

June/July 2006
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Wine Grower

OFFICIAL JOURNAL OF THE NEW ZEALAND WINE AND VITICULTURAL INDUSTRY

New Zealand at London Wine Trade Fair



INSIDE

Vintage 2006: biggest, and potentially the best



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OBJECTIVES:

The basic objectives are:

- To facilitate a climate conducive to the profitable sale and increased enjoyment of more New Zealand wine.
- To inform and motivate New Zealand grape growers and wine makers, and those involved in the presentation and sale of New Zealand wine to maintain and enhance the highest standards and unique characters of New Zealand wine.
- To ensure that a high level of knowledge and appreciation of our industry's aims and achievements is imparted to people outside the industry whose activities affect our industry.
- To maintain high standards of journalistic quality and presentation, with accuracy and authority in all reports, and fairness and relevance in all expressions of opinion.

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New Zealand Wine
the riches of a clean green land

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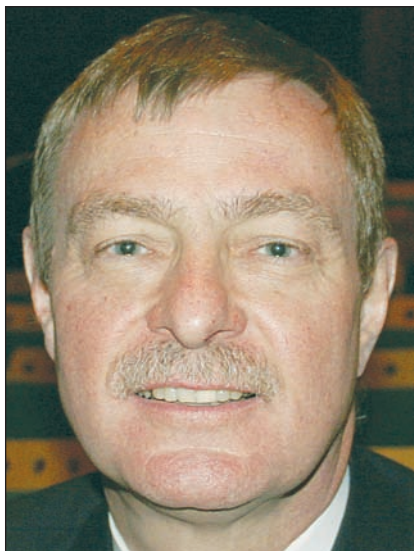
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Cover: A corner of the New Zealand pavilion at the 2006 London International Wine & Spirit Trade Fair reported by the Kiwi contingent as being their most successful so far. (Story on page 24).

US will be world's largest consumer of wine by 2008

Part 2 of the address to the International Cool Climate Symposium by American wine marketing and strategy consultant, Robert M. Nicholson. Part 1 looked at the international wine market. This concluding part surveys the US market.



Robert Nicholson

To focus now on the US and to put this key market in perspective :

USA is the fourth largest producer of wine; of the top four only the US and Spain have positive production growth.

USA is the third largest consumer of table wine (by volume) and will grow to No 1 position by 2008. USA has been No 1 consumer of table wine by retail revenue since the late 1990s

and will be as large as France, Germany and Italy combined by 2008.

"Baby boomers" and "Millennial Echo-Boomers" are leading the growth in US wine consumption; per capita consumption is up 38% since 1996 with development of "hip", user-friendly wines.

USA is the largest and most profitable premium wine market today, for both domestic producers and exporters.

Wholesaler consolidation is causing an uproar in the trade and creates problems for all companies except the largest wineries. Wholesaler and retailer consolidation and their growing power make obtaining and maintaining product distribution more difficult.

Innovation has created "brand clutter" – the unprecedented number of new products has significantly fragmented wholesaler attention

The "Sideways" movie pushed Pinot Noir unit volume ahead by 73% in food stores.

Wine enjoys the most positive image it has had for many years with consumers, from mainstream press

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and from the government.

A major development in the US has been wine passing beer as the most popular alcoholic beverage.

The US is projected to surpass France and Italy in volume shipped in the next few years.

Some historical perspective.

Since prohibition in 1934, the US wine market has grown to 300 million cases in 2005. Table wine has been the major growth category that has been on a strong up trend since 1970.

US retail sales value of all wines grew to \$25 billion in 2005 from \$11 billion in 1991, with 25% growth in the last four years.

In 2004, California wine represented 70% of total US retail wine revenues,

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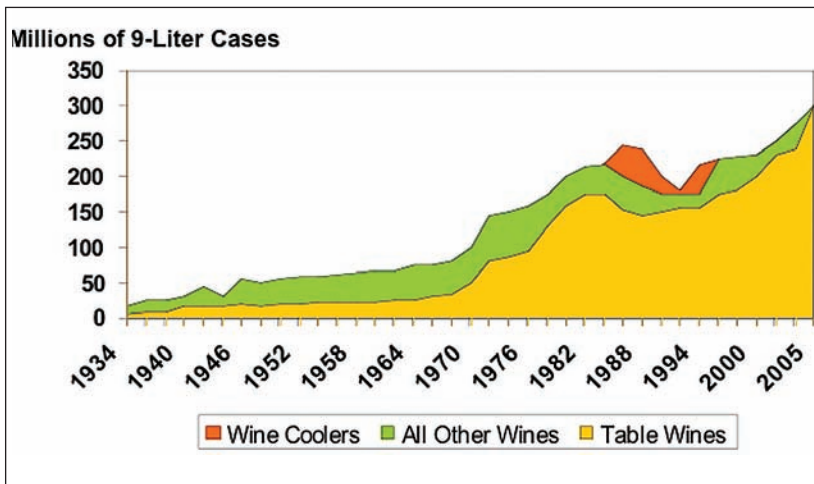
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Picture 1: Growth in US wine sales by volume.

with imported wine at 23% share.

In 2005, domestic table wine grew by 6.5 million cases or by 4% while imports grew at a stronger 8.5 million cases or by 11%.

In 2005, imported wines have captured a 27% share of wine market volume.

Looking at how the California premium market is segmented by retail price, from 1990 to 2004 wines with a retail price above \$3 per bottle at retail grew in winery revenues from \$1.3 billion to \$ 6.2 billion. The strongest growth has been in wines priced above \$14 at retail that have experienced an annual compound growth rate of 19% or by over 11 times for the 14 year period; some of this extraordinary growth is from what we can define as "cool climate" wines; strong growth for the same period has also been seen in wines that retail between \$7 and \$4 per bottle, that have had an annual compound growth rate of 11% since 1990 and have grown by over four times.

This long term growth in US premium wine sales is reinforced in recent Nielsen data that tracks scan information at the point of sale; for the 52 week period ending 19 November, 2005 total retail wines revenues in markets that scan (these markets

account for approximately 35% of total US wine sales) grew by 4%; for wines that retail between \$9 and \$11.99 the growth was 16%; for wines that retail between \$12 and \$14.99 the growth was 24%; for wines that retail above \$15 the growth was 32%.

The reasons for this continued growth of the US premium wine market are best illustrated by:

- Higher wine quality (i.e. some cool climate wines) is a strong consumer benefit (& smaller winery benefit);
- More wineries in the market have resulted in more aggressive promotions – there are 75% more wineries in the last 10 years with over 350 new brands in the last year;
- Cultural and lifestyle trends have led

to increase in wine consumption;

- Growing affluence with an upwardly mobile consumer base;
- Large untapped market with a growing number of wine consumers and coming of drinking age of Millennials;
- Favourable demographics for increased wine consumption, more on Millennials;
- New World wine style = fruit forward, palate friendly wines with influence of better quality, with some cool climate wines.

WW II (73 & over) 32 Million

Swing (60 - 72) 30 Million

Boomer (41 – 59) 77 Million

Generation X (29 – 40) 44 Million

Millennial (11-28) 70 Million

Numbers in various US "generations".

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American generations

Looking closely at US consumer demographics, World War II generation are declining as wine consumers. They are now 73 or older and are only 32 million in number. The swing generation is the smallest at 30 million today.

The surge in population following the end of World War II produced the "baby boom", the segment that has driven every part of the consumer market since they came of age.

There were 77 million baby boomers between the ages of 41 and 59 in 2005. The birthrate dropped in 1965, producing Generation X, who number only 40 million. Finally, the Millennial generation is entering adulthood.

There are nearly 77 million Millennials representing 26% of the US population, a majority of who are just coming into adulthood.

The most significant development in the US wine market in recent years has been the emergence of Millennial or Echo Boomer generation young adults as adopters of wine in early adulthood. The Millennial generation are making wine an important part of

CONSUMER SEGMENTS 2005

U.S. Adults aged 21 & over

	Millions	% Sample	% Volume
Core Wine Drinkers	35.6	13.7	87
Marginal Wine Drinkers	49.1	18.9	13
Beer/Spirits Drinkers	64.2	24.7	0
Non-Drinkers	111.0	42.7	0
Total	260.0	100	100

Source: Wine Market Council

Breakdown of US drinkers

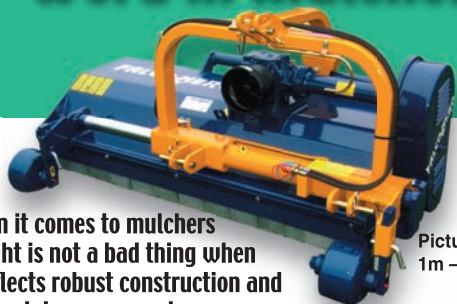
their lifestyles in a manner not seen since leading edge baby boomers were of similar age in the 1970s.

The Wine Market Council's recent consumer survey shows that in a country with almost 300 million people, only 16% of the population between the ages of 21 and 59, or slightly in excess of 30 million people, consume

88% of the table wine sold in the USA.

The US has a small core of serious wine consumers who have a per capita consumption of 45 litres per year, compared to a low national average of only 7 litres per capita. Most of the balance is consumed by another 30 million consumers, so called marginal wine drinkers, who are mostly under 40

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Price and Varietal Category Performance

Market: TOTAL U.S. FOOD		LATEST 52-WEEK PERIOD ENDING 11/19/05				
CATEGORY	Share TTL \$ Vol	\$ Volume (000)	\$ % Chg vs YAG	Share TTL Case Vol	Case Volume	Case % Chg vs YAG
TABLE WINE	98.00	\$ 4,016,337.6	10.0	96.95	64,893,804	4.2
DOMESTIC WINE	72.59	\$ 2,975,121.2	10.1	77.15	51,641,173	3.4
IMPORTED WINE	25.41	\$ 1,041,216.4	10.0	19.80	13,252,637	7.5
\$6-\$8.99 750 ML	13.67	\$ 560,429.5	10.7	9.52	6,372,719	11.4
\$6-\$8.99 1.5 L	0.90	\$ 36,851.4	0.2	0.71	472,968	4.8
\$9-\$11.99	13.82	\$ 566,442.1	15.9	7.14	4,780,535	16.4
\$12-\$14.99	5.17	\$ 212,013.4	22.9	2.00	1,335,865	23.7
> \$15.00	5.59	\$ 229,062.1	30.4	1.55	1,037,094	32.5
CHARDONNAY	20.58	\$ 843,281.0	7.6	17.44	11,674,932	6.1
SAUV/FUME BLANC	3.12	\$ 127,684.4	10.5	2.57	1,720,916	6.1
RIESLING/JHNSBRG	1.16	\$ 47,737.0	12.2	0.77	517,855	7.7
GEWURZTRAMINER	0.45	\$ 18,604.0	15.6	0.34	227,165	13.2
PINOT GRIS/GRIGIO	1.83	\$ 74,952.2	47.3	1.56	1,044,743	54.3
CHENIN BLANC	0.33	\$ 13,406.6	7.3	0.37	244,733	7.9
CABERNET SAUV	10.54	\$ 432,058.7	16.5	7.69	5,149,859	12.7
MERLOT	10.39	\$ 425,876.1	3.1	8.91	5,962,690	3.6
ZINFANDEL	2.08	\$ 85,435.5	13.3	1.41	946,344	8.3
PINOT NOIR W/BLENDS	3.16	\$ 129,406.0	74.0	1.61	1,080,582	69.3
SYRAH/SHIRAZ	1.18	\$ 48,548.2	28.3	0.89	595,987	24.9

Breakdown of US drinkers.



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years of age, enjoy wine once a week, or less, but who have not yet acquired the taste for frequent wine consumption.

Between 2000 and 2005 the core wine drinking population has risen from 10 to 14%. In the same period, the percentage of adults represented by the marginal wine drinker population has grown from 15 to 19%.

This growth is the mainly a result of the adoption of wine consumption by those who have previously been exclusively beer and/or spirits consumers, but who now also drink wine.

The segment of the population that drinks beer and/or spirits but no wine has decreased from 33% in 2000 to 25 to 16% in 2005.

Growth has also come from the adoption of wine in early adulthood by Millennials.

The core wine consumer base of the wine market began growing slowly twelve years ago, and has accelerated in growth more recently as Millennial generation young adults and others have entered the category in significant numbers.

Core wine consumers comprise 14% of the adult population, but account for 87% of the table wine volume consumed in the US. Marginal wine consumers are 19% of the adult population, and they account for the remaining 13% of the table wine volume.

Persons who drink beer and/or spirits but not wine are 25% of the adult population - a number which has seen significant decline in percentage in recent years.

Non- drinkers are 43% of the adult population. The very slight growth of this population (1%) in recent years merely reflects the ageing US population, with more adults reaching a stage of life where overall alcohol consumption declines.

Current developments in US

There are a number of characteristics that successful premium wines demonstrate in the US market. Generally these wines have:

- Innovative packaging; inviting packaging and brand names; non-traditional names break down intimidating barriers;
- Contemporary wine style (fresh, fruit forward, new world style, some cool climate wines); wines that appeal to the mainstream American palate are flavourful;

- Well defined product line, priced to over deliver in quality against competition in subcategory;

- Some geographic anchor, with flexibility in sourcing;

- These brands are consumer oriented in their positioning;

- Highly approachable, sometimes slightly irreverent and often unpretentious;

- They have clear and simple brand message;

- Strong appeal to Millennials;

- They have easy opening – screw-cap closures making significant inroads.

Here are some examples of successful premium domestic wine brands in the US with their ownership and estimated 2005 shipment volume, some of these brands will extensively use cool climate wines

- Blackstone (Constellation) – 1.25 million cases

- Philips-Hogue (Vincor) – 1.2 million cases

- Ravenswood (Constellation) – 1.1 million cases

- Lohr (independent) – 750,000 cases

- Kenwood (independent) – 590,000 cases

- Rodney Strong (independent) – 590,000 cases

- Rex Goliath (Constellation) – 500,000 cases

- Bonny Doon (independent) – 360,000 cases

- Red Truck (independent) – 200,000 cases

And as we have already discussed, continued development of our premium product portfolios will be critical to sustained market growth and to satisfy the curiosity that the trade and consumer have about wine.

In the USA most California grape growers and wineries are now competing against producers in two dozen other countries; the quality bar gets raised each year and this benefits the consumer and in turn raises competition.

The global wine industry is changing significantly; the industry now has “open sourcing” with few trade secrets; all viticultural and oenological breakthroughs are shared locally and globally; technology is improving quality throughout the world with high-density plantings delivering more flavor intensity in our premium wines.

We are better at matching the land and climate to grape varieties.

Increased clonal experimentation is producing higher quality wines, better yields and disease resistant vines.

Innovative wine making methods are producing more complex flavors in our wines.

To illustrate the sustained strength of the premium wine market in the USA, total varietals sales in supermarkets have been growing consistently in recent months. Total generic sales, or standard wines, have been decreasing in supermarkets but the total domestic table wine category has been growing. Imports have shown strong growth also in US supermarkets. Australia, Italy and New Zealand have outstripped the market and their competitors.

Importance of coolclimate wines

In closing, I would just like to use current trends in US winery valuations to reinforce the point about the importance of cool climate wines to the premium wine market. Premium winery multiples are at record high and are unlikely to decline any time soon for well-positioned companies.

The value of premium, cooler climate California viticultural land increased in the last few years and it continues to increase.

It has become clear in the future that more US wine companies will be willing to suffer the rigours of the complex financial markets to source funds.

This then fuels the “grow-or-die” theory that compounds the need for growth through acquisitions and joint venture to drive revenues, market share and global distribution clout.

And as globalisation in the wine industry continues, we have mega mergers between the largest wine companies for the reasons we have already discussed.

I am sure we will see an increase in old world/new world marriages. And we are now finding that the second tier companies are now recognizing the need for global growth through joint venture or acquisition.

And from what I can tell, none of this is producing homogenised premium wines.

So therefore, there should be no doubt about the important role that cool climate viticulture and oenology plays in the wine world and the contribution that this type of conference makes to sustaining the growth of global premium wine sales that we all so much want to see continue through the next millennium. 