Wine Business Solutions

The Wine Paper 36

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Building a Better Dashboard

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There was a time when Australia led the wine world in terms of global business intelligence. The industry knew where it was going and was happy to share, safe in the knowledge that by the time its competitors figured out what it was doing, Australia would already have commenced attacking the next opportunity.

You can plot the downfall of the Australian wine industry almost exactly to a change in leadership that had a different attitude towards this business intelligence gathering and the sharing of it. It's very hard to fly when you can't see where you're going. It's harder still to communicate your strategy if you don't share your flight plan. Unfortunately this happened at exactly the time when Australia's view of the world needed to become more sophisticated. The old singular measures of volume and value would be instrumental in leading the industry in completely the wrong direction. Australia, as they say, 'wound up in the ditch'.

Without a complete dashboard covering all of the opportunities, their evolution and their respective profit pools, major strategic mistakes can and are still being made.

Just as one example, I received last week via email (as you do these days) a Wine Australia presentation ex Singapore via New Zealand. As you would expect, it was professionally put together and nicely presented. All looks good. Until you read the first thing in the first box on the first page, that is. Under the heading 'What Does Success Look Like?' it states "Volume Increase in Sales of Australian Wine".

Huh? Has no one worked out yet that that's what got Australia into all this mess in the first place? Is no one questioning why our largest European competitors are working so hard to cut back production? Has no one projected out the Austrian model of driving up revenue whilst <u>decreasing</u> sales volume and seen what that will do for Australian wine businesses' cashflows?

The very last item in the report exhibits the same quality of thinking and analysis - "Australia remains the market-leader in the UK but the premium market, while growing, is relatively small".

Excuse me but didn't the Brits more or less invent the concept of fine wine? It may appear small from an Australian perspective if informed by its own sales, but I very much doubt that the French see it that way. Around 29 Million cases p.a. are sold in the On-Premise sector alone in the UK. According to our research, the average bottle of Australian wine on a wine list sells for under £30. The average bottle of French wine sells for nearly £50. France has more than 4.5 times the listings of Australian wine. Even if costs were 20% higher in France than Australia, it's entirely possible that France could be making more than <u>35 times as much money</u> out of the British On-Trade as Australia. I'm sure that they want to keep that to themselves…

Figure One – Ratio of Profitability of French Wine Compared to Australian Sold in the UK On-Premise

		AUS	Ratio	FRANCE
EBITDA	15%	$13.50	7.5	$101.20
Op EX	30%	$27.00	plus 20%	$32.40
COGS	55%	$49.50	plus 20%	$59.40
Ex cellar price - $A		$ 90.00		$ 193.00
Exchange rate	2.06	£43.69	2.06	£93.69
Freight	£1.80	£45.49	£1.80	£95.49
Warehousing	£2.40	£47.89	£2.40	£97.89
Freight out	£3.00	£50.89	£3.00	£100.89
Duty	£24.58	£75.47	£24.58	£125.47
Agent Margin @ 20%	20%	£94.45	20%	£156.00
Wholesaler Margin @ 20%	20%	£118.05	20%	£195.00
Price per bottle		£9.84		£16.25
Restaurant Margin	60%	£24.59	60%	£40.33
Value added tax @ 20%	20%	£4.92	20%	£8.07
Average List price		£29.51		£48.40

How did we get here? For many years Nielsen UK and the supermarkets they provide data to, have been representing that wine sold in supermarkets reflects the whole market. As Wine Australia never paid for its analyst to travel, no one thought to challenge this idea and this thinking clearly continues to misguide Australia's strategy today.

Why does this continue? The industry has for a long time been blinded by the 80/20 rule. That is, the long standing belief that four companies represent around 80% of the industry. Certainly at different stages during the last 30 years they have been responsible for up to 80% of production and therefore levies paid to support Wine Australia (AWGA these days). They therefore set the agenda. They fund the research.

If this 80/20 rule were true for revenue and profit, then the industry has nothing to do but accept its fate. Australia would forever be bound by the actions of these companies, the image they make for the rest of the industry and the control they have over the national organisations.

According to the latest IBIS World study, however, those four companies account for just 39% of the industry's revenue and virtually none of its collective profits. Through choosing to play at the tail end of the market, they have missed out on 20 years of growth in premium segments, watched their own market segments shrink in value and been outcompeted by lower cost producer countries. All eyes have been on Treasury, as the only company listed on the ASX, but they actually make the others look good. Despite the massive long-term destruction of the value of its absorbed brands and businesses, TWE at least is profitable.

Pernod Ricard Pacific Holding Pty Ltd – financial performance

Year	Revenue ($ million)	(% change)	EBIT ($ million)
2009-10	631.9	-8.3	-28.2
2010-11	511.6	-19.0	-38.7
2011-12	511.7	0.0	-26.7
2012-13	492.4	-3.8	-51.2
2013-14	511.6	3.9	-28.5

Accolade Wines Holdings Australia Pty Limited – financial performance

Year	Revenue ($ million)	(% change)	EBIT ($ million)
2009-10**	614.6	N/C	-258.6
2010-11	666.2	8.4	-29.2
2011-12	438.7	-34.1	22.5
2012-13	415.5	-5.3	-15.2
2013-14	456.9	10.0	34.4
2014-15*	466.5	2.1	N/A

*Estimate **Year end February

SOURCE: ANNUAL REPORT AND IBISWORLD

Casella Wines Pty Limited – financial performance

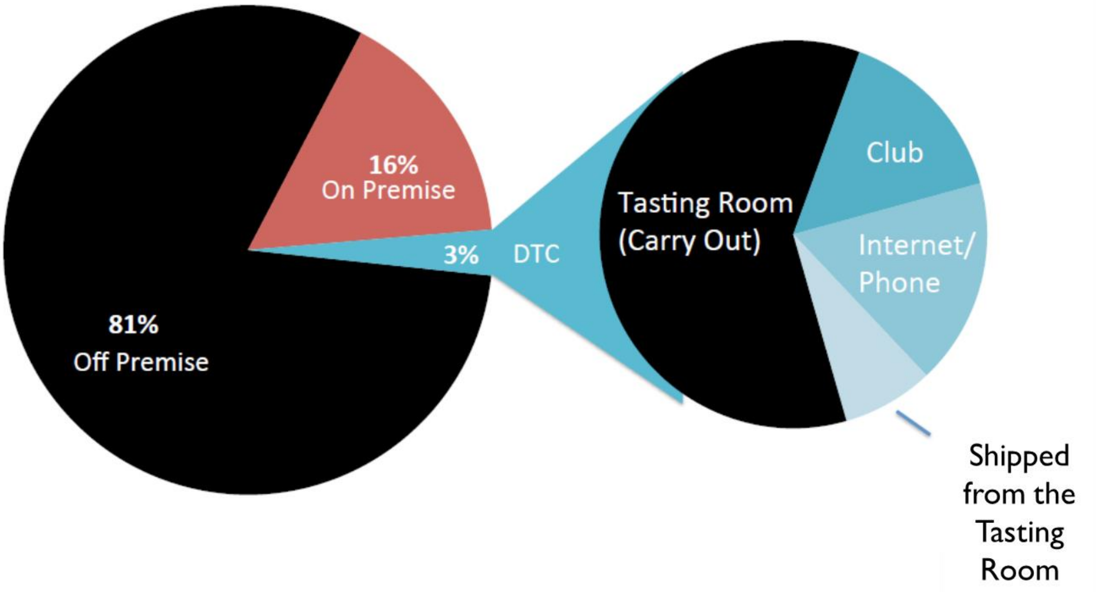
Year	Revenue ($ million)	(% change)	EBIT ($ million)
2009-10	410.9	N/C	20.9
2010-11	412.6	0.4	68.0
2011-12	343.7	-16.7	-30.2
2012-13	346.2	0.7	-5.0
2013-14*	367.3	6.1	N/A
2014-15*	381.4	3.8	N/A

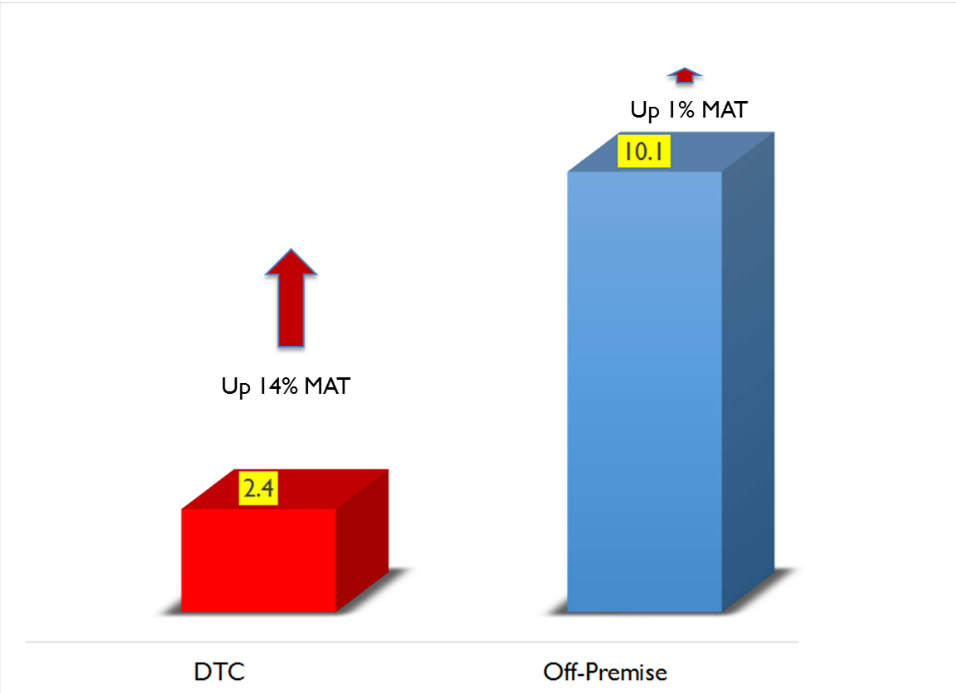
*Estimate

SOURCE: ANNUAL REPORT AND IBISWORLD

Another more extreme example of missing the (profit) point, is the US market where shipments out of cellar door / tasting rooms represent less than 1% of the volume of the US wine sales.

Figures Two and Three – Key US Retail Sales Segments – Source, Ship Compliant and Nielsen





Sales in $ABillion

Sources:

ShipCompliant

and

Nielsen US

Those shipments, however, are worth around $A2.4 Billion and are growing at around 14% per annum. The entire retail sector, as measured by Nielsen, is worth just over $A10Billlion. This is all fairly well known but what is perhaps not understood is that as these direct shipments are up to 8 times as profitable as selling through three tiers of distribution, it is possible that there is more profit in these DtC sales than there is in the entire off-premise sector. They key difference is the majority of these off-premise sales are divided up between the three biggest companies, where DtC sales are shared between thousands. Having a strategy to compete direct to customer in the US is, therefore, going to be critical going forward.

As we have been saying all along, the wine industry needs to be thought of as a minimum of five completely different businesses that have nothing to do with each other in terms of how grapes are grown, wine is made, the product is sold, the end consumer thinks about it and the way we need to communicate.

CHOOSING YOUR CUSTOMER

Beverage Wine Consumer	Branded Wine Consumer	Aspirational Consumer	Adventurous Appreciator	Collector
The Commodity Business	The FMCG Business	The Image and Lifestyle Business	The Food, Wine and Travel Business	The Luxury Brands Business

Yes, there is overlap. The amount of bulk wine washing around in the market has a direct impact on all but the top end. Likewise, competition in the $20 plus space tends to determine the number of people trying to sell wine at $13-18, even though that constitutes entering another business sector altogether, with different routes to market requiring a much lower cost base in order to be sustainable.

A massive oversupply in La Mancha, however, has practically no bearing on the market for Rioja, just as the projected 100,000 acre surplus of Californian wine grapes will have little effect on the demand for Napa Valley Cabernet.

The high Australian dollar and great competition from Chile, South Africa and Argentina etc. has had a massive effect on those four Australian companies in particular but is almost irrelevant to the $20 plus category where Australia has failed to take its opportunity during the last 5-7 years. Spain, Italy and France most definitely have, most notably in the Australian market itself.

So what would that dashboard look like?

Bulk Wine and Lower Price Bottles.

Just as everyone found stories of Murray Tyrrell sticky his elbow in wine vats to measure the temperature beguiling, people are equally charmed by Bruce Tyrrell talking about counting the number of pages of bulk wine listings as a barometer of market health. Too few or too many are both bad. The industry can be vastly more sophisticated than that, of course, and we are certain Tyrrells are too.

SAWIS perhaps provide the global best practice model for measuring the commodity part of the market, currently. Wine Australia once possessed most of this capability. Funding issues have meant that a lot of this has lapsed. Even the great work done by the Australian Bureau of Statistics has been halted.

We regard this as the very most fundamental part of the Dashboard. It instructs the industry as to its own shape and size. It does not, however, act as a good guide as to what to do next. That must come from the market backwards. More importantly, it doesn't highlight where the money is, leaving the South African industry in perhaps a worse place than Australia if it uses its existing production base to guide strategy rather than thorough market analysis.

The amount of cut price wine cleared by online retailers is another good indicator of industry health. In the US they count flash site sales. As part of our Direct to Customer Benchmarking, we do monitor sales through online third party retailers. We need to make this data more robust and plan to do so through encouraging greater participation. Given that there only 5-6 major players, other than Dan Murphys, it may be possible to set up an index where headline numbers only are provided, in confidence, and totals only are shown. We can do better.

Cask / Box wine (still a significant part of Australian wine volume), cleanskins (wine sold without label) and private label wine are all subject to the same issues in terms of measuring them as branded wine.

Branded Wine.

This has become problematic in Australia as Aztec has this sown up so tight that only those previously mentioned 4 companies and 3-4 others can afford / access to the data. National Organisations, National Publishers, Independent Aggregators such as ourselves and others have been denied access. Via their contracts, Aztec have also stopped supermarkets and wide range wholesalers providing data to third parties.

Given the failing of Nielsen in this area, I can understand Aztec's commercial reasoning for wanting to protect its investment. It has gotten to the point where competition is being invited in, however, as no industry can function without this sort base line business intelligence.

<u>$13 and up</u>

Here the dynamic changes and the set of measures must also. The On-Premise represents around 50% of sales opportunity outside of direct sales in the Australian domestic market. How can this be? According to our research, there is now practically no wine listed on Australian wine lists that would sell in off-premise retail for $13 or less, the price point under which around 80% of off-premise sales occur. Restaurants' business models dictate this. Wine is seen as a key profit centre that helps support much higher wages and property rental than most other developed countries have to deal with.

The situation is slightly different in export markets where a higher proportion of wine that would sell for $13 or less in the Australian market, often under the designation South Eastern Australia, is sold into restaurants. This, of course, has the effect of further damaging Australia's image. At the same time, it is not helping the companies that make this wine as the market is always evolving away from lower price / lower quality wine. Everyone loses while this remains the default way to play. South Africa has the same issues.

In the $13-18 zone, off-premise sales are still the majority and good data is essential. Above $20, all previous attempts that I have seen to usefully portray this category in the Australian off-premise have been pretty much useless. The same is true in the UK. The US is big enough to be slightly more accurate but Nielsen and Aztec (IRI) still rely heavily on chain store data which, of course, is skewed towards the bottom.

On-Premise listings tend to lead off-premise sales and are the key metric for anyone who is serious about building a premium wine brand. We cover the Australian, UK and Canadian markets. Wine Metrics measure On-Premise listings in the US but again use restaurant chain data.

On-Premise sales (as opposed to listings) is a bit of a holy grail. Nielsen tried to do this in the UK and failed horribly. There are producer groups in Australia that are going to try to do this but again, they represent the largest players which is fine on the distributor side but potentially misleading where those companies that are both producer and distributor are concerned. Listings vs Sales remains an important idea. For example, our research shows that 22% of white wine listing is the UK On-Premise are Sauvignon Blanc whereas Matthew Clark, the largest wholesaler, claims that Sauvignon Blanc represents 42% of their white wine sales. Anecdotally, from talking to lead distributors, the same ratio exists in Australia.

Direct sales are a completely different story in terms of the availability and veracity of the numbers. Ship Compliant has almost perfect data in relation to the US market as they collect virtually all of it. This serves as an invaluable tool for our clients looking to negotiate pricing with US importers and wholesalers.

Silicon Valley Bank also do a thorough benchmarking of the US market. We in turn benchmark Australian, New Zealand and South African wineries by asking them the same set of questions. Improving quality is all about improving participation. We will be driving that very hard this year. Hopefully you can help.

At the top-end, we are seeing the same situation that is taking place with branded wine. Top end collectable wine is no longer being listed in the On-Premise in the way it was ten years ago. This is partly commercial. Restaurants no longer want to stock wines that don't turn over for 'show off value'.

It's also about fashion. Emerging wine drinkers and young sommeliers are largely disinterested in the styles of wine that do well at auction. Being both collectable and relevant to emerging drinkers is something most historically top end Australian producers are failing at. Cullens is one of the few exceptions. Leading French wine brands, by contrast, seem to be able to seamlessly transition from the restaurant to the auction room. That, at the end of the day, is what all premium producers should be aiming for.

So what does this look like when we put it all together?

Successful Brand	**Target Consumer**	**Benefits Sought**	**End Values Sought**	**Dashboard**	**Key Category Health Measures**
Grange	Collector	Discernable Quality and Prestige Brand Association	Sense of accomplishment Comfortable Life Social Recognition World at peace Equality	Auction Indexes Sotheby's and other (free) high quality insights	Engagement with Emerging High End Wine Drinkers
Marques de Riscal	Engaged Wine Drinker	Discovery and Learning	Social Recognition * Exciting life Sense of Accomplishment	Direct Sales Benchmarking On-Premise Research	Perceived producer dynamism Food Compatibility
Oyster Bay	Aspirational	Enhanced Social Status and Self Image	World at peace Social Recognition True Friendship Exciting life Sense of Accomplishment	Off-Premise research On-Premise listings (to a lesser extent)	Fashionability Communicability Environmental Credentials
[yellow tail]	Branded Wine Drinker	Special to Share, Easy to Drink	True Friendship	Off-Premise data (almost exclusively in some markets)	Brand Trust
Own Label	Beverage Wine Drinker	Recommended Reliability	Inner Harmony	Bulk wine sales data Off-Premise sales data On-Line Wine Sales	Country Image

First Four Columns ex Hall, J., & Winchester, M.K., (2000). What's really driving wine consumers? Australian and New Zealand Wine Industry Journal, Vol 15(4), 68-72. Second Row has been added in, is conjecture and has yet to be proven by research.

What's at stake if this is not done? Try reading New Zealand Winegrowers' 46 Page Market Guide to doing business in Australia. See if you can think of anything that they've missed in terms of beating Australian wine businesses. I couldn't.

The question then becomes – Why does the 60% of the Australian industry that is actually making a small amount of profit (around 6% of revenue according to IBIS World, notwithstanding that that is mostly WET rebate where the majority of producers are concerned) stand by whilst their national organisations appoint ex supermarket buyers as market managers and talk about one wine market like it's 1995? However it gets achieved, Australia can only become globally competitive if it does five things, in my view;

1. Manage the exit of unprofitable growers so that bulk wine and low-end bottle wine production becomes about the sort of broad acre, large scale, fully mechanised viticulture that Australia can do better and cheaper than anyone else.

2. Chose its battles where the Branded wine segment is concerned. This sector is generally controlled by the market leaders through greater production scale, sales volume and, therefore, market investment capability. Accolade and Treasury, by working together in the UK and Australia, have that in terms of their production base. Gallo, Constellation and The Wine Group hold the same market power in the US. Only [yellow tail] successfully competes against that sort of market muscle.

3. Develop respect and innovative products for the Aspirational wine drinker. Ignoring this consumer cost the Australian wine industry 40% of its domestic white wine market. Not respecting this consumer cost Australia its market position in the US. Italy, New Zealand and Argentina, meanwhile, continue to run away with that market opportunity.

4. Make the entire promotional effort about appealing to the engaged wine drinker. This is where the biggest growth is. This, as we have earlier demonstrated, is where the money is. This is how all great wine producing nations set their image. This is where Australia truly can be globally competitive.

   This, much as we would all like it to be, is not a job for those four earlier mentioned companies. Australia has a particular advantage in terms of being able to communicate directly with this consumer. Australia's best fine wine producers must do so on the ground in the US right now or miss the biggest single growth phase we may every see in a wine market.

5. Excel in the Luxury end of the market and do so with quality, dignity, credibility and not in a way that is seen as exploiting naive investors as some competitors have done. Above all, become relevant to younger drinkers.

None of this is hard. It just needs someone to lead. Are you up for it?

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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