

A Summary of:

Wine Industry Outlook Conference 2004

EMERGING MARKETS: THE NEW VISION

Summary prepared by:

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The following are my summaries of (and personal commentaries on) the presentations to this conference, which was held on 25 November 2004.

Copies of the full PowerPoint presentations are available from the website
www.winetitles.com.au/outlook:

login: outlook

password: outlook04.

SESSION 1 – ASSESSMENTS AND PROJECTIONS

The Global Economic and Business Outlook

Richard Gibbs, Head of Economics, Macquarie Research Economics.

This was a “vanilla” economic presentation which focused on economic factors as a whole, with only negligible wine industry-specific content.

In commenting on the potential increase in Asian domestic demand, Gibbs made an interesting observation about advertising expenditure in China. Advertising had been banned until only a few years ago, but it has already reached US\$50 billion per annum.

Also of interest (although query the relevance) is the fact that trading in AUD/USD is the fourth largest currency trade in the world, which is totally out of proportion to the value of our GDP's current account, etc.

Global Wine Outlook: Australia's Relative Position

David Cooke, ABN Amro Equities Australia

This presentation was far more tailored to the Australian wine industry.

Cooke gave details showing that “official” average grape prices had declined by only 5% over the last 3 vintages. However, he noted that this decrease was much greater when the effect of fixed price contracts was stripped out.

In terms of the global demand and supply expectations, the ABN Amro view is that “the worst should be behind us”. He noted demand has grown at double the rate of supply growth during the period 1999 – 03.

He noted that, notwithstanding EU subsidies of A\$1.08 per case, there has been a decline in EU production in the period 2003 – 2007, but the forecast is that Old World wine will continue to remain in oversupply.

However, New World wine supply/demand equilibrium is expected to be achieved by vintage 2006, depending on the size of the next vintage in Australia and California, and assuming constant grape prices, exchange rates, etc.

The compound annual growth rate (CAGR) of demand is running at just under 5%, whereas supply is exhibiting only about 2% growth.

In terms of the US situation, Cooke noted how the California vintage had increased by 27% in the 2000 vintage alone. However, he claimed that up to 25% of bearing acreage had been pulled out during the last two years. An extremely prominent wine industry person (who is now associated with Food And Beverage Australia Limited) – was sitting behind me, and he was extremely skeptical of this figure. Obviously, a lower US crush could have significant benefits for Australian producers, with higher grape prices putting upward pressure on selling prices for American wine.

Although the global wine industry has experienced 10 straight years of volume growth, traditional wine consumers are still turning away from wine, whereas new wine consumers are drinking more – which is to Australia’s benefit, as New World wines are gaining ever increasing “share of throat” for such consumers.

Cooke expects Australian wine exports to grow at 15% CAGR, with the UK and USA remaining the key growth drivers, representing 2/3 of growth. UK wine consumption is anticipated to grow at 5% per annum with Australia continuing to take market share from Old World wineries.

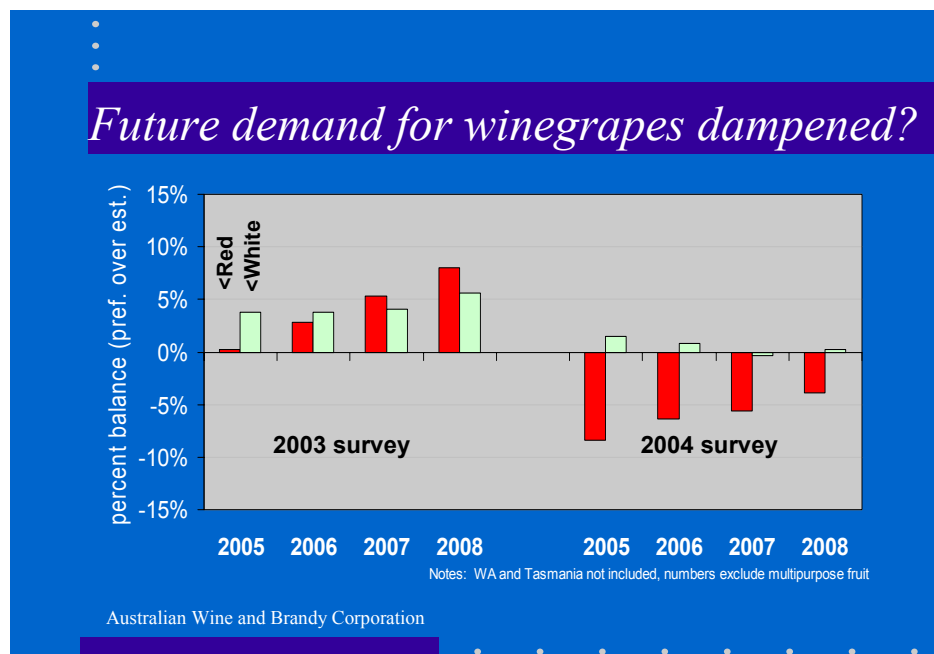
He is forecasting 7.5% CAGR in US consumption, up from approximately 5% in previous years, although the average price of Australian exports to the US has been trending down.

(Germany has one of the lowest prices per litre for our exports, at just A\$2.40 per litre. However, it is our fourth largest market now, and has been regarded as something of a “release valve” for the recent oversupply.

Australian Wine Outlook: The Supply/Demand Balance
Lawrie Stanford, AWBC

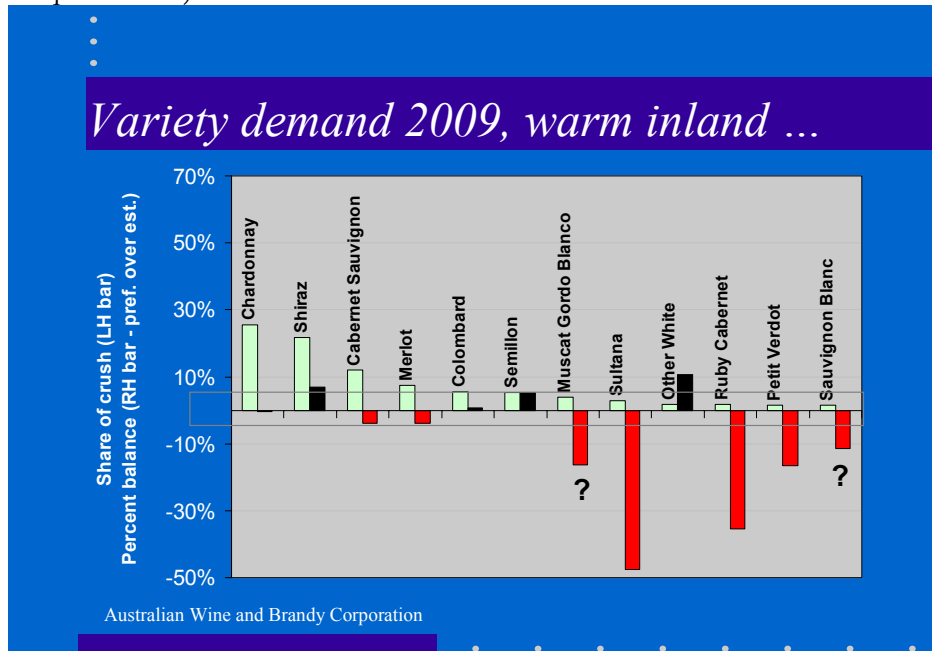
One of the current problems for the industry has been caused by the big 2004 harvest, with average yields being well above the previous averages, and above the trend line. This occurred at the same time as decreasing sales in the United Kingdom, with growth rates down from 22% to 13% - 14% (although sales have recovered toward the end of CY2004).

There has been a significant shift in producer attitudes from the 2003 survey to 2004, with expected oversupply of red grapes going forward to 2008 (notwithstanding the expected undersupply for the same period in the 2003 survey).

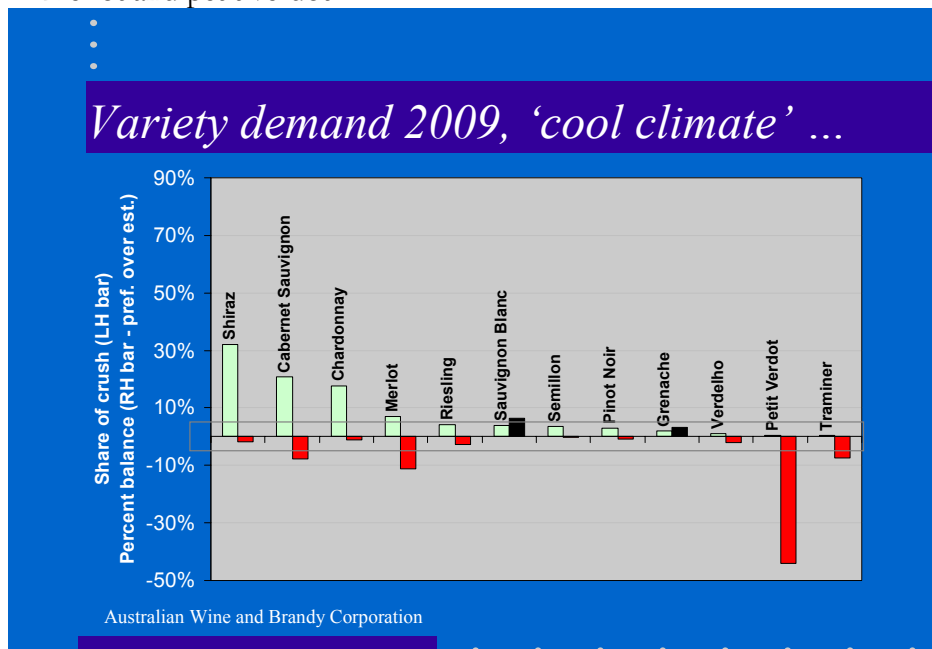


Looking at future demand for grapes by variety, Stanford expects there to be:

- For warm inland areas;
 - Excess demand for chardonnay, shiraz, and cabernet sauvignon;
 - Excess supply of sultana, ruby cabernet and petit verdot (the data indicates oversupply of Muscat Gordo Blanco and Sauvignon Blanc, although Stanford queries this).



- Cool Climate
 - Excess demand for shiraz, cabernet sauvignon and chardonnay, and oversupply of merlot and petit verdot



In terms of wine, Stanford also expects supply growth of about 2-3% in the period to 2010. Therefore, with expected sales increases in excess of this rate, we will be unable to meet demand in the medium term, with demand only met in the short term through exhaustion the current oversupply of stocks.

SESSION 2: EMERGING MARKETS: THE NEW VISION

Wine Brand Australia: The New Vision

Johnathon Scott, AWEC

This paper was something of a “strategy paper”.

The new AWEC Strategic Plan talks about “the journey”, the “destination vision”, “Road Map Strategic Plan” etc. The presentation finished with the following “positioning criteria”:

- **Authentic** – the brand can realistically claim this, and deliver on it with current perceptions of Australia, but moving one step up.
- **Emotional** – sense of vision and personality appeal to the heart not just to the head.
- **Idea** – the positioning should expressed as a singular unifying idea;
- **Organisation** – wide – the positioning is relevant for all parts of the industry and drives key messages for all markets and all stages of development;
- **Unique** – is identifiably different from all other competitors both new and Old World.

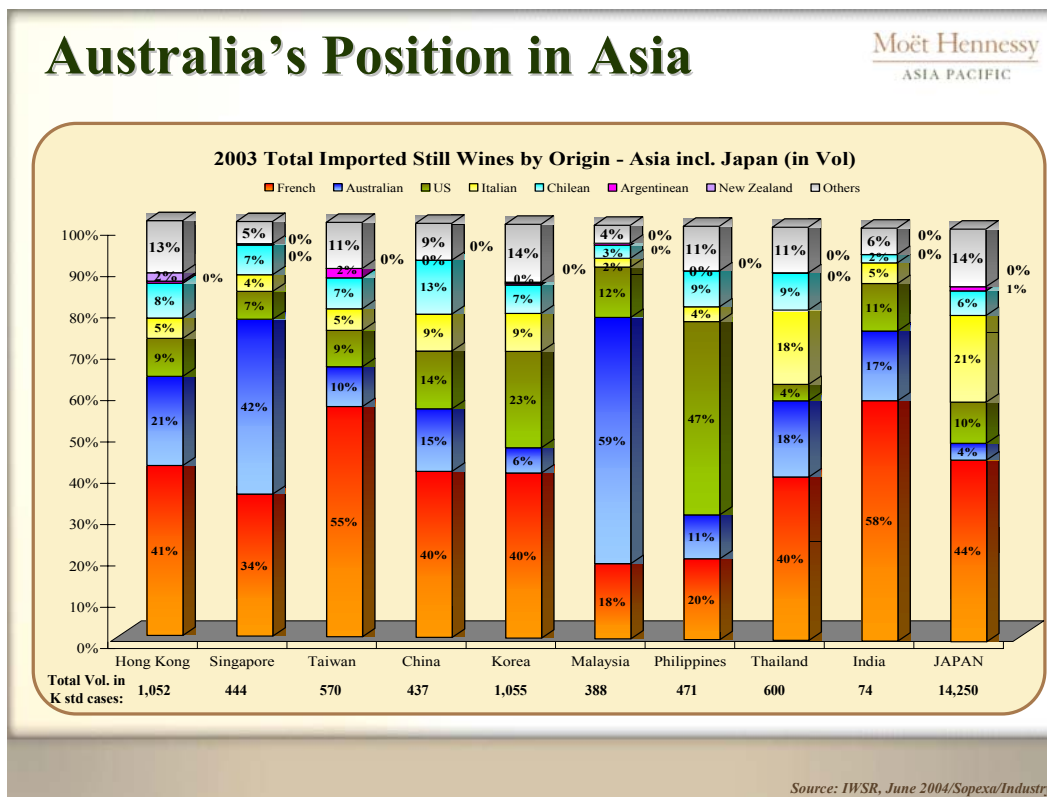
Building Business in Asia Pacific: New Distribution Models

Mark Bedingham, Moët Hennessey Asia Pacific.

This was an outstanding presentation. The presentation ran overtime but no-one complained. The PowerPoint slides are numerous and very detailed.

Everyone is aware that “Asia” cannot be considered as one market when preparing export plans. Although it is one region, the countries which comprise it are very different in many ways. Given the size of some of the major population centres, the best idea is to adopt a city focussed basis. For example, the GDP per capita across China is USD1,100 whereas the figure for Shanghai is 4.5 times this amount, for Guangzhou it is nearly 6 times this amount, and Shenzhen is 9 times the average. He also noted that Shangri-La now have 34 5-star hotels in China.

Bedingham provided a series of very detailed slides breaking down Australia’s position in Asia, compared with its opposition.



He also distinguished between those Asian markets in which the Old World did best, and those where New World wines had been particularly successful, listed a series of potential reasons, and in doing so identified ways in which this success could be built on.

China is one market which is not identifiably in either camp – although all the key wine producers in New and Old World countries want to establish export markets in China, because of the potential size of the market.

There has also been a huge increase in the hypermarket business, thereby increasing the potential distribution network, with Carrefour in Shanghai, WalMart in Shenzhen, and DairyFarm opening in 2006.

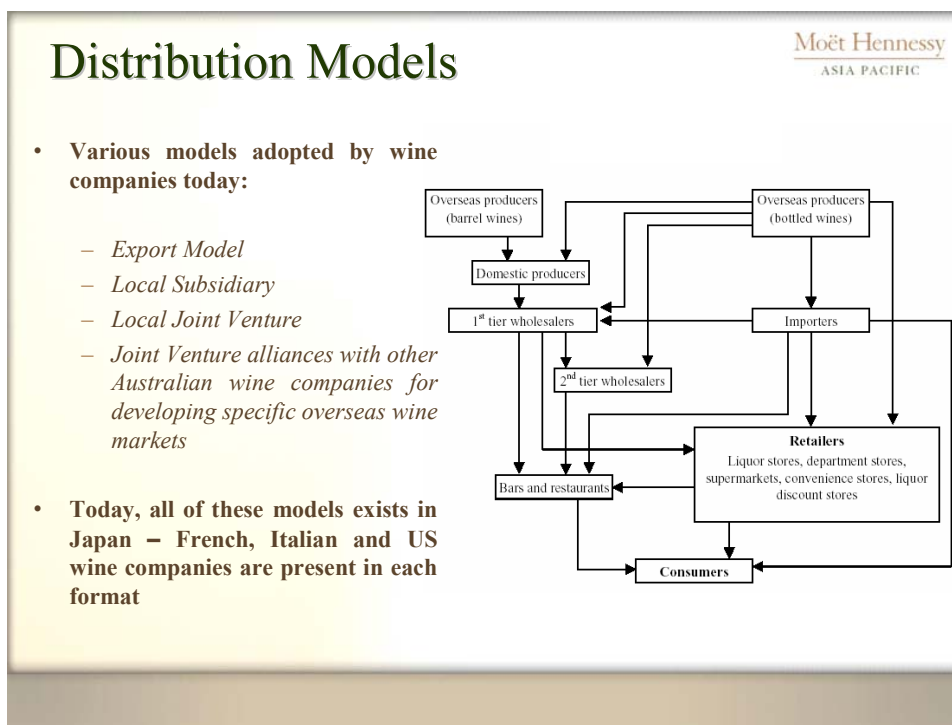
Bedingham was very upbeat about the potential for Australian Wines in Japan, particularly with:

- younger, wealthier consumers;
- the huge growth of international hotel chains;
- the food friendly nature of New World wines with “fusion” cuisine (which represents an increasing share of the restaurant market in Tokyo and Osaka; and
- the incredible evolution in retail licensing laws, with convenience stores and home delivery companies (pizza and Asian cuisine) able to sell alcohol, as well as regular supermarkets.

Some of the suggested brand building exercises put forward by Bedingham (for the Australian wine industry as a whole, but which can be equally applicable to individual brands) were:

- An emphasis on viticultural regions and diversity – “terroir” is especially relevant for Japan
- being featured in influential “lifestyle” press and programs in Japan
- Involvement with Japanese sommeliers.
- Proper educational materials in the local language.
- Wine courses delivered in the local language – designed separately for the trade and for consumers.
- Recognition of the key “prescriptors” in each market (e.g. Japanese Sommeliers Association) and
- Collaboration with the leading tour operators from China, Japan, Korea and Taiwan to arrange properly structured wine tours to Australia in the correct language.

Bedingham believes that the classic model of distribution is the most neglected area for all Australian wine companies, big and small. He believes that it is no accident that Australian wine companies attached to international groups develop export markets most quickly because of their distribution structure, which involves the establishment of a subsidiary or joint venture in the export market. He notes that the joint venture may be with a local partner, or even with a competitor in the home market (i.e. another Australian wine company). French and Italian companies have been adopting this latter strategy in export markets.



The benefits of his suggested model include

- more control over distribution (pricing, marketing, communication and dealings with trade customers); and

- adding 20% to 40% to “see-through” Gross Margin (albeit with more risk and a higher initial cost).

This structure will be available in China from 1 January 2005, which is when the prohibition on wholly owned foreign entities engaging in sales activity for wine and spirits distribution in China will be abolished. It will be possible to set up such entities outside the Free Trade Zones.

Export into Asia: A Pragmatic Approach from an Australian Company Perspective – Nicolas Olivry

This was an unfortunate presentation in a number of ways. Olivry was always in trouble when his presentation started after the lunch break was scheduled to start. However, he ignored the unrest in the crowd and spent 55 minutes giving his presentation in full (which was only scheduled for 20 minutes).

The consensus at the conference (and at Wine Australia the next day) was that his paper was a waste of time – full of platitudes and statements of the obvious, with no practical examples or relevance.

SESSION 3 - THE AUSTRALIAN DOMESTIC MARKET – INSIGHTS AND EVALUATION

Consumption Demographics: Market Segmentation – Trends and Opportunities

Michelle Levine, Roy Morgan Research

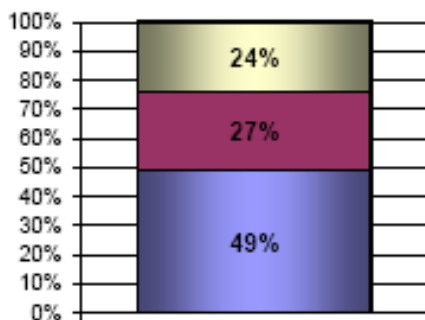
Levine did a very good job of mentioning (many times) the type of service which her company can offer. Unfortunately, the specific information about the wine industry was a bit sparse – no doubt you have to become a subscriber to get more information.

The main information from Roy Morgan Research is based on a survey of around 55,000 people, with 26,000 of these contributing to a more detailed survey. Of these, 12,953 of the July 2004 survey were wine drinkers of some sort. 48% were classified as “habitual, indifferent and occasional consumers” and 52% as “dedicated, definite and involved consumers”.

The respective consumption of these two categories represented 35% and 65% of total wine volume. Almost half of the first category consumes only 1 brand, whereas this figure is 23% in the second category. The figures are reversed for consumption of 3 + brands with 24% in the former category, and 55% of the latter category consuming 3 + brands.

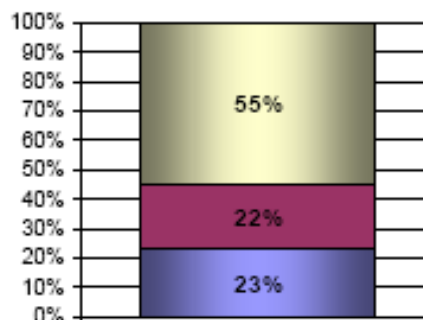
A snapshot of the market

**48% of wine consumers
35% of total wine volume**



Habitual, Indifferent and Occasional Consumers

**52% of wine consumers
65% of total wine volume**



Dedicated, Definite and Involved Consumers

■ 1 Brand ■ 2 Brands ■ 3+ Brands

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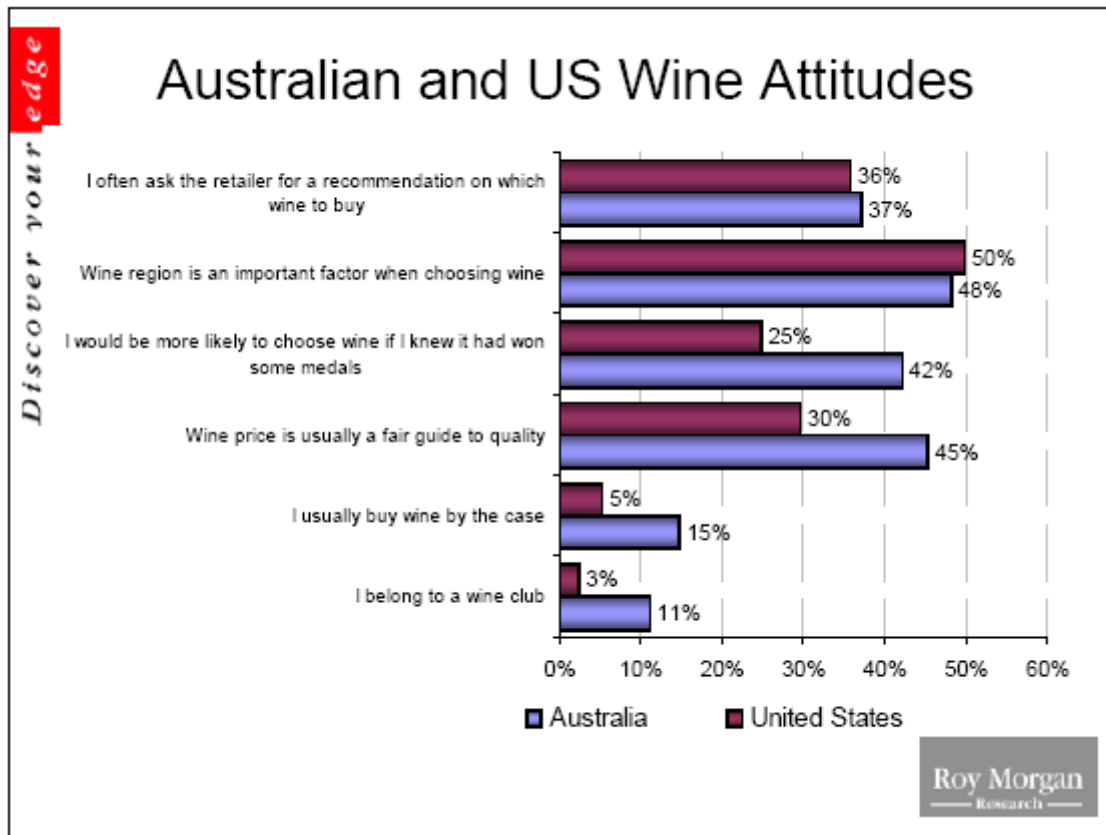
Roy Morgan
Research

Other statistics provided included:

- 37% of wine drinkers in Australia often ask the retailer for a recommendation on wines.
- 42% say they would be more likely to choose a wine if they knew it had “won some medals”.
- 64% say “I would prefer retailers to display their wine by type or variety rather than brand”.

Levine’s conclusion from this is that the wine consumer in Australia is not brand driven (although this does not fit with the above slide showing the percentage of people who drink only one brand!).

One of the “tidbits” which conference attendees found interesting (and were left wanting more) was a comparison of Australian and US wine attitudes.



Building Value: Trends and Challenges for Australian Wine Brands

Anton Van Den Berg, A C Nielsen Australia

Some of the interesting commentary to come from this presentation included:

- Total wine growth is running only at 6% compared to 9% for beer and 14% for RTDs. This 6% is driven mainly by whites over \$10.00.
- The two major retailers are pursuing liquor sales because total package liquor growth is running at 7.1%, compared to total packaged grocery growth of 4.5%.
- The top 5 producers account for 68% of the value of the liquor market (compared to the top 10 grocery manufacturers (including tobacco) contributing only 35%).
- Of the top 10 white growth brands over \$10.00 for 2004, only three (Wolf Blass, Houghton, Moondah Brook) come from the Big 4 manufacturers. Furthermore, when ranked by value, 5 of the brands are from WA and two are from New Zealand.
- The “opportunity takers” above \$10.00 are strong brands which are often:
 - Family owned;
 - Using niche or emerging varietals (sauvignon blanc and SBS blends, Italian styles);
 - Focused on strong brand image – regionality seems to count, and the brands are not necessarily supported by above the line advertising.

The conclusion was that wine growth was steady but the opportunities in the wine market are not going to the big companies as a group:

- Strong brands, regardless of the manufacturer, are the key – scale simply provides the resource to leverage success and positioning;
- Surplus wine makes cleanskin and private label solid margin protection options. Driving brand equity behind brands reduces the need for retailers to default to these options.

PANEL SESSION

Session 3 speakers plus Bruce Tyrrell (Tyrrell’s Vineyards) David Woods (Hardy Wine Company), Jamie O’Dell (Beringer Blass) Robert Hill Smith (Yalumba)

The following is a list of some of the more interesting responses from the panel members, in no particular order.

Jamie O’Dell:

- The increased listings of BOB and cleanskins have taken the place of non-differentiated products, not the strong brands;
- The difference between a “brand” and a “label” is “the additional emotional value which people are prepared to pay for”.
- Consumers are influenced more by the underlying packaging than by who the winemaker is, the use of oak, the history of the brand, etc. Packaging provides “cut-through” in a crowded market.
- In Australia and the US, no single wine brand had more than 5% of the market share. Therefore, every brand is replaceable – no customer would walk to the next liquor store to buy a product which is not ranged at the current store.

David Woods:

- Wine Australia is an exercise in preaching to the converted. The beer and RTD market is huge, and that is where the wine industry should be trying to attract new consumers. This is not done via \$50.00 per head tastings in hotels, but in Westfield shopping towns, night clubs, etc. The RTD market is one which should be targeted. The launch of “Pink” has been so successful because it has lured consumers away from RTDs.

Michele Levine:

- The Linda “Sleep wonderfully warm with Linda” and Cadbury Roses campaigns were so effective because they provided an emotional connection – they allowed customers to be confident in their brand of choice, even though they may have known nothing whatsoever about the product.

Robert Hill Smith:

- The Yalumba “TELL – Talk, Eat, Live, Laugh” is the beginning of a 5 year campaign. Yalumba are seeking to “break the mould”, and “grow the category and grow the brand”.

... and to finish

Not from the Outlook conference, but from the Italian website, AGI Online:

VINEYARD SHARES PERFORM BETTER THAN STOCK EXCHANGES (BUT NOT IN AUSTRALIA)

Florence, Italy, Dec. 2 - Do you want to invest in the stock market? Buy stocks in vineyards, but avoid Australian ones, which do not do well. This little fact emerged from the new work index on vineyards quoted on the market, realised by Mediobanca and presented today in Florence. The biggest 48 shares were studied from 12 countries during the period January 1, 2001-June 30, 2004, explained Gabriele Barbaresco of the Mediobanca study centre. There are no Italian vineyards on the list. In the period under consideration, national stock exchanges fell by 19.4 percent, while vineyard share prices increased 16.9 percent. Performance, however, was quite different from country to country. In Canada, wine shares gained 149 percent while the national market fell 8.4 percent, and the same was seen in the United States (+88 percent and -14.5 percent), Spain (+7.3 and -13.9 percent), France (+4 percent and -35.5 percent) and Chile (+42.1 percent and +39.7 percent). The only country which saw a different trend was Australia, where vineyard shares dropped 9.1 percent and the stock exchange gained 9.4 percent.

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James is also the freelance wine writer for Business Review Weekly (BRW), is a legal contributor to the Wine Industry Journal, lectures in wine law for the Monash University Masters of Wine Technology and Marketing, and operates “The Wine-O” – an internet wine retailer specialising in direct-marketed mixed dozens.