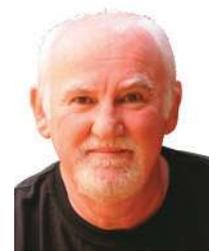


American snakes and ladders - Part 1

China may be all the rage but reward for effort also awaits in the US



By Tony Keys

This is the first of a series of articles in which Tony will provide an indepth analysis of the present and future of Australian wine in the US market, covering a multitude of topics including the differences between the east and west coast markets of the US, who Australia's competition is and what they're doing, and what it costs to get wine on a shelf and whether there are any sweet spots that Australia can meet. In this article, Tony crunches some market numbers, speaks to representatives of a new breed of local importer, and questions the merit of promoting regions.

It's a strange relationship Australia has with America. Sometimes it appears obedient slave, at other times its best buddy. Recently US Vice Admiral Joseph Aucoin was in Canberra requesting Australia engage in a 'freedom of navigation' operation. That is, send Australian warships cruising up and down the South China Sea passing the hotly contested Spratly Islands, off the coast of the Philippines, and the Paracel Islands, off the coasts of Vietnam and China.

China is building artificial reefs in the South China Sea and installing military bases so they can secure rich deposits of oil and gas. Also after the same prize are Vietnam and Malaysia. This is not a political article so let's leave it there. The point is, Australia may be best buddies with the mighty America but can it afford to offend its geographical neighbours?

Looking at America and China from an economical view point, Australia's largest export markets for all goods and services are China (32 per cent of total exports), Japan (16%) and South Korea (7%). The US accounts for just 5% of all Australian exports.

According to the Australian Trade Commission total Australian exports to the United States of America amount to \$20,495 million. Coming this way the Americans sent goods and services to the value of \$44,081 million. China is a whole different story; exports are worth \$90,297 million and \$59,496 million in imports.

If the above appears anti-American call it the stick before the carrot, but it's worth getting the trading situation in the open; the right and wrongs of politics is a different story.

The US population is estimated at 321 million (2015), Canada adding another 35 million. In 2014 Americans consumed

2.91 billion litres of table wine, or 10.6 litres per capita for the population over 21 (source Wine Institute); other sources put it at 9.5 litres. China may have an extra billion people but wine consumption is lower, estimated at between 1.5 and two litres per capita.

The markets appear to be poles apart, the point of difference is the USA is a mature market while China is a developing market. What Australia needs to make sure is it doesn't go astray in China as it did in America.

Nor should Australia ignore what the US has to offer while it chases riches in China. The rise and fall of Australian wine in the American market is a fascinating story combining several factors and changes of direction which, in retrospect, Australia should have seen coming and acted on but didn't.

Australian wine exports to the US in 2015 show tantalising signs the market is recovering and should encourage wineries to reengage with America or consider it as a possible export market.

It should be noted the second wave needs to be gentle. The tsunami of Australian wine that crashed on American shores in the '90s and early this century damaged the reputation of Australian wine; the repercussions are ongoing.

Bold, high alcohol wines that had the consistency of maple syrup were in vogue for a while as were critter brands. Yellowtail was the first and has been successful having carved out a market segment others are envious of. The downfall was the sheep-like mentality that prompted other producers to create their own critter brands. Yellowtail is still there and doing well and a few old vine wines also find market share. The rest have slithered down the snake either to

oblivion or retreated back home to lick wounds.

To re-enter or approach the US for the first time a new way must be found. Americans are open to Australian wines but are mistrustful of the past. New wines, new approaches and new attitudes will win them around but they have been burnt so soothing balm is needed.

In the latest Wine Australia export report to the end of December 2015, the comments on America start: "After facing difficult times in the past few years, the tide is turning for Australian wine in the US market. In the year ended December 2015, value increased by 4 per cent to \$443 million and volume increased by 2 per cent to 168 million litres. The average value per litre increased by 2 per cent to \$2.64. Bottled average value is the main driver behind this rise, increasing by 7 per cent to \$3.62."

The overall figures look encouraging: an increase in value of 4 per cent totalling \$443 million and volume up 2 per cent to 168 million litres, or 18.67 million nine-litre cases, including wine shipped in bulk. It's a staggering amount:"

- glass bottle red, 65,246,000 litres, up 2%
- glass bottle white, 39,784,000 litres, down 6%
- red wine shipped in bulk, 13,601,000 litres, up 4%
- white wine shipped in bulk, 47,946,000 litres, up 16%.

Like the UK, Australian sparkling wine is suffering from the duo of Champagne at the premium end and prosecco lower down. Australian sparkling was down 29% to 840,000 litres (Table 1).

The category Wine Australia heads, 'other wine', came in at 510,000 litres (up 3%).

Table 1. Sparkling wine imports to the United States for the year ending December 2015.

	Volume		Average value		Value	
	million litres	change	USD/litre	change	million USD	change
France	26.7	7%	\$23.36	2%	623.8	10%
Italy	48.5	18%	\$5.37	-8%	260.4	8%
Spain	17.6	9%	\$4.80	-1%	84.2	9%
Australia	1.0	-15%	\$4.32	5%	4.2	-10%

For the 2015 report Wine Australia gets its jollies from the higher FOB price segments but one has to remember it only totalled \$33.6 million.

Examining the premium segment in more detail:

- \$10 to \$19.99 segment \$19 million
- \$20 to \$29.99 segment \$6.7 million
- \$30 to \$39.99 segment \$3.4 million
- \$40 to \$49.99 segment \$735,000
- \$50 plus \$3.8 million.

The \$10 plus sector totals 1.9 million litres, or 207,000 x nine-litres cases, a small amount compared with the 105 million litres of Australian bottled wine shipped to the US in 2015. The largest sector was wine in the \$2.50 to \$4.99 FOB per litre (95.4 million litres). That translates to around 90% of Australian wine shipped in bottle to the US which retails between US\$4 and US\$7 for a 75cl bottle (A\$5.61 and A\$9.81, respectively).

As in all markets price is important and US\$5-\$8 (A\$7-A\$11) is the favoured consumer price point in American retail. The Australian wines on sale across the US reflect Australian big production, but not the depth of quality, excitement and interest that is available here and could be there.

The question this raises is, does the dominance of the big brands present an image problem for all Australian wine selling in the US?

Kathy Marlin, managing director of Negociants USA, says, "In terms of image for Australia it remains static - formulated years ago by consumers and certainly not the 'buzz' on everyone's minds today. This volume channels predominately into grocery which is not the area we need to concentrate on to build image. I don't feel this has any real negative impact on our quest to develop the category in the premium segment today or in the future. No doubt that if the category comes back

into favour and there is enormous focus on redevelopment of that value segment, we will risk exposure to a lacking respect for our higher quality offering."

The top five brands by volume of Australian wine sales, according to Impact Databank, are:

- Yellow Tail: 54.2%
- Lindeman's: 10.6%
- Fish Eye: 7.8%
- Jacob's Creek: 4.7%
- Little Penguin: 3.2%

These brands account for around 80% of Australian sales in the US. It appears the producers of the above brands have become trapped. There is no denying the success of volume but pricing has become stagnant. Established brands have also become the wine of parents, and perhaps in the minds of emerging generations to wine, grandparents. There is also the issue of pedigree - the five wines come from a place that is no place in this universe: South East Australia.

It cannot be denied that the above brands offer what the average American consumer wants as otherwise they wouldn't sell in such vast volumes. We shouldn't criticise them for being popular. Unfortunately, they also swamp the individuality of the remaining 20%. It's getting recognition for the minority that will in turn show there is suaveness and sparkle to Australian wine, should the consumer choose to go there.

It was the Gen X cohort (birth dates from the early 1960s to the early 1980s) that started to slacken their enthusiasm for Australian big brand wines. To attract the Millennial Generation (birth years from the early 1980s to the early 2000s) companies are creating new brands.

Treasury Wine Estates (TWE) launched 19 Crimes brand in 2011 but grew it slowly, its retail price put at US\$12-\$14 (\$16.70-\$19.50). The name and marketing

is aiming to resonate with millennials, especially males.

In an interview with *Shanken News Daily* last December, the then TWE president Americas, Sandra LeDrew, said the 19 Crimes brand had reached 200,000 nine-litre cases. She also predicted the newly-released Cabernet would reach 100,000 cases within 18 months.

Another misplaced perception Americans have of Australian wine is the dominance of Shiraz. Cabernet Sauvignon is the grape they like. More could be done to promote what Cabernet we have to offer.

Again, tapping into millennial males, TWE via the Lindeman's brand launched the Gentleman's Collection in 2015 with a retail price around US\$17.

TWE has separated out Penfolds, turning it into a luxury brand. It's been a smart move instigated by previous CEO David Dearie and continued by current CEO Michael Clarke. It appears to stand alone and above the other brands in the company's portfolio. In the 2016 Drinks International top 50 most admired wine brands, Penfolds claimed the number one spot. The success of Penfolds in the US has been welcomed by other importers, as they see it braking down the price barriers to their wines.

Marlin says Negociants has weathered the storm and has managed both volume and equity back into its portfolio over the past four years. "We have the healthiest footprint we've ever had and are seeing greater interest." It seems ironic that Negociants' growth for several wines it represents is slowed due to allocations rather than by demand.

The latest Gallo Consumer Wine Trends Survey, which profiles American wine drinkers, dealt with consumers' fear of wine. Unfortunately it hasn't changed a great deal over decades. The success of new brands such as 19 Crimes and Gentleman's Collection is somewhat reliant on giving the assurance Baby Boomers and Gen X got out of brands such as Lindeman's and Jacob's Creek combined with a degree of sophistication that attracts the younger consumer while making them feel comfortable and not drinking mom and pop wine.

The recommendation of friend, family or co-worker is still the most effective form of getting a person to try a new wine.

The survey compares baby boomers (age 50-70) and millennials (18-35). ▶

The baby boomers like information; the younger generation can be attracted by the label.

An Impact Databank report projected consumption per capita will decline for the fourth consecutive year in 2015. All wine is under attack from other forms alcoholic drinks. Americans are returning to their beloved spirits. RTDs and cider are also on the increase. Figures from Wine Australia compiled by Peter Bailey and released in October 2015 are depicted in Table 2.

To attract the consumer Australia also needs first to attract both retail, on-sales (restaurants/bars) and media. Wine Australia commissioned Wine Opinions to carry out a five-year comprehensive research program. As part of year one of this program, Wine Opinions conducted a quantitative survey among the US wine trade to establish a baseline of trade sales and perceptions of Australian wines and assess the outlook for Australian wine on the US market in the future from the trade's perspective. Part of the report released in April 2015 dealt with American trade attendance at tasting events organised by wine producing countries:

- Italian wine events (78%)
- French wine events (76%)
- Spanish wine events (65%)
- New Zealand wine events (53%)
- Argentinean wine event (52%)
- Australian wine events (48%)
- Chilean wine events (46%).

Less than half the media, producers, importers and wholesalers - called gatekeepers or influencers - bother to attend an Australian wine event. It that because they think they know Australian wine or think it has little to offer them? In another part of the report there is a table, 'Importance of Imported Wine Sales Factors'. Sixty two percent of respondent's rated style or flavour profile of the wine as very important, with a further 32% saying it was somewhat important. Combining this with the attendance rate at Australian wine events, does this infer they feel Australian wine is somewhat lacking? There is irony in that 74% said wine tastings for the trade were very important, yet only 48% attended Australian events.

The current sales of Australian wine are focused on six of the 50 US states.

	Growth rates	
	2014	2009-14 CAGR
Beer	2.4%	1.9%
Spirits	4.6%	4.1%
Wine	3.0%	4.3%
RTDs/Premixes	2.0%	7.4%
Cider/Perry	57.9%	46.7%

Table 2. The percentage growth in alcohol categories in the United States in 2014 and during the five years from 2009.

These key markets in the calendar year 2015 accounted for \$287 million of the \$443 million worth of wine shipped (figures from Wine Australia):

- California – up 3% to \$136 million
- New York – up 29% to \$53 million
- Florida – up 36% to \$44 million
- Texas – up 23% to \$28 million.

Unfortunately two of the key markets recorded a decline:

- New Jersey – down 32% to \$14 million
- Illinois – down 11% to \$12 million.

Wine Australia says these markets are home to 116 million citizens (36% of the US population) and have the largest and densest cities in the country.

What has to be remembered is Australia is not alone in wanting a share of the US wine market and there is a huge domestic industry led by California. Bottled wine imports are listed in Table 3. It's also worth noting the average value and the Australian position at the bottom of the ladder. It puts the \$34 million of higher-priced wines in perspective and shows how much work needs to be done before we can gain enough momentum to move off the first rung.

According to Gordon Little, CEO of New York-based Little Peacock Wines, getting wine poured by the glass in restaurants and bars is of great importance in the five boroughs (Bronx, Brooklyn, Manhattan, Queens and Staten Island). He explains the maths, quoting US dollars:

"NYC is its own magical market in that it has many different neighbourhoods catering to many different incomes. Overall, restaurants want to recoup the bottle cost on the first pour, if not make a little extra. Typically, [there are] four to five pours per bottle. I think of it as: bigger pour of cheaper wine, whereas in

Australia it's smaller pour of more expensive wine. There is rarely a line on the glass like there is in Australia.

"Brooklyn (and non-NY markets) \$8-10 a bottle wholesale is great. For happy hour, we're talking \$5-6 per bottle for a \$6-7 glass.

"Manhattan we can go up to about \$18-19 a glass which corresponds with other countries wine glass pours, if not higher. I sold a Pinot for \$17/bottle and saw it in a restaurant at \$19/glass.

"I don't sell a lot at these prices and when I do I'm usually doing a deal to whittle down stock in order to reduce inventory or move vintage (normal wholesale price would be \$20-22 bottle).

"Our most successful pours are in the range of \$120-144/case (nine litre) wholesale. There are exceptions. The Beelgara brand is about \$7 a bottle wholesale and it can be a pouring wine at \$10 a glass because the quality is good and restaurants want to make extra margin so they can fund an orange wine that tastes like rotten apples and costs \$20 per bottle but want to put it on for \$15 a glass."

Little is a new breed of importer. His is a small portfolio of interesting wines that Gordon Little and his team (also small) hand sell around finer New York eating establishments and bars. Under the American system wine has to go through a distributor but he doesn't rely on the distributors' sales force preferring to use his and his teams' shoe leather to acquire and maintain listings.

Also in the same vein, based on the other side of the country in California, is Henry Hudson and Tom Donegan who run Hudson Wine Brokers which represents a dozen wineries; again, individual wines that require hard work, hand selling and shoe leather.

In New Jersey, Screw Top Imports, founded by brothers-in-law Mark

Lightfoot and Joe Bernard in 2014, has the same template Hudson and Little use. Says Joe Bernard: "The fact of the matter is that Australian wines are not well represented here but hopefully that is changing. Our hope is to get enough wineries to share our vision that we can actually market wines of quality from Australia. Cool climate may capture that notion, or it may not, but it would be helpful to have some collective name that captures the personality and quality of the wines and the winemakers. Americans are open to Australian products and culture, we just need to give them a reason."

It is importers such as Little, Hudson and Screw Top along with others like them that will make Australian wine interesting to the American consumer again. Pounding the pavement and having fun while doing so is part of the sales technique along with knowledge and commitment to the brands they represent.

There can be no denying a brand that sells millions of cases is a success and Casella has been incredibly successful with the Yellowtail brand. But it's confined to a consumer cohort, hence price sector. Having acquired Peter Lehmann Wines for \$57 million in November 2014 and later Brands Laira from Coonawarra (price not disclosed) it has new brands to promote ranges of wine at higher price points. On acquiring Peter Lehmann John Casella said in an interview with the

Sydney Morning Herald, "It puts us into the premium area faster than if we tried to do it ourselves." The company wouldn't comment on Brands Laira's possible future in the US market but it's strong in Cabernet Sauvignon and Cabernet is top of the favourites in the US.

According to Wine Australia figures, 88.6% of Cabernet exports to the US in 2014-15 were in the retail price bracket US\$5-\$8. This would probably include the majority of Yellowtail Cabernet sales. It's more than likely Casella is looking to position Brands Laira and Peter Lehmann in higher retail sectors. The US\$11-\$20 sector is showing double digit growth.

Casella is well positioned to push Peter Lehmann and Brands Laira to greater sales volume and, in turn, promote the reputation of all Australian wine. Treasury Wine Estates is in the same position. One has to smile at the giants of the industry giving a helping hand to smaller producers, even if it is inadvertently. It should be considered a small price to pay but the large volume producers can at times be small minded regarding any competition.

Pernod Ricard is the world's second largest alcoholic drinks company after Diageo. Its presence in the US is huge. The US contributed 28% of its total sales in the first half of 2015-16. The Jacobs Creek Brand is important but it has to compete with far more popular brands in the portfolio such as Absolut Vodka and Jameson Irish Whiskey.

Jacobs Creek as a brand could suffer, as in my opinion does Casella's Yellowtail, from the past success of the brand name. In short, it's hard to get higher prices no matter the quality of wine by introducing a reserve or special. Treasury Wine Estates is ahead of the game in this aspect with its 19 Crimes and Gentleman's Collection.

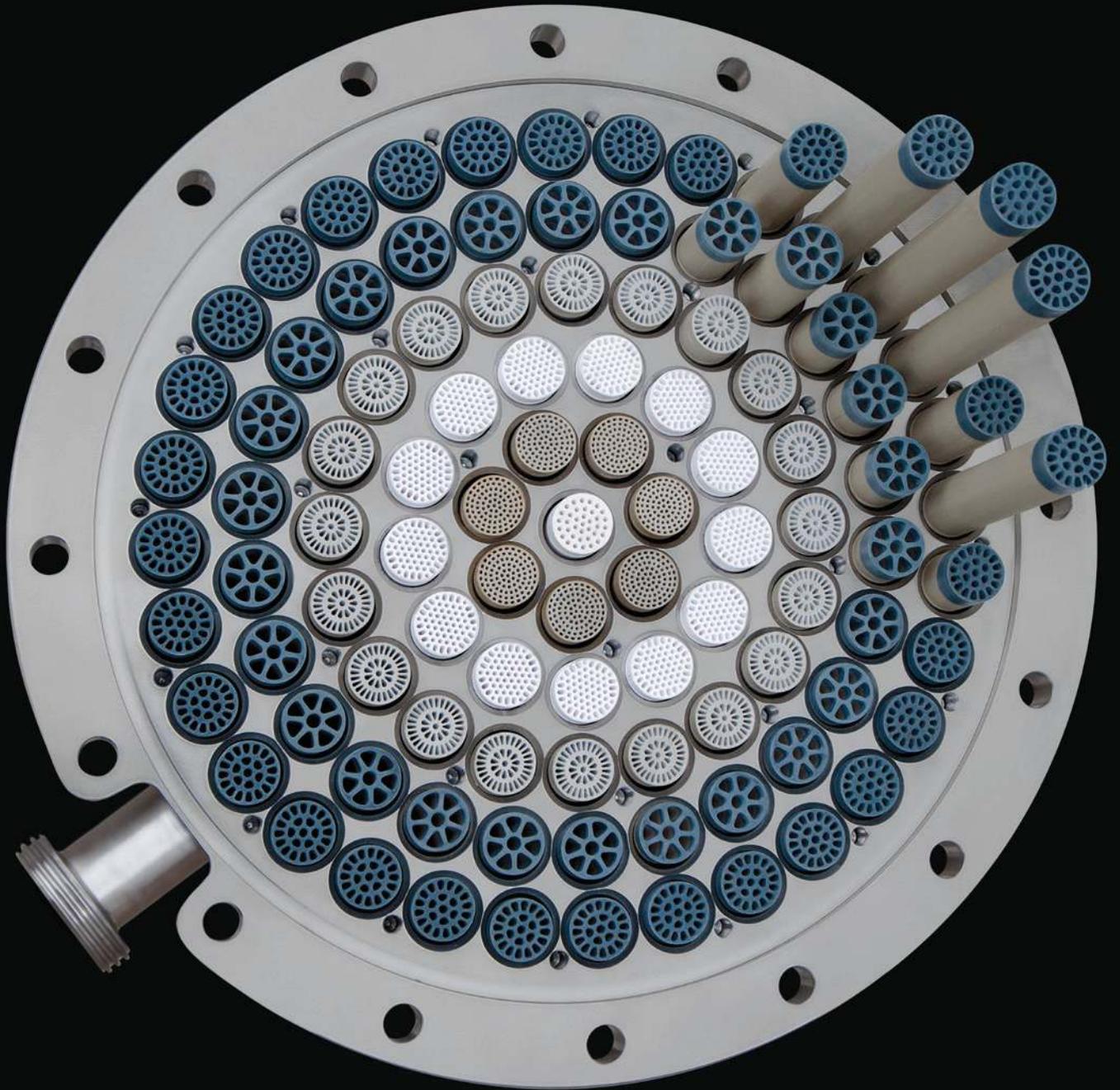
Region vs. brand? The critter brands were a huge success and, in a certain sector of the market, still are. Yellowtail can be found in palate stacks, both bottles and magnums (US\$11.09, Jan 2016), at Costco warehouses. The TWE brands 19 Crimes and Gentleman's Collection do not rely on regional identity but the story of the brand. It works for Penfolds Grange so why shouldn't it work further down the ladder? Worth noting is an article on Californian wine exports titled 'Pitfalls to avoid for Californian wine exports to UK', written by Charles Day, the senior vice president and area manager of the North Coast [California] Food & Agriculture group, Rabobank, and published in *The North Bay Business Journal* (29 February 2016).

Day said: "The number of very specific American viticultural areas, or AVAs, in California is confusing British consumers. While the wine industry has worked successfully to educate domestic consumers on the difference between a Russian River Valley and Sonoma Coast Pinot Noir, for consumers in the UK the 16 AVAs in Sonoma County is too granular to discern differences." ▶

Table 3. Bottled wine imports to the United States for the year ending December 2015.

	Volume		Average value		Value	
	million litres	change	USD/litre	change	million USD	change
Italy	253.2	4%	\$5.57	-5%	1,410.9	-1%
France	98.9	10%	\$9.34	-11%	923.9	-2%
Australia	108.2	-1%	\$3.53	-2%	381.9	-3%
Argentina	63.3	2%	\$4.88	-2%	309.1	0%
Chile	61.7	3%	\$3.88	2%	239.5	5%
Spain	46.1	3%	\$5.38	-8%	248.4	-5%
New Zealand	37.7	15%	\$7.85	-2%	296.2	13%
Germany	19.7	-7%	\$5.10	-7%	100.4	-13%
Portugal	16.6	11%	\$5.52	-7%	91.5	4%
South Africa	9.5	6%	\$5.15	-4%	48.9	2%
Total	729.5	4%	\$5.68	-5%	4,145.5	-1%

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It's something Tasmania and the Yarra Valley have already worked out; too many sub-regions can be confusing for consumers. It should also be remembered the concept of Australian wine geographical indications holds different meaning for government legislators, lawyers, winegrape growers, wine producers, wine retailers and consumers. The aspect of terroir, which is highly contested for and against among those in the industry/trade, is not as important to the majority of consumers. Consumers more often than not think of soil, topography, and climate as part of the snobby aspect of wine.

This presents a conundrum if critter brands bearing the bland South Eastern Australian GI have peaked in sales and stalled in price, isn't this now time for the region to shine? In part, but trying to promote more than 60 Australian GIs is a route to confusion. At this stage of transition, the set-back Australia doesn't need is muddled consumers.

In an unpublished article last November, Jeff Burch, CEO of Burch Family Wines, commented, "How do we promote a fine wine business out of Australia when our largest export is 'supermarket' wine which is very price sensitive?"

"There are two distinct wine businesses operating out of Australia, one is volume, cheap and acceptable quality for a price, the other is small volume, high quality, high cost,

aspirational or luxury category."

Burch questioned the need to have GIs for regions that mainly produce the wines that went into what he calls supermarket wines and for this US article I am calling critter brands.

Burch: "The whole GI thing is largely a waste of time in export markets apart from a few best known GIs like Barossa, Margaret River, Tasmania, Yarra Valley and Coonawarra. Most export customers would struggle to name five Australian GIs and I would not be surprised if Jacobs's Creek got more votes if a poll was held."

Burch sees consumer confusion, using the example of wineries in the GI Margaret River explaining why it is different to GI Riverina. He says it leads to the conclusion that there is no fine wine in Australia because most wine exported is from Riverina, Murray Valley and Riverland.

In the same article Robert Hill-Smith, chairman of Yalumba Wines, gave a practical example of using a state GI over a region (in this case South Australia over Riverland): "I think that is a regional and individual winemaker decision. A lot of creative energy has gone into elevating consumer perceptions but so far have not moved the needle."

The warning being, if not a noted region such as Margaret River, Barossa Valley or Yarra Valley, expecting the region to give credibility to wine cannot be relied upon and will require a great

deal of work - perhaps more time and money than a single winery can afford.

To get the regional message across will require full regional support and acting as one in a co-operative action. Again, money will be the driving force and there isn't a great deal of promotional money from state or federal coffers.

To build a market, the market needs to be visited and this costs money. The advice from retailers or gatekeepers is two visits a year are required - sound advice in one aspect, but in return the retailer, or collection of retailers, needs to sell wine that is earning (not sales) in excess of \$20,000 to fund two visits a year.

Yes, the US has a lot to offer; no, it will not be easy. The worth will have to be calculated by each individual winery. Those with foresight and ambition will find the path, others won't.

Wine industry commentator Tony Keys has spent more than 30 years in the wine industry including the retail sector in the UK and roles with the Australian Wine Export Council and the Australian Wine Bureau in London. He is author of The Key Report, a weekly report containing news, views, analysis and opinions on the wine industry: www.thekeyreport.com.au

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