Wine Business Solutions

The Wine Paper 48

December 2017

The Year in Reflection

Page 3 – It's about Money

Page 5 – It's about Wine

Page 8 – It's about Sales

Page 10 – It's about You

Page 11 – The Top Ten Tips for Building a Better Wine Business

Dare we say it. The wine industry is supposed to be about lifestyle. Celebrity television presenters make heroes of people who bleed for their art and give us their finest craftsmanship for what ends up being apprentice wages. I say that it's about money, not just because we all need to live but because you need it to compete. Take two public listed companies for example – Delegats (Oyster Bay) and AVL (McGuigan).

($A Millions)	Delegats	AVL
Revenue	$ 228	$ 226
COGS	$ 106	$ 170
Gross Margin Dollars	$ 123	$ 56
Gross Margin %	54%	25%
Sales and Marketing Investment	$ 50	$ 41
NPAT (Profit)	$ 35	$ 4

According to their last Annual Reports, these two have almost identical turnover when converted to $A. That is where the similarity stops. AVL is involved in low margin / high volume business that was the winning formula in the 1990s if you were the 'cost leader', which they never were. They've had 20 years to rethink and remodel. Where they should have been aiming was premium, regional, cooler climate Shiraz, Chardonnay and Riesling – styles that can show off Australian quality in a unique way that can be sold at price points that are both where the market is growing fastest and where sustainable returns are possible.

In the US, Gallo, Constellation and Jackson Family Wine Estates et al. have done it with Cabernet, Pinot and Chardonnay from premium regions. Why no response from Australian listed companies? Treasury have their 'Premiumisation' strategy but that absolutely not the same thing.

The key reason is that AVL and others have their assets in the wrong place for the current market and they are not generating enough cash to dig themselves out. Delegats on the other hand could change their model tomorrow, as demonstrated by their Barossa Valley Estate purchase, as their profits are nearly ten times what AVL's are. The real kicker, however, is the additional $10Million a year that they are investing in brand building. Strong brands support healthy margins just as healthy margins do brands. It's a virtuous circle.

How is this relevant to small to medium business? The biggest roadblock we are seeing currently in terms of our clients being able to see where they are going, generate sound budgets and invest in brand building, is their accountants. Virtually every time I see a client's books these days, it's the same thing. We have numerous clients with turnover of not much more than $1Million who are paying tens of thousands of dollars to accountants who are not giving them back a set of usable management accounts in return.

What accountants are doing instead is showing their clients how to minimise tax, which is important, but not nearly so as being able to see how profitable you are, especially when benchmarked against competitors. With Xero and other cloud based accounting platforms keeping cash at bank live, accountants have less to do these days. That doesn't seem to be being reflected in either their fees or their useful output.

The costing method used consistently by these accountants is 'Opening Stock plus Inventory Purchases minus Closing Stock'. This only works where sales and inventory investment are constant which almost never happens in the wine industry. Inventory is a Balance Sheet item. Inventory movements are Cashflow items. The actual cost of the wine that you sell each year (COGs) is what should be going into the P & L.

I've had people ring me who were already broke and didn't realise it because of this misunderstanding. They only found out that their margins and expense ratios hadn't been set correctly and that the 'reward' that their accountant had given them in their P & L for building inventory wasn't real <u>after</u> they ran out of cash.

To be fair, this involves considerable work, work accountants aren't interested in chasing clients to do. Doing a proper costing for a medium sized business is a substantial exercise. It's one, however, that I would urge you all to do. You can't properly plan business investment and operating expense budgets otherwise.

The other significant way in which your tax accounts will differ to management accounts is that most of the owner's expenses typically get tipped into tax accounts. This may be OK during the normal day to day of a business. It can become an issue, however, when you want to raise capital and/or have the business valued.

Better always to keep a set of management accounts that show your Management, key stakeholders (including those that might one day take over the business) and anyone thinking of investing, exactly where the business sits in terms of margins, expenses and profits. It's so much more difficult to have 'fiscal discipline' if those parameters aren't set properly in the first place and are therefore not clear to all.

For Australasian wine producers, this will become even more important very soon as the Wine Equalisation Tax (WET) rebate disappears (worth up to $290,000 to the $1Million business). Some clients have said to me that this won't be a problem as they will simply stop the activity designed only to get more rebate.

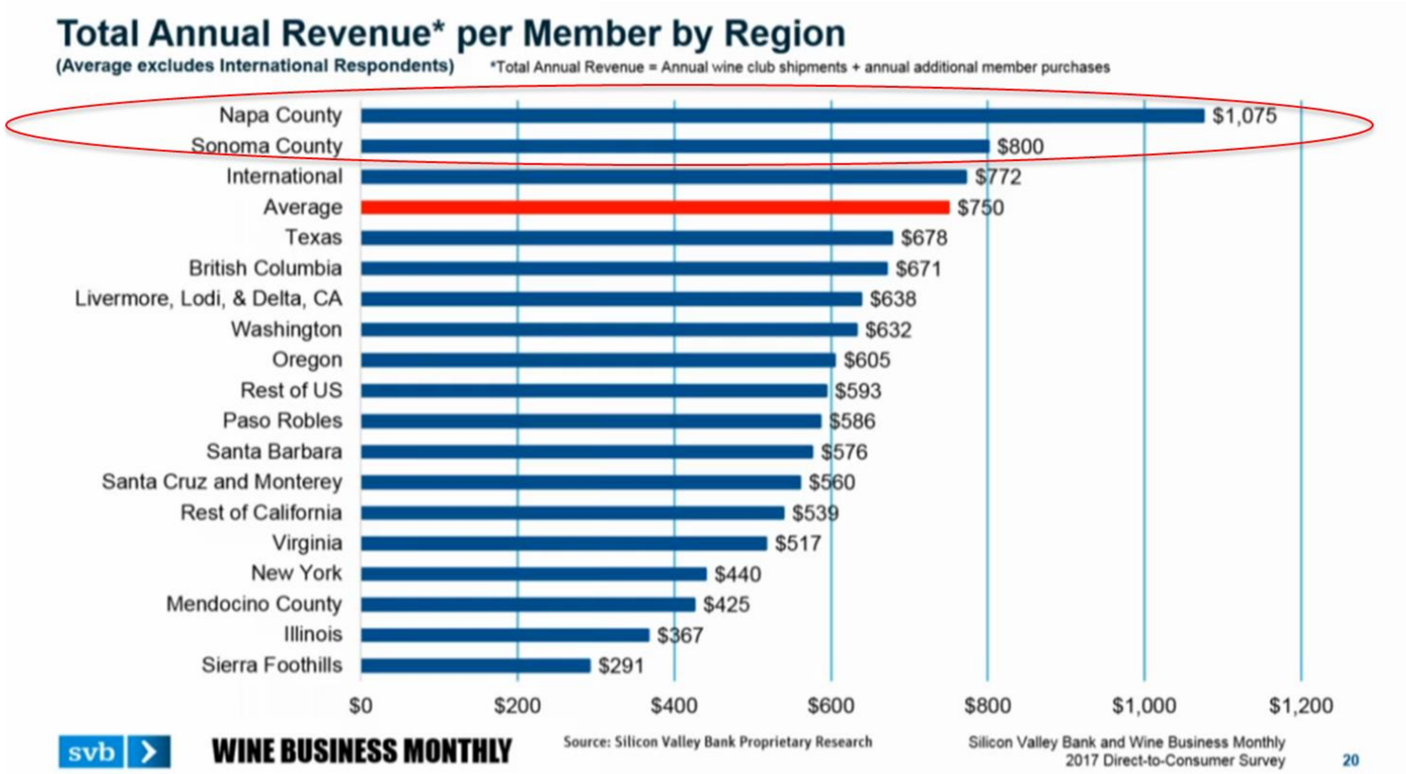
This, of course, speaks to the greatest evil resultant of the rebate. I used to think that it was that it created disincentives against exporting and growing businesses. Now I am of the view that it is the incentive to produce wine the market doesn't need undermining pricing power and the ability to invest in brands, that is the greater harm. Other countries should take note. Nothing good comes from government intervention. The tax, the rebate and the administration thereof has done massive harm to Australian competitiveness.

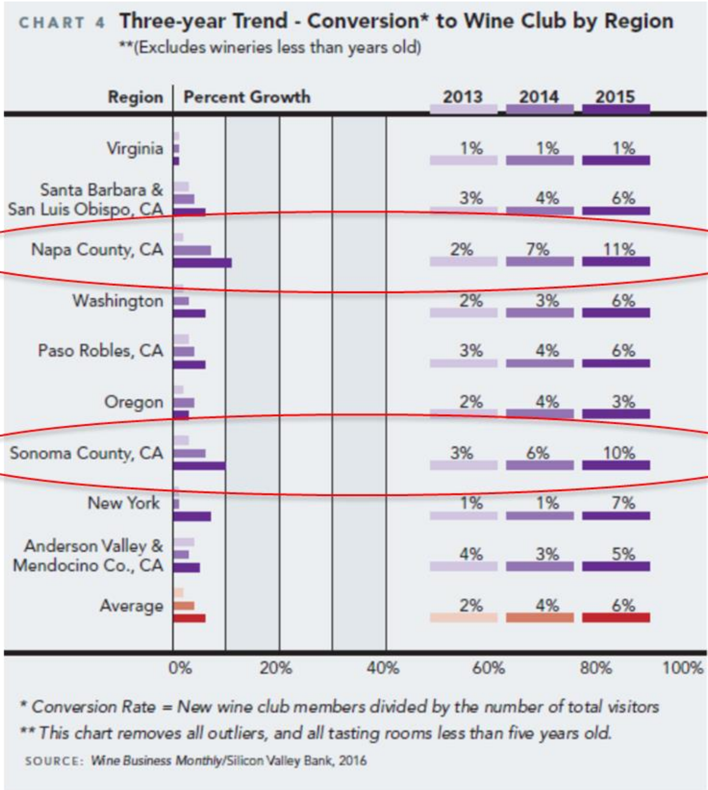
After being invited to give a keynote presentation at the Business of Wine and Food Tourism in Stellenbosch, I really felt that I'd had an epiphany. We are all in the Tourism business. We need to excel at that. That is where the margins are. That is where the biggest growth prospects stem from. That is where the money is, right?

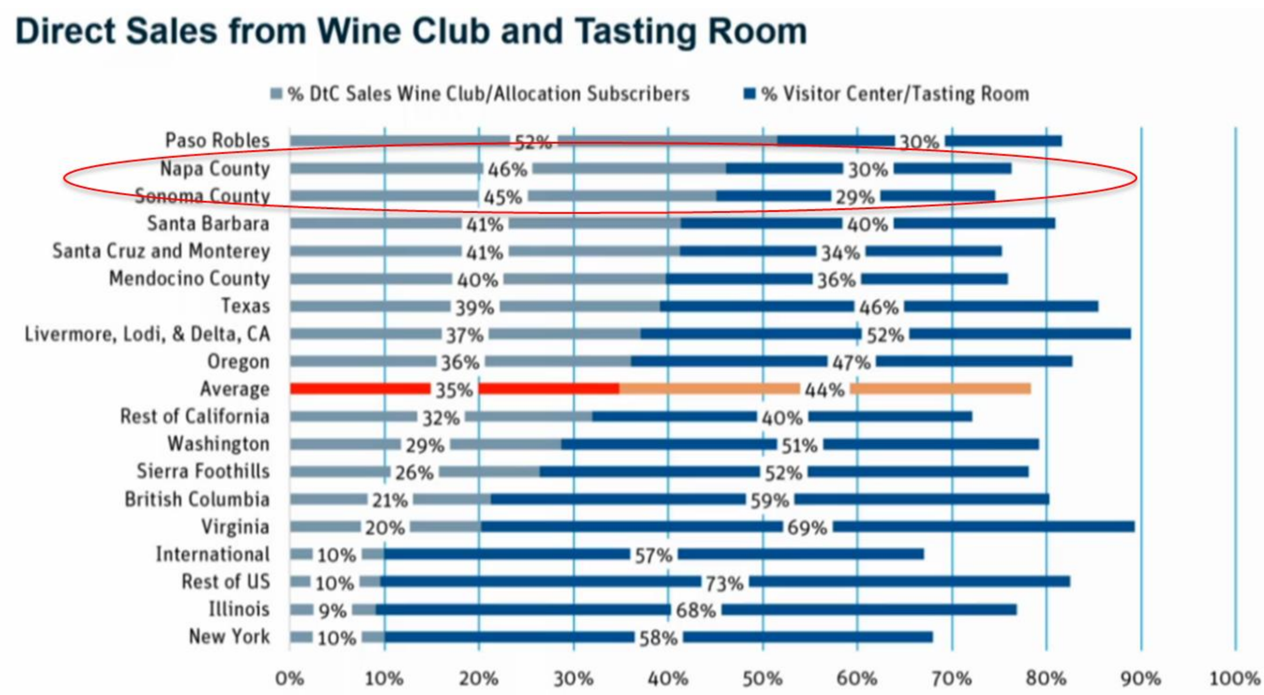
All that is true but I'm afraid that it doesn't stop there. If you look around the world at the world's most successful wine tourism regions, it all starts with great wine and a very clear value proposition base around what wine they do best. Think Napa, think Bordeaux, think Champagne. It is Christmas after all…

Whilst it is critical that a region's tourism product and supporting infrastructure be world class, this is all window dressing. In the case of food, very expensive, not terribly profitable window dressing, in most cases. Wine must be the main game. That is both where you can make the most money at great margin and is what you compete on, first and foremost.

There are also a bunch of perhaps unexpected advantages that you get from having a strong wine brand. If you look at the US, for example in the following charts, it is as though there is a wave of self-belief and confidence that sweeps across the land from East to West, from the new regions like New York to the longest established regions of California. Club member spend is highest in Napa and Sonoma. So is Club conversion and post purchase sales to Club members.







As we saw in the last Wine Paper, Napa and Sonoma also sell the greatest amount of wine to inter-State and international tourists. From [our DtC benchmarking](), you can neatly see where regions of Australia, NZ and South Africa sit on this continuum. This reflects the maturity of regions when it comes to the various elements of DtC evolution.

Having a wine strategy is a hard thing for regions to achieve. It means you have to stand for something, that some will have to accept that the 'hero styles' are not what they personally do best and that some people's land gets more highly rated than others.

But have a strong regional wine brand and all boats float. There has never been a more important time to do it. Everywhere we look, all our research confirms that leading restaurants, retailers and consumers buying online know what regions do which wine styles best and even who the top producers are.

This flows over to National strategy. It's not enough to be about Sustainability (think New Zealand). That all helps but falls into the realm of assurance. For the same reason, it's not enough to be about preserving nature either (think the South African Fynbos / diversity campaign – 'Diversity is in our Nature').

It's even less so about putting Hipsters to the forefront (think Wine Australia). Everyone has those and South Africa is doing a better job of promoting theirs in Europe, in any case. The wine styles that they're making often show no provenance and can be made anywhere. The quantities of wines mean that they can and must be substituted, usually by wine from everywhere else. And it's not even, dare I say it, about promoting women. Whilst it is a fantastic thing to be doing, everyone has those as well.

Nope – it's about wine. Wine the wows. When you start with 'wow' (Sparky Marquis had that bit right) all of those other elements are for working back into your story. Not the other way around.

You don't get to 'wow' by telling a story (as Wine Australia thought possible at one stage through its digital platform, re the country's winemaker's stories). Otherwise the large South African companies would be the world's most successful. They are totally world class at that.

You get there by being as the French so often are. Humble in the presentation of their product. Supremely confident that the wine (or food for that matter) will speak for itself. The French have their ups and downs too but overall, they win.

They win because their entire country is their food and wine tourism product. They win because they believe, perhaps more strongly than anyone else, that quality is easily perceptible, that it is essential and the only worthy pursuit of the artisan producer. They have laws to protect what they do better than anyone else, on a region by region basis, all underpinned by the overarching brand – France.

This is why I get so troubled by people saying that Australia doesn't need a national brand. It has never needed one more. It won't get there without more regions working out what their own wine strategy is. The $50Million Export and Regional Wine Support Package provides a unique opportunity not just to think about how to build a tourism lead direct sales funnel to the US and China but to consolidate what it is that regions can do better than anyone else in the world and think how to sell that. Against global competition, nothing less will do.

We've chalked up quite a milestone during the year. Over 1000 wine business owners and senior managers have now attended our 2-day workshops during the 15 years WBS has been operating. As a result of that and this newsletter, we have over 250 client files on people like yourself who have paid us for a minimum of half a day's consulting time. We have our own 'direct sales funnel' that works, you could say.

DtC has been a major component of what we teach in these workshops. Through the client projects that we work on, the feedback and interaction we have in our workshops and the benchmarking we carry out across four countries, we have a very good feel as to where people are up to on their DtC journey.

Most people get the basic concept. Almost all are yet to transform the tasting experience. There is massive easy upside to be gained by doing that. Most do, however, have clubs, run great events and have a reasonably well functioning web site. Australasians and South Africans are perhaps better than Americans at post cellar door follow up. We're more comfortable selling at arm's length, it seems. Clubs tend to have better retention rates than US regions do as well. Personalised service is key. And Australia rules when it comes to telephone sales. Langtons, Vinomofo etc are the best in the world at what they do.

And winemakers, all in all, are pretty good at hand selling their own product. You have to be. Often, there is not enough money to fund someone else to do it for you (refer – 'It's about money'). You have the passion, you can sell your own story better than anyone else and it is you that they all want to see - right?

In Australia, New Zealand and South Africa, where we are seeing this break down is at the point at which you stand to create your most profitable business but have to hand part of the selling job over to someone else – the cellar door. That is where American businesses truly excel and why Napa and Sonoma beat all.

We've got people that we work with who are expert in Sales Staff recruitment, management and training. Using a model of paid tastings and events alongside appropriate staff incentives there is a way to fund more professional staff. With the right processes in place, we have consistently seen sales double or more.

We have DtC workshops starting with Central Otago, Marlborough and Hawkes Bay in February. These will be half funded by NZTE if you are registered. I'll be back in South Africa in April as always and we'll be conducting DtC workshops right around Australia during 2018.

I'll also be attending the DtC Symposium in California in January and visiting Oregon. Let me know if you're going. I can help with 'must visit' wineries and other tips to optimise your time there.

The realisation that I'm about to clock up fifteen years as Principal at Wine Business Solutions should give me pause for thought. That's as long as I spent on the client side working in the international wine business.

What am I most proud of?

The opportunity to work with the absolute best producers in Australia, New Zealand and South Africa. Great producers like Brokenwood in the Hunter, Giant Steps in the Yarra, Cullens and Vasse Felix in Margaret River, Jeffery Grosset and Stephanie Toole in the Clare, Shaw and Smith and Hahndorf Hill in the Adelaide Hills, Moppity and others in the wider Canberra Region, Richard Kershaw of Elgin and Chard Farm in Central Otago, all of whom are exemplars of excellence.

I could go on and I know someone will be annoyed that I didn't mention them or that I mentioned someone else. The point is, I started this business to help those that needed it most and ended up, as so often happens with consulting, with the very cream of the crop.

I never pretend to be smarter than my clients. Often, I'm not. The value comes from all that is shared. From experiencing the same thing dozens of times in different situations across the wine world. From seeing that one critical thing that is a complete grey area for my client that, to me, is either black or white based upon experience and research backed insight. From spending all day long thinking about what you are too busy to.

Why do I do it?

Just last week one of my clients said to me that my advice had had a huge impact, not just on how they operate their business but on how they lived their lives. They had taken my advice on designing their life as well as their work and had been able to take two significant overseas holidays celebrating the proceeds of a lifetime of hard work making wine (and to sort out a nasty tax problem they might have had otherwise).

They weren't one of those big names earlier mentioned. They were just a couple of regular people like my wife and me. I was so pleased to have been credited with making a difference.

That's what we're here for. To all of you who have contributed to making WBS a success, I wish you the very best for Christmas and hope to see you somewhere in the wine world next year. Oh – and one last thing, if you forgot to order our US On-Premise report, here is a link. The UK report will be out in January.

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.

Wine Business Solutions

Phone +612 9744 8332

info@winebusinesssolutions.com.au

http://winebusinesssolutions.com.au