the train that is coming down the track at them. Australia and South Africa can tell them all about it.

Figure 7 – The Share of Total Listings Held by the Major Supplier Regions

Region	2014	2013	Change
Veneto	9.1%	10.0%	-9%
Champagne	7.3%	8.2%	-11%
Languedoc-Roussillon	7.0%	6.3%	12%
Rioja	4.5%	3.6%	26%
Mendoza	4.2%	3.9%	8%
Marlborough	4.0%	4.1%	-1%
Loire Valley	3.5%	3.7%	-5%
Rhone Valley	2.9%	3.4%	-15%
Bordeaux	2.8%	3.1%	-9%
Burgundy	2.4%	2.8%	-17%
SEA	2.3%	3.6%	-36%
California	2.1%	2.5%	-15%
Sicily	2.0%	2.0%	2%
Piedmonte	1.9%	1.9%	4%
Chablis	1.7%	1.9%	-8%
SW France	1.4%	2.0%	-33%
Tuscany	1.4%	1.5%	-10%
Puglia	1.3%	0.9%	52%
Douro	1.3%	0.9%	50%

Sometimes the story of the changes taking place in the market are best told through analysis of regions.

The larger regions constitute ideas that are big enough to be widely understood (and therefore easily bought and sold by the wine trade) but not so big that changes in share tell us little on their own, without going deeper. Think about how Wine Australia's obsession with reporting only National volume and value threw winemakers completely off course in the mid-2000s.

You can see very plainly what's hot and what's not, by looking at the chart above.

The reasons why are the focus of our Wine On-Premise UK 2014 report. As usual, we also look at:

- Who the best distributors are,
- What the most listed wine brands and styles are,
- Which countries and regions perform best where each style is concerned,
- What restaurants charge by the bottle / glass etc. and
- How much wine business owners can expect to make from On-Premise sales?

If you have got your copy yet, please just email me and we can send it to you with an invoice.

The next big question before charging off and looking for a distributor is – "Can I get what I need to make my business model work?" Many who have had to deal with British supermarkets have walked away in disgust never to return but is there money in selling to the UK On-Trade and independent retail?

In our experience, many decisions in relation to export are based upon what neighbours or associates are achieving in a given market. Australia has been one of the worst performing major exporters to the UK in terms of On-Premise listings and price points achieved although thing have improved this year. The following example demonstrates how pricing to compete with other Australian brands could be a mistake.

If the basis of a decision to invest in the UK market was a threshold profit (for example, of $A100,000) and the company considering the opportunity were to use the average price achieved for Australian wine on a wine list in 2014 of £29.51, then with cost of goods of 55% and operating expenses of 30%, that business would need to sell more than 8000 cases to meet its mark. $A80.50 FOB won't get many excited either.

Figure 8 – Volume of Case Sales Required to Make a $A100,000 Profit at Given Margins

Number of cases needed to make $A100,000		**8,282**	3.5	**2,377**
EBITDA	15%	$12.08		$ 42.08
Op EX	30%	$24.15		$24.15
COGS	55%	$44.28		$44.28
Ex cellar price - $A		$ 80.50		$ 110.50
Exchange rate	1.84	£43.75	1.84	£60.05
Freight	£1.80	£45.55	£1.80	£61.85
Warehousing	£2.40	£47.95	£2.40	£64.25
Freight out	£3.00	£50.95	£3.00	£67.25
Duty	£24.58	£75.53	£24.58	£91.83
Agent Margin @ 20%	20%	£94.45	20.0%	£114.80
Wholesaler Margin @ 20%	20%	£118.05	20.0%	£143.50
Price per bottle		£9.84		£11.96
Restaurant Margin @ 60%		£24.59		£29.90
Value added tax @ 20%	20%	£4.92	20%	£5.98
List price		£29.51		£35.88

If that same company were to raise its FOB price by $30 per case and target the average price for all wine on UK wine lists of £35.88, then that business would only have to sell 2400 cases to achieve the same outcome. This leverage effect of nearly 3.5 times is due to a very large chunk of immovable, fixed cost.

This is composed mainly of duty but freight and warehousing are also expensive in the UK. Just as in Singapore and other high tax markets, this creates a huge incentive to take your brand upmarket, to work on your quality and your supporting story. It makes no sense at all for producers from prime regions to compete on price in the UK. The French worked this out a long time ago.

Duty rates did rise slightly during the year even though the duty escalator has been scrapped for now and the average price per bottle fell but what impact has exchange rate had on producer profitably?

The $A exchange rate at this time last year was $1.60 to the Pound and it's now $1.84. Whilst the drop in average price and rise in duty, of course, had a negative effect, this dip in exchange rates would typically lead to a **75% increase** in profits based on the average price of a bottle of wine listed in the UK 2013 vs 2014, if all other costs remained the same. The thing is, the same three levers resulted in a 70% drop in profits when comparing 2013 vs 2012.

Summarising - Premium pricing will produce every good outcome provided wine quality stacks up. Whenever supplier and importer are setting up terms, however, much care needs to be taken so as to insure that there is enough margin to absorb both changes in exchange rates and increased taxes as these will have a vastly different effect on the supplier's business when compared to that of their distributor's.

Figure 9 – Impact of Tax, Exchange Rates and Listed Price on Ex Cellars Price and Profits

		2013		**2014**
EBITDA	15%	$14.90	**75%**	$ 26.10
Op EX	30%	$29.79		$29.79
COGS	55%	$54.62		$54.62
Ex cellar price - $A		$ 99.30		$ 110.50
Exchange rate	1.60	£62.06	1.84	£60.05
Freight	£1.80	£63.86	£1.80	£61.85
Warehousing	£2.40	£66.26	£2.40	£64.25
Freight out	£3.00	£69.26	£3.00	£67.25
Duty	£24.00	£93.26	£24.58	£91.83
Agent Margin @ 20%	20.0%	£116.60	20.0%	£114.80
Wholesaler Margin @ 20%	20.0%	£145.70	20.0%	£143.50
Price per bottle		£12.14		£11.96
Restaurant Margin @ 60%		£30.35		£29.90
Value added tax @ 20%	20%	£6.07	20%	£5.98
List price		£36.43		£35.88

Once again, 2014 surpassed all others on virtually every front. We've a lot to be thankful for. As the year draws to close, I'd like to thank all of you who made that possible.

The year got off the a great start when Willi Klinger arranged for me to address 500 members of the Austrian winemaking community on developing winning global strategy. Thanks to all at the Austrian Wine Market board for a great stay there and to Pepe Schuller MW for an amazing visit to the Wachau Valley.

The South African industry were great supporters during the year. 42 people attended two Stellenbosch workshops. A big thanks to Bonnievale's John Barnardt for his help there and to Christo Conradi and the team at Vinpro who had me address the South African industry on winning through innovation. Wonderful to meet all of the team at WOSA, at that time. Great spirit there and across the industry leadership group.

NZ Winegrowers, the NSW Wine Industry Association and Wine Tasmania, Fine Wine Partners and others kept us busy with On-Premise related projects. Always happy to help there.

It was fantastic to be involved with Wine Tasmania's first wine business conference. This was a great initiative that other regions could benefit from undertaking. Thanks to Sheralee Davies and her team who looked after me so well and helped with our workshop. Thanks to Larry Jorgensen (WA), Paul Mason and Nicola Belsham (Martinborough) and all others who have helped me work with their region's members through workshops and/or regional strategy discussion/facilitation.

Wine Communicators Australia organised for me to present their Consumer Insights series in Adelaide, Melbourne and Sydney. A big thanks to Pernod Ricard's Angus Barnes and CEO Jeffery Wilkinson for that.

It was a massive year for Direct to Customer consulting. We are proud to have worked with many of the best businesses in Australia on this front. I'll be attending the 2015 Direct to Consumer Symposium in California next month in order to discover all of the 'latest and greatest' developments in the US.

It's been an interesting year on the Mergers and Acquisitions front with a number of exciting new projects emerging as the year ends.

Above all, we'd like to thank our clients, especially the very small businesses that we don't necessarily make a lot of money from helping but for whom we live and breathe. Hope you all have a wonderful Christmas and New Year break. We look forward to helping you build a better wine business in 2015.

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

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.

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