the IWSR

the International Wine & Spirit Research

magazine

June 2011

Global wine at an all time high

Global still light wine sales (excluding travel retail) increased by 1.6% in 2010 over 2009 to reach a new record of 2.44bn nine-litre cases, according to The IWSR. Growth was spearheaded by the US and China.

Italy remained the largest market, despite a slight 0.5% decline to 296.2m cases. The US – the second-ranked market – climbed by 2.3% to 288.1m cases despite the poor economy. At current growth rates, it is predicted that the US will overtake Italy in coming years, given the relatively low per-capita consumption in the US.

Third-ranked France continued its long-term decline, falling by another 2.2% to 273.8m cases last year. This is only marginally below France's 10-year compound annual growth rate of -2.6%.

The performance of sixth-ranked China was undoubtedly the greatest cause for optimism, with a 34.3% increase in 2010 to 125.1m cases. This represents a phenomenal increase of around 32m cases in just one year.

The near 2% decline in the UK market is a source of concern to most wine exporters as about 99% of the 133.9m cases consumed are imports. The sluggish economy and duty increases contributed to the reduction in consumption.

Nevertheless, the UK remains the leading import market globally with a 19.6% share of global imports, followed by Germany at 19.1% and the US at 11.4%. Overall, global exports increased by 3% to 683m cases.

Italian wines had the highest international sales (excluding domestic sales) in 2010, with 141.1m cases sold, a rise of 4.3%. France, ranked second in international sales, also enjoyed a good year selling some 130.5m cases in 2010, a rise of 2.5%. France, in particular, benefited from rising import sales in China. Third-ranked Australia was one of the few major exporter countries to incur a decline. International sales of Australian wines fell by 1.7% to 77.6m cases as the country continues to suffer from the strength of the Australian dollar.

Global sparkling wine sales were also one of the bright spots last year, rising by 4.5% to 202.7m cases. Improving economies helped boost Champagne sales, while non-Champagne sparkling wine continued to benefit from its growing adoption as an everyday drink.

Cognac overtakes whisk(e)y in Chinese market

The Cognac market in China increased strongly again, up 17.5% in 2010 to almost 1.9m cases.

The three main brands – Hennessy, Martell and Rémy Martin – all saw double-digit growth, due to strong demand at all levels of the route-to-market in China: VSOP is perceived by consumers as an uptrade from 12yo Scotch and both on-premise outlets and importers have larger margins on Cognac.

Whisk(e)y rose by just under 3% to 1.88m cases. Within that, Scotch sales increased by 4.4% to 1.7m nine-litre cases. Pernod Ricard's Chivas Regal remains the leading Scotch brand in China following a 3% increase to 584,000 cases. Diageo's Johnnie Walker increased by 4.7% to 429,000 cases. Third-ranked Ballantine's, another Pernod Ricard brand, gained 5.3% to around 300,000 cases. Pernod Ricard's share of the Scotch category is roughly unchanged at 54.2%, while Diageo gained modestly, from 29.3 to 29.9%.

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Wine and Wall Street

James Clarke looks at the ever-changing face of wine industry ownership

Anyone following the business news in recent months could be forgiven for thinking that large, publicly owned companies had lost their taste for wine. Last year saw Diageo sell off vineyards and facilities in California, Pernod Ricard part with wine brands and assets from New Zealand and Spain, Constellation Brands divest its European and Australian wine interests and Foster's decide to spin off its own wine arm, Treasury Wine Estates, as a separate listed entity. The trend continued into 2011 when Brown-Forman disposed of its Fetzer and Bonterra wine brands in March.

Conflicting interests

What lies behind this apparently irresistible corporate urge to get out of wine? Some industry observers point to the long-term perspective required in the wine business. Newly planted vines take several harvests to bear usable fruit, and better-quality wines can spend years maturing before being bottled and sold. Such patience is in short supply when the stock market is looking for performance on a quarterly basis. It is precisely the absence of such pressures that Stephanie Gallo, vice-president of marketing at family-owned E&J Gallo, believes is central to that company's success: "It enables us to innovate, invest and cultivate relationships for the long term, without having to answer to the demands of Wall Street... When I look at...just the business of the wine industry, I think it is best-suited for private ownership." Is there, as Gallo suggests, a fundamental mismatch between public company expectations and the winemaker's best interests?

Such a clear-cut conclusion may seem logical, but closer analysis shows the reality is more nuanced. Diageo's sale of its Napa Valley assets was part of a leaseback deal, through which its Chateau and Estates division will continue to operate the vineyards and wineries for the next 20 years, signalling the British group's intention to stay in the wine business. Pernod Ricard's disposal of some wine assets was one of several divestments to pay down the debt incurred by the acquisition of Absolut vodka. CEO Pierre Pringuet was careful to confirm, in March 2010, that Pernod would "definitely not sell" its priority wine brands, which include Jacob's Creek and Brancott Estate, despite the need to get borrowing down. And the buyer of Brown-Forman's Fetzer and Bonterra labels was the Chilean wine giant Concha y Toro, itself a public company listed in New York and Santiago. Moreover, Brown-Forman retained its high-end Sonoma-Cutrer winery.

Other examples of wine businesses in public ownership include LVMH Moët Hennessy's Estates & Wines division, with brands like Cloudy Bay and Cape Mentelle, and Distell in South Africa, so the industry cannot be totally incompatible with the rigours of the financial markets.

> "Some wine businesses appeal to the corporate sector when the economy is strong"
> – Rob McMillan, Silicon Valley Bank

Rob McMillan, founder of the Silicon Valley Bank's wine division, underlines the often cyclical nature of public corporations' interest in wine: "Some wine businesses appeal to the corporate sector when the economy is strong and consumers are spending on wine, but the return on assets is low." Factor in a downturn and the pressure for quarter-to-quarter growth, and things start to look different. "There's only one harvest per annum," as McMillan neatly puts it, so impatience with wine grows to the point where the corporate investor sells off the assets to focus on its own core business. And so it continues until the economy picks up and the cycle starts again.

As with any investment, a sound understanding of the target helps. The longer timescales inherent in the wine industry were mentioned earlier. The need to finance maturing stock will be familiar to those working in Scotch whisky or Cognac, but the requirement to buy and maintain land (vineyards) will be less so. And in some parts of the world, the area approved for wine-growing is already fully planted, pushing costs higher still. Of course, fruit can be bought in from other vineyards, but then consistency of quality and continuity of supply bring their own challenges, sometimes calling for long-term contracts. When the grapes have been crushed and the wine made, matured and bottled, there remains the challenge of margins. Both in percentage and absolute cash terms, wine usually generates lower profits for producer, distributor and retailer than spirits. There are exceptions, with icon wines, such as the finest Bordeaux châteaux or boutique offerings from the New World capable of fetching eye-watering prices, but these are, by their very nature, limited in quantity. This modest profitability is reflected by the small part wine plays in the total turnover of the major groups like Diageo (6%, according to its 2010 Annual Report) and Pernod Ricard (5% as per May's Q3 results update). The majors see value in wine, but are careful to tackle the sector on their own terms. This might take the form of limiting financial exposure through a sale-and-leaseback deal, as Diageo has done. Another common approach is to focus on a limited number of brands – just four in Pernod Ricard's case while Moët Hennessy prioritises seven mostly smaller, top-end wineries.

Private equity involvement

For all its peculiarities, wine continues to attract a broad range of investors. Private-equity (PE) groups have a track record of involvement with the industry and are behind some of the largest deals. Texas-based TPG sold the Californian winemaker Beringer to Foster's for $1.2bn in 2001, and has recently been cited in the

Wine and Wall Street cont'd

Australian press as a possible candidate to reacquire the brand from Treasury Wine Estates. Another US private-equity player, Cerberus, made an unsolicited $2.5bn bid for Treasury in September 2010, while it was Champ Private Equity of Sydney that bought Constellation's Australian and European business in December. If private-equity firms don't face the same pressures as publicly quoted companies, they still expect a healthy return on their investments. The rate of that return is in double digits on an annualised basis, though PE groups are often prepared to wait – five to seven years is not uncommon – to achieve it.

Diageo's Blossom Hill: a capital-intensive business

Of angels and assets

Although the scale of capital involved in the largest transactions gives private equity the lead role, there are plenty of sizeable wine acquisitions made by smaller, privately owned companies. Many of these will already have experience of, or be directly involved in, the wine industry. Boisset is a larger example and a leading family-owned winemaker in France. Its US offshoot, Boisset Family Estates, has just acquired Buena Vista, one of California's oldest premium wine brands, in addition to vineyards and assets at three other wineries in the state. Foley Family Wines is another privately owned winemaker with a taste for overseas expansion, recently adding a string of New Zealand wineries to its portfolio of properties and brands in California and Washington. McMillan of Silicon Valley Bank sees the main benefits of such an acquisition or "roll-up" strategy as critical mass in the marketplace and the greater attention this commands from distributors. The winemaking team can also work on a range of brands, but McMillan warns there are limits to the synergies possible. Centralising production is difficult across multiple sites if they are widely spread, while the duplication of wine styles and price points will dilute efficiency, he says.

> "The business of the wine industry is best suited for private ownership"
> – Stephanie Gallo, E&J Gallo

One man with first-hand experience of investor involvement in wine is Ruud Maasdam, a former IT executive from the Netherlands, who founded Staete Landt Vineyards in New Zealand's Marlborough region. He planned to bring in a small number of investors to help fund vineyard expansion from the current 21 hectares and construct a winery, enabling him to use contract fruit in addition to his own. The credit crunch has slowed the recruitment process, but Staete Landt currently has two UK-based investors. Maasdam calls them 'angels' and both are independently wealthy individuals with a strong interest in wine and Marlborough, acting as ambassadors for the boutique winery by championing its products at tastings and events in the UK. Importantly, such investors have different expectations of return to private equity or companies and view their holdings as longer term, perhaps even to be handed on to the next generation. Maasdam hopes to find two or three more such angels in key export markets who will not only invest in the company, but spread the word about its wines, though he plans to retain majority control of the business, which makes and sells around 12,000 cases per annum. This ownership model would be difficult to replicate on a much larger scale, but it seems to work well for Staete Landt, providing stable long-term funding from sympathetic investors, while giving the latter a hand in the company's export development.

There is no single ownership structure to suit all parts of the wine industry. The long-term perspective and capital-intensive nature of wine, coupled with its relatively modest margins, make it unsuitable for investors seeking fast returns. But the involvement of large, publicly quoted groups shows that wine can add value when the investment is carefully managed. Private-equity firms – often among the more aggressive types of investor – also see money to be made in the wine sector. Private, often family-owned companies already working in wine may seem a more natural fit, and the angel-investor model definitely has merit for smaller wineries, but anyone thinking of putting money into wine should bear in mind Ruud Maasdam's take on the old adage: "If you want to make a small fortune in the wine business, start with a large one." ■