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Does Your Consumer Own Your Brand?

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Building deeper consumer relationships

At the recent Wine Industry Financial Symposium in Napa, there were ongoing conversations about rising competition at retail and declining traffic at tasting rooms. Wineries are becoming more focused on developing deeper, stickier relationships with consumers, which often starts with basic communication.

Global trade: lower volumes

The light harvest of 2017 is weighing down exports volumes for the major European producers in 2018. The situation is likely to continue in Q4, awaiting the first wines of the 2018 harvests reach the market.

M&A: e-commerce gaining relevance

Despite the still modest share of e-commerce in wine trade, large companies are taking positions in established niche operators. This is a way of acknowledging the value of the intelligence that can be obtained online. It also suggests that buying an existing player may be more attractive than in-house development from scratch.

Bulk wine prices

Prices for generic wines from Spain and Italy are easing off, anticipating the greater availability that the 2018 harvest will provide. International prices for Argentine wines are also lower, in this case driven predominantly by the peso devaluation.

Takeaways from the Wine Industry Financial Symposium: It's time for the wine industry to find new owners

In September, we attended the Wine Industry Financial Symposium, where the California wine industry and numerous financial-service providers meet to discuss key issues facing the sector. Our key conclusion from the event is that wineries of all sizes need to find new owners – we're not talking about selling the winery, but rather about continuing to build deeper relationships with consumers – creating a sense of ownership by the consumer with the brand.

Industry survey results

One of the key events at the conference was the presentation by Sonoma State University (SSU), featuring the results of its recent survey of wineries, company executives, and grape-growers – and taking a look at the issues and topics that are top-of-mind for the industry.

The survey made clear that there is a lot of room for optimism. Respondents were quick to note that the strength of the economy, strengthening direct-to-consumer (DTC) sales, and ongoing premiumisation create a strong foundation for future growth. However, it is also clear that individual wineries face numerous hurdles as they try to tap into growth opportunities.

It's getting crowded in here!

While the labour shortage was the top concern for wineries in the SSU survey, the increasing level of competition was the clear number-two. Interestingly, when reading through the data, it becomes evident that this is true both for wineries going through traditional three-tier, as well as those focused on DTC.

Among large wineries, 58% flagged brand proliferation as a drag on revenue and profitability, as did 40% of small wineries. As one participant responded in the interviews following the survey: "Too many retail establishments and too many distributors. It is getting insane, the level of competition."

A growing threat from private-label

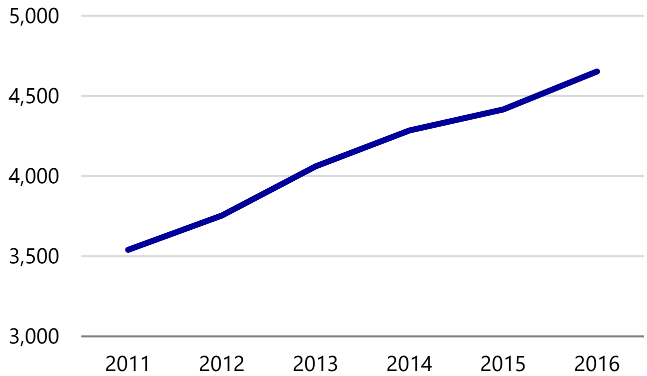
Among wineries targeting the traditional wholesale/retail channels, SKU proliferation remains a challenge, as new competitors continue to enter the market and new brands are introduced. This is not a new phenomenon, but the competition is becoming even more intense. Aside from other producers, retailers are also increasingly jumping into the fray as they build up their private-label (PL) offerings. In the SSU survey, 34% noted that "private labels were negatively impacting their brands".

Declining traffic for DTC

But even for those targeting DTC, the level of competition is clearly increasing. Among survey respondents, 39% of those focused on DTC indicated that traffic had declined. This was an ongoing theme of discussion at the conference, as many of those in the North Coast noted that tasting-room traffic had declined after last year's wildfires – and it still has not returned to previous levels.

The wildfires likely have had an effect on tasting-room traffic for many wineries (with effects felt unevenly), but the rising number of wineries is also intensifying competition for the visitors who arrive. According to the Wine Institute, in 2011, there were 3,540 bonded wineries in California, but by 2016, that number had risen by 31%, to 4,653 wineries – an increase of more than 1,000 wineries in just five years *(see Figure 1)*.

Figure 1: Number of California wineries, 2011- 2016)



Source: The Wine Institute, 2017

Going deep – not wide

The wildfires and increased competition are external factors in driving declines in traffic at tasting rooms, but the declining number of visitors is also a reflection of evolving strategies that wineries are using in the current context. Several wineries mentioned a trend of visitors seeing fewer wineries per day, but visitors staying longer at each winery. In the SSU survey, 81% of respondents indicated that they believed that "investing in consumer relationships" was very important in the current context. Increasingly, wineries are focusing on spending more time with visitors who arrive – and building deeper relationships with them.

Relationships are built on communication

There is a growing number of software packages and services that help wineries target consumers and influencers more effectively, and the products and services available are becoming increasingly sophisticated. We see a strong future for these services and encourage wineries to explore the available options – but for some wineries, building deeper consumer relationships may start with basic communication.

A study by WineDirect last year noted that 89% of all DTC e-commerce was generated by just 20% of wineries. The biggest differentiating factor of the success of those wineries was the size of their email lists. Email, they noted, was the single-most effective digital-marketing tactic. Capturing the emails of tasting-room visitors and communicating with them after they're gone can yield handsome results. This may seem basic, but the WineDirect data suggests that for many in the industry, there is still a lot of room for improvement.

The effectiveness of basic communication was also echoed by one of the presenters at the symposium.

During one of the break-out sessions, Judd Wallenbrock, President and CEO of C. Mondavi & Family, discussed some of the efforts the company has been implementing to build up its DTC sales. Among other initiatives, he flagged efforts in outbound telephone sales to consumers in the company database as having delivered incredibly high returns. C. Mondavi & Family were pleasantly surprised to find that these calls were not perceived by consumers as telemarketing, but as "a phone call from their winery".

Finding new owners = not just a winery issue

That phrase, "a phone call from their winery", was a reminder of what a powerful opportunity wineries have to develop deep relationships with consumers and to make them feel invested in the brand – a sense of real ownership. In today's market, beverage brands often need to be very creative and intentional to create that sense of ownership in the brand.

BrewDog, the largest craft brewer in the UK, crowdfunds some of its equity – "equity for punks", as they call it – by literally getting their consumers to "own the brand".

Drake, the Canadian recording artist, was clearly trying to get consumers to "own" his brand earlier this year when he announced an IPO for his American whiskey brand, Virginia Black, which was only selling an estimated 6,000 cases per year.

Likewise, Naked Wines has emerged as the largest DTC e-commerce platform for wine in the US – not by just "selling wines", but by inviting consumers to be part of their "mission" to help small winemakers... and get some good wine in the process.

Keep in touch

In short, looking outside of the wine industry, we see beverage companies increasingly going to great lengths to create deeper, more meaningful relationships with consumers, giving them a sense of ownership in the brand.

Building deeper relationships with consumers is clearly becoming a higher priority for the wine industry, particularly as the market becomes increasingly crowded. Some wineries are investing to become much more sophisticated as to how they identify and target their ideal consumers – and this will likely become a necessary skill set in the future. Other wineries, however, are finding that building deeper relationships with consumers can start with even more basic steps – the answer may be just a phone call or an email away.

Other findings: labour scarcity is top-of-mind

The issue of trying to connect with the consumer at a deeper level in a crowded market gave plenty of food for thought, but it is worth noting that this was only the number-two concern for wineries. According to the SSU survey, the top concern for all wineries is labour. The scarcity and rising cost of labour has been an ongoing source of frustration for the industry in recent years, and it is steadily gaining importance in the minds of many winery owners. The labour shortage is a growing challenge in the US, with ramifications far beyond the wine industry (see Rabobank's recent report, *Animal Protein's Labor Pains*, to see how the labour shortage is affecting meat producers). But while the shortage may be a fairly widespread challenge across the country, the wine industry is feeling the effects more intensely than others, for at least two major reasons: the rise of cannabis legalisation and the recent wildfires.

With cannabis legalisation taking hold across many US states, cannabis production is gaining increasing traction in California. This is creating a new competitor for labour in many of the same markets in which wine grapes are grown.

On the other hand, the recent wildfires that tore through the North Coast of California at the end of 2017 destroyed over 6,200 homes and residences. Many of those who lost homes work in the wine industry. The homes will be replaced eventually, but this creates a significant disruption to the labour pool in the near term – both because winery workers lost their homes and because the construction industry is now competing for labour as it ramps up efforts to replace the homes destroyed by the fires.

Winery M&A

The summer is a good time to shop online

Despite heat and holidays in a few major markets, corporate activity continued in the summer months. In addition to the usual flow of deals involving industry consolidation – one winery buying another – and ongoing acquisitions by financial investors, we again saw a remarkable number of deals involving distribution-related companies in all geographies. This time, e-commerce was also a returning rationale behind several deals, and some high-profile names were involved.

Pernod Ricard purchased alcoholic drinks e-commerce specialist Uvinum, a Spanish company currently operating in 14 countries. Uvinum's expertise in technology, e-commerce, and specialised content management in the sector are key points behind this deal that is a perfect match with Pernod's strategy.

AB InBev, through its global incubator ZX Ventures, has bought Australia's online alcohol retailer BoozeBud, whose cutting-edge technology delivers a highly personalised experience for consumers and is attracting an increasing number of suppliers.

Dr. Oetker announced the purchase of BELViNi, an e-commerce wine retailer with a strong focus on the German customer base.

Securing access to selected markets – in this case to Scandinavia – has also triggered an interesting winery deal: Moncaro, an Italian, Marche-based cooperative winery, has sold 18% of its equity to Winemarket Nordic, the privately held Swedish wine distributor.

In Asia, interest is going beyond just reaching the customer: listed wine and spirits retailer Major Holdings has agreed to acquire The Wine Cave Company, which is involved in wine-trading, storage, and consignment services.

Eastern Europe in the spotlight: private-equity thirst

Although several eastern European countries have a long tradition of making wine, most of the product has traditionally been sold locally, or regionally at best. More recently, the search for product differentiation and the tight harvest of last year have improved the region's visibility. M&A deals involving eastern European wineries are also increasing.

Russian spirits group Beluga has bought the Villa Romanov winery. This deal reflects the spirits companies' interest to expand into other categories.

Meanwhile, listed holding Georgia Capital, which focuses on investing in Georgia, has acquired the remaining 39.5% equity stake in Kindzmarauli Marani that it didn't yet own, having bought 60.5% in April 2018. The group aims to increase its presence in the growing domestic and international markets for Georgian wine.

Global trade

Export trends of major producers

The light harvest of 2017 is weighing down export volumes for major European producers in 2018.

France

Exports of French wine declined by 2.2% in volume terms during 1H 2018 *(see Table 1)*. A 3.5% increase in sparkling-wine exports and a 4.9% rise in exports of large-format wine packages (2-10 litres) were offset by declining volumes in bottled and bulk table wines. Sparkling wines, other than champagne, saw the best performance, up by 6.7% in volume.

In value terms, exports increased by 5% YOY, with average prices rising in still wines, while contracting slightly for all sparkling. Bordeaux wines saw a 19% increase in average price per litre, but wines from Languedoc-Roussillon also witnessed a double-digit increase in prices.

The US (+7% in value) consolidates its position as the largest buyer of French wine, even if sales of champagne to the country diminished in the period (-14% in value).

Sales to Germany and the UK increased in value terms, while sales of bottled wine to China declined, both in volume (-28%) and value terms (-12%).

Italy

Exports of Italian wines declined by 9.8% in volume during 1H 2018, but increased by 4.1% in value terms. The numbers reflect a rise in average price per litre that was particularly relevant for the cheaper segments: bulk (+51% YOY), 2-10-litre packages (+26%), and common table wines (+17%). The decline in volume is the result of a drastic contraction in exports of bulk wine (-34%) and still bottled wine (-3%) that could not be offset by the good performance of sparkling (+5%) and 2-10-litre (+9.5%).

In markets, exports to the US had a strong performance, with a 3.3% increase trend in volume. Exports to Germany declined by around 16% in volume, but increased by 3.7% in value terms. Bulk exports declined, but sales of sparkling wine grew.

The UK contracted both in value and volume.

Spain

In 1H 2018, exports of Spanish wine declined 10.6% in volume, but increased 6.9% in value when compared to the same period last year. Bulk wine saw an average price increase of 42%, reflecting the impact of a tighter output in 2017.

For other categories, average prices increased 14% to 16%. However, price increases were not enough to offset lower bottled-wine volumes, and revenues declined by 0.5%. For bulk wine, export income increased by 27%, despite a 10% drop in volume.

In sparkling wines, volumes declined by 5%, but revenues increased by 9%.

Bulk-wine exports to France – Spain's biggest off-taker in the segment – declined by 5% in volume, but with an average price increase of 50%.

Exports to Germany, the UK, and the US – the largest buyers of Spanish wine – declined in volume terms, with only sales to Germany increasing in value (+9%).

US

In 1H 2018, US wine exports increased by 2.4% in volume and 0.2% in value terms. The apparent decline in the average price per litre reflects a change in the mix between bottled wines (-11.5% in volume) and bulk (+32.3%), while average prices actually increased in both segments. As earlier this year, the sharp increase in bulk exports relates to higher sales to the UK, the largest buyer of US bulk wine, as well as to other European countries (Germany, Belgium). At the same time, both the UK and Germany virtually halved their imports of bottled US wine.

Exports to China declined by around 7% in volume, but increased by 10% in value as sales of bottled wine increased, with all of the decline affecting cheaper exports of bulk and 2-10-litre.

Table 1: Change in wine exports for selected countries, 1H 2018

Country	Volume change (%)	Value change*(%)	Period of measure
France	-2.2	5.0	Jan-Jun
Spain	-10.6	6.9	Jan-Jun
Italy	-9.6	4.1	Jan-Jun
US	2.4	0.2	Jan-Jun
Argentina	-3.5	-1.6	Jan-Jun
Chile	-9,2	3.9	Jan-Jun
South Africa	0.3	10.3	Jan-Jun
Australia	12.4	19.3	Jan-Jun

* Note: value changes in local currencies, Argentina and Chile in USD
Source: Wine by Numbers, OIV, Rabobank 2018

Argentina

In 1H 2018, exports declined by 3.5% in volume and 1.6% in value (measured in USD). Average price per litre increased for bottled wines and 2-10-litre packages, but declined for bulk wine. Since the export decline was related to bottled wines, the average price per litre was affected by a negative-mix effect. Although exports to Brazil increased, sales to the US, the UK, and Canada – the largest buyers of Argentine wine – all declined.

Chile

Chilean exports declined by 9.2% in volume and increased by 3.9% in value. Exports of bulk wine were down by almost 20% in volume and broadly stable in value terms, as higher prices reflected tight availability. Exports of bottled wine declined by 1.6% in volume, but increased by 4.5% in value. China consolidated its position as the largest buyer of Chilean wines, with volumes increasing for both bottled wine (+6%) and bulk (+59%), along with average prices also rising. Sales to the US – still Chile's second-largest market – declined both in volume and value.

South Africa

In 1H 2018, exports were virtually unchanged in volume terms, but increased by 10% in value (in local currency) when compared to the same period last year. Bulk-wine exports were 4.3% lower than a year ago, but average prices were 25.6% higher. Volumes for bottled wine and for 2-10-litre packaged wine increased by 3.4% and 13.6%, respectively, with average prices also rising in both segments. Volumes of bulk wine sold to major European buyers were up significantly – UK (+13.5%), Germany

(+50.1%), Denmark (+34.4%), and France (+20.9%) – while sales to North America and other markets declined. Exports of bottled wine to the UK (South Africa's largest export market) and China increased, more than offsetting lower volumes sold to other major markets such as Germany, the Netherlands and the US.

Australia

Exports increased by 12.4% in volume and 19.3% in value (AUD). Volumes of bulk-wine exports increased by over 31% when compared to 1H 2017, while bottled-wine volumes were stagnant and exports of 2-10-litre packages contracted by approximately 12%. Average price per litre increased for all segments, with rises of between 13% and 17%. Exports to China and the UK were the key drivers behind such a strong performance. It is worth noting that average prices of bulk wine sold to China declined by 9%, but prices for bottled wine sold to the same country increased by almost 22%.

The US remains a major market for Australian wine, but the country bought lower volumes of bottled wine (-19,7%) and more bulk wine (+13.5%) during the period.

US import trends

US wine imports rose 9% in value, but declined by 4% in volume during the first six months of 2018, compared to the same period in 2017 *(see Table 2)*. The lower volumes reflect a significant contraction in bulk-wine imports (-19% in volume and -5% in value), as bottled-wine imports were up by 2% in volume and 10% in value during the period. Sparkling wines saw further growth, both in volume (+10%) and value (+9%). Vermouth remains a relatively small segment, but maintains a very strong momentum, up by 21% in volume and 34% in value. Imports of another small segment – wine-based mixes, such as sangria and coolers – are also increasing, rising 15% in volume and 19% in value in the period.

From a geographic perspective, volumes imported from Italy, France, New Zealand, Portugal, and Canada increased, offsetting lower volumes from Germany, Argentina, South Africa, Spain, Australia, and Chile.

Imports from Italy rose 3% in volume and 12% in value. In value terms, all wine categories saw double-digit increases, except for bottled table wine, which rose by single digits (+6%). By volume, imported bottled table wines were down by 2% and bulk wines by 7%. Volumes of imported vermouth, sparkling, and still wines over 14% ABV increased by 34%, 16%, and 21%, respectively. All categories experienced increases in average import prices.

Imports from France rose 10% by volume and 18% by value. Imports of bottled table wines, the largest category, increased by 11% in volume and 25% in value. Sparkling-wine imports declined by 6% in volume and 3% in value. Other categories are significantly smaller, but had a positive trend in the period: in value terms, bulk-wine imports were up by 48% in the period and still wines over 14% ABV by 110%.

Import volumes from Spain declined by 3% in volume terms, and only imports of Spanish sparkling wines increased in the period (+7%). In value terms, imports increased by 6%, with average import prices increasing for all categories.

Imports from Australia declined by 29% in volume and 18% in value. Bottled-wine imports declined by 12% in volume and 14% in value, while imports of bulk wine were down by 44% in volume and 34% in value.

Imports from New Zealand rose by 6% in volume and 13% in value. The rise was primarily driven by higher sales of bottled wines, up by 11% in volume, while imports of bulk wine were stagnant in volume terms. Higher average prices reflect a combination of rising prices per litre and a change in the mix.

Chile saw sales to the US decline by 6% in volume and value, with declines in shipments of both bottled (-11%) and bulk wines (-3%). In USD terms, average price per litre increased for bulk wine, but declined moderately for bottled wines

Table 2: US imports by country of origin, Jan-Jun 2018

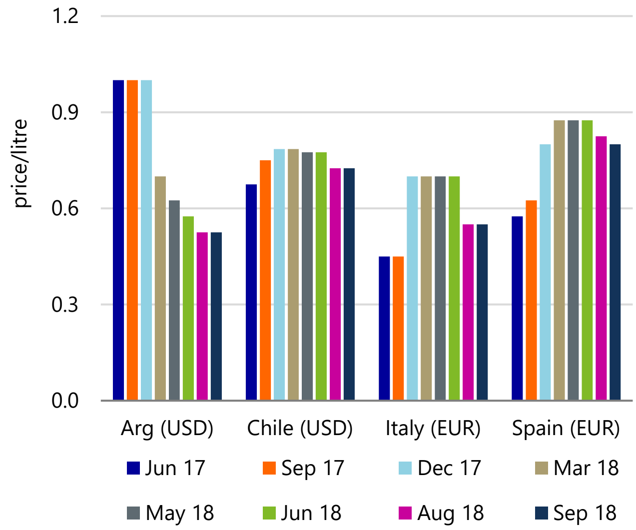
	Value (USD million)	Change (%)	Volume (thousand cases)	Change (%)
Italy	1,044.3	12	19,981.0	3
France	996.5	18	9,987.9	10
Spain	196.8	6	4,798.9	-3
Australia	166.3	-18	8,062.6	-29
New Zealand	229.0	13	4,214.3	6
Chile	130.0	-6	7,261.1	-6
Argentina	139.2	-10	3,030.0	-19
Portugal	50.9	9	1,151.5	6
World total	3,201.7	9	70,454.8	-4

Source: Gomberg-Fredrikson Report, Rabobank 2018

Bulk-wine pricing

The summer months are relatively quiet, but not uneventful. In the southern hemisphere, international prices (USD-denominated) have been predominantly affected by weak emerging-market currencies, with Argentina particularly hit, but Chile and South Africa also somewhat affected, even if relatively low volumes were traded *(see Figure 2)*.

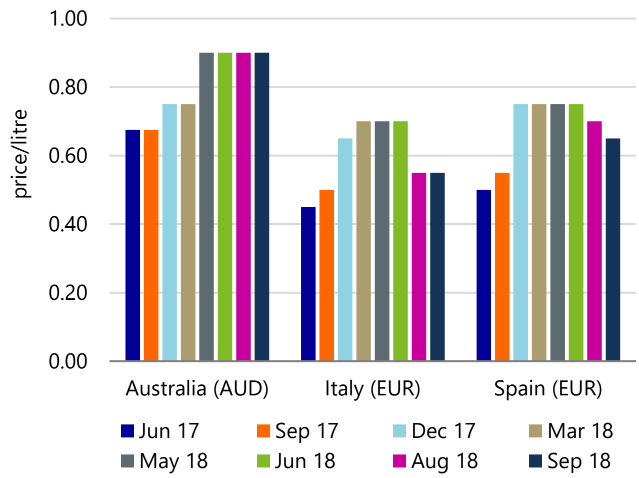
Figure 2: Prices for generic red bulk wine by country of origin and currency, Jun 2017-Sep 2018



Source: Ciatti Company, Rabobank 2018

In Australia, average prices are trending up – contrary to trends for similar varietals in Europe – but still below their historic peak in 2001 *(see Figure 3)*. It must be noted that, although the 2018 harvest in Australia was smaller than the previous year, it represented just a return to the historic average.

Figure 3: Prices for generic white bulk wine by country of origin and currency, Jun 2017-Sep 2018



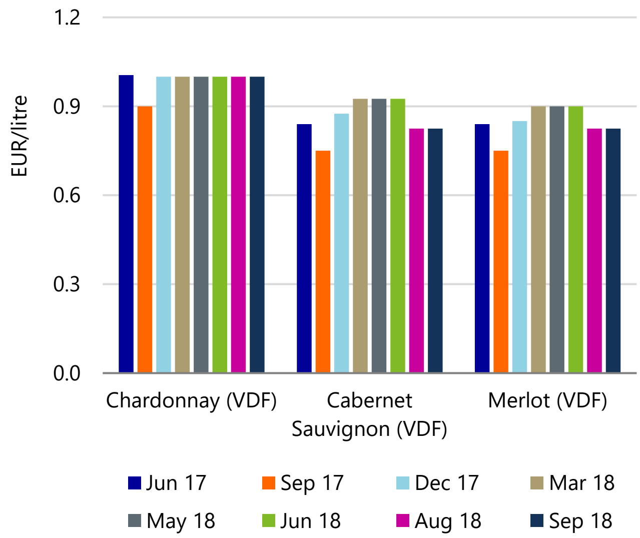
Source: Ciatti Company, Rabobank 2018

In Europe, the harvest is virtually finished, and in general terms, volumes are back to historic levels in France, Spain, and Italy. However, certain areas in France and Spain have been affected by mildew, with French organic wines likely to be the most affected.

In Spain, prices for wines from the most relevant bulk wine-producing regions – Castilla-La Mancha, Extremadura, and Comunidad Valenciana – are declining, underperforming initial expectations. After all, the total output growth represents just a return to the level of two years ago, the quality is high, and wineries have abundant storage space. Up by around 20% over last year, production in Italy is also back to historic trend, although regional differences remain. With greater availability, generic bulk table-wine prices are easing off.

In France, the summer months are always quiet in terms of trade, and limited inventories this year did not help to reach relevant volumes *(see Figure 4)*. This year's crop represents a return to normal levels, after a 2017 shortage for most products and in spite of mildew problems in certain areas such as Languedoc. Prices are likely to depend very much on the specific product and quality.

Figure 4: Prices for French bulk wine by varietal, Jun 2017-Sep 2018

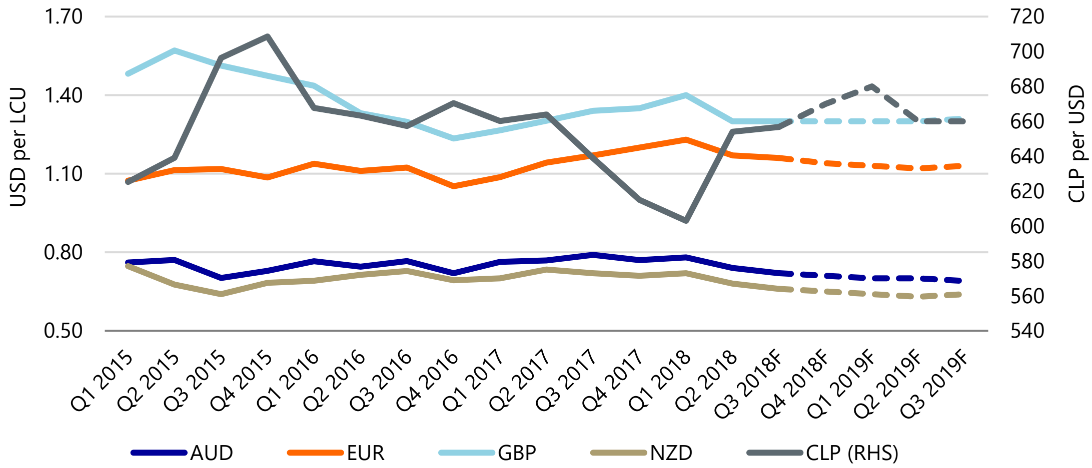


Source: Ciatti Company, Rabobank 2018

Currency outlook

The drop in the value of the Argentine peso during Q3 has marked it out as the weakest-performing currency in the world, year to date, by a strong margin. While the peso has been particularly pressured by idiosyncratic factors, most global currencies have underperformed the mighty US dollar during the third quarter. Boosted by the Trump Administration's tax cuts late in 2017, the strong US growth story and progressive rate hikes by the Federal Reserve have resulted in the US dollar sucking flows from higher-risk emerging markets. Several emerging markets have been feeling the pain inflicted by the higher costs of maintaining USD-denominated debt, and the anxiety has been worsened by fears of slowing growth in China. The Australian dollar and the NZ dollar have also been impacted by fears that growth is slowing in their largest trading partner. Both Australia and New Zealand are burdened by current account deficits, and these leave their currencies more exposed to a down-drift of risk appetite in emerging markets. In Europe, the euro is again haunted by a revitalisation of budgetary woes triggered by Italy's populist government. The British pound has been remarkably stable going into the final furlong of Brexit negotiations, but it faces the risk of a strong move dependent on the outcome of the talks. *(see Figure 5)*.

Figure 5: Wine currency movements and forecasts, Q1 2015-Q1 2019f



Source: Bloomberg, Rabobank 2018

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