TREASURY WINE ESTATES

Australian Wine Industry Technical Conference

Address by David Dearie, CEO, Treasury Wine Estates

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Good afternoon, it's great to be here today. In fact after the week I've had it's better than ever to be surrounded by such an esteemed audience of winemakers, viticulturists and wine lovers, rather than journalists!

It's fair to say it's been a pretty tough week. Looking at some of the coverage in the newspapers following our announcement on Monday, that TWE was taking the painful but necessary steps to address excess inventory and bulk wine issues in the United States, I thought long and hard about the implications for my remarks today.

But on careful reflection I'm convinced that our actions in the US reinforce, rather than weaken, what I had already intended to speak about today.

Put simply TWE's recent actions in the US demonstrate, more clearly than ever, that quality comes at a price.

I remain totally convinced that strong brands can command a higher price, will generate greater consumer trust and trade loyalty, and will ultimately provide superior shareholder returns.

I view this Conference as incredibly important. The technical aspects of our industry are sometimes forgotten in the everyday hurly-burly of discussions on wine, and the state of the Australian wine industry.

However I'm in no doubt that our technicians and viticultural practitioners are the 'unsung heroes' of our industry, without which we wouldn't have so many great Australian wines and wine brands.

Today I want to talk to you about a building a premium future for Australian wine by embracing quality and realising full value for the products we sell, and the wines consumers enjoy.

And I want to express my views on what I believe our industry needs to do if it is to maximise the opportunities of near insatiable demand for premium brands by consumers in almost all developed, and a great many developing, markets around the world.

To talk luxury you first need to understand value.

Because what differentiates a luxury product is an inherent ability to command price; and consumers must see the value, which could simply be the trust and prestige they see in the brand name, for the extra they are being asked to pay.

Wine as a luxury good still has much to learn, and you don't have to go too far within the drinks industry to uncover some interesting lessons for our sector.

Take Vodka, for instance, the technical specification really isn't much to boast about. As the official description of the product in the USA's federal regulations states:

"Vodka is neutral spirits so distilled, or so treated after distillation with charcoal or other materials, as to be without distinctive character, aroma, taste, or color".

As a result the spirits industry needs to work hard to build brands and tell consistent stories about the quality of those brands.

And yet that is exactly what some companies have done.

Take a look at the phenomenal success Diageo has had with its Ciroc vodka brand in North America. As featured in Marketwatch's recent 'Hot Brands' edition, Ciroc has gone from 340,000 cases in 2009 to over 1.83m cases in 2012, off the back of some great brand building and very clever marketing.

It is also worth considering the current dominance of spirits within the international showcase of global travel retail; think about the brand building and story-telling major spirit brands have embraced in order to profile their products; and ponder why certain spirits bottles are instantly recognisable in contrast to the 'wall of sameness' that exists in wine.

Taking these factors in to account and you start to understand the significant price difference between yet another $20 private label vodka and a bottle of premium vodka sold at five times that price.

Even within established spirits brands leading companies are continuing to innovate, to develop their thinking and products to deliver greater commercial value and brand prestige.

They recognise, rightly, that the creation of value remains a constant challenge if a brand is to retain its luxury status.

So spirits provide wine with some valuable lessons in the consumer positioning and brand building of their product. Indeed critics would allege, with some degree of justification, that wine has been far too passive and far too slow in creating the value that supports a focus on premiumisation.

Put bluntly, we've all been guilty in the past of commoditising Australian wine and ultimately eroding brand value.

Let me be abundantly clear, I know the Australian wine industry continues to make fantastic products, but I passionately believe we need to drive the marketing, shelf appeal, and value creation behind our products.

Our focus on technical and viticultural excellence has not been matched by a comparable effort on brand building, with an insufficient share of research funding and a lack of imagination characterising our efforts.

Too often the calibre of the wine itself has been lost in a sea of commoditised marketing that treats a 21st century consumer in a similar manner to their counterparts from the 1980s.

Time has moved on, and so must we. The only constant is that the consumer remains king.

One example where I believe TWE got this right was the Penfolds Ampoule.

Now I know that the Penfolds Ampoule created a fair amount of comment, not all of it positive, when it was unveiled last year.

Some thought charging $168k for any wine was inherently wrong; others felt it was a gaudy and unsophisticated approach to seize the title of the world's most valuable wine; and most thought we would struggle to sell them.

Of course, I acknowledge and respect these views, but the reality has been quite different with Penfolds Ampoule demonstrating just what is possible from a branding and price perspective when fine wine meets sculpture and is presented as a scarce and exclusive resource.

Within six months all twelve ampoules were successfully allocated with several showcased at leading international airports and high-end retail stores. Consumer interest was also phenomenal with over 7 million media impressions globally since launch.

And while I understand that the Ampoule might not have been everyone's cup of tea; everyone in our industry needs to carefully consider the alternatives to building brands and creating value.

I passionately believe that we have an opportunity to create a profitable and sustainable industry, where all parties – from the farmer to the retailer – benefit and are rewarded for their efforts.

Our alternative future is one characterised by Private Label, bulk wine and people exiting the wine industry; a future where we become simple purveyors of 'grape juice'.

We also need to face up to the fact that some in our industry currently strip out, rather than add value to, Australian wine. Some 'winemakers' have given up on quality and value creation to focus simply on lowest cost production.

Yes, efficiency is - and should remain - a vital ingredient in any business but charging full value for a quality product that has been lovingly crafted by highly skilled tradesmen is not something our industry should shy away from.

Wine remains a complicated and intimidating product for most consumers and price is a major factor in determining value and quality.

Low cost production is characterised not just by poor marketing and a focus on cheap grape supply but also led by a lack of investment in the technical aspects of our industry, in R&D, in viticulture and production.

Such behaviour ultimately exposes the Australian (and global) consumer to a cheap, commoditised product. It destroys 'Brand Australia' and reinforces a vicious circle of value destruction rather than creation.

The recent history of Australian wine in the UK provides a sobering example here. From the high point of being a 'hot' country of origin, and brands consumers craved, to Brand Australia being characterised by 3 for £10 offers and the now infamous 'critter labels'.

When you consider the approximate tax and duties involved of roughly $2.60 per bottle, how can this possibly be regarded as sustainable?

All parts of our industry shoulder the responsibility to build Australia's reputation for excellence and quality in wine - it really doesn't matter if you're a large winemaker or a family-run business.

We are blessed with fantastic wine makers, viticulturists and technical experts who need to be rewarded by charging full value for the quality wines they produce. Profit is not, and should not be, regarded as a dirty word.

There should also be real profit for the retailer too.

Winemakers don't run charities and our industry has no future if it cannot generate sufficient commercial returns. The best way to do that is through quality, the finest raw ingredients, passionate stories around our brands, and innovation in everything from blends to packaging.

Naturally, supply and demand also has a big role to play in our industry's future, and as these cycles change so do perceptions of value.

New Zealand Sauvignon Blanc in Australia provides an interesting case study here. Initially a limited amount of Kiwi brands came to our shores, and those that did commanded higher price points; price in many ways was a reassurance of quality.

This initial success in Australia should not have come as a surprise, because for an average price of $15 per bottle consumers knew they could buy a wine that was consistently reliable from a taste and quality perspective.

But as a 'gold rush' mentality took hold New Zealand made too much Sauvignon Blanc, crashing the average price to under $10 per bottle and eroding their reputation for quality.

Only now, after careful reflection, are they building back.

In contrast, at the luxury end the situation has been much more consistent and impervious to swings in supply/demand. Put simply, over the last two decades there has remained a significant shortage of luxury wine.

This situation is only likely to be exacerbated as we move into a more balanced supply position globally, and we must take the opportunity provided by this to move Australian wine up the value curve.

Adding value back in to our industry also requires a frank and honest appraisal of the tax regime we operate in, and the Government support we require.

And on the WET Rebate I will pull no punches.

I understand why some in our industry react with dismay at the prospect of losing a $500k handout from the Federal Government.

But the fact remains that the WET Rebate blatantly fails to meet its original policy intent, is widely rorted, underpins the excess supply that has blighted Australian wine and is enjoyed with relish by our competitors from across the Tasman!

From a cost of circa $200m in 2008/09 the WET Rebate is now forecast to hit $310m in 2015/16, something that should dismay us both as an industry and individually as Australian taxpayers.

I firmly believe that we should be working with Government to identify new and useful investments to help rebuild 'Brand Australia' in international markets and entice more consumers to our cellar doors.

Instead too many in our industry plead for the continuance of a good old fashioned subsidy – one that we would rightly challenge were it applied to other sectors; and one that does nothing to support the necessary structural reform, and route to premiumisation, Australian wine requires.

So, sadly, our recent history is a story of value destruction rather than creation.

A race to the bottom rather than to the top.

One prominent Australian wine critic recently told me how Australian retailers used to brag about the returns they made from Penfolds, and now they brag about how low their price is. He stated how can this possibly be good for either the Australian wine industry or retailer shareholders? Good point.

Over the 1980s and 90s Australian wine moved from having a reputation for great value to simply one of being cheap.

The great Aussie shopping basket provides further confirmation of this trend, with wine one of the rare products to be suffering from deflation – in sharp contrast to bread, milk, and importantly also beer and spirits.

Quality must remain our byword, and only by telling the quality story can our industry thrive; and it is by embracing quality that we will seize the opportunities the burgeoning demand for luxury products provides.

Wine is a global industry and 80% of all Australian wine is exported.

If we don't build inherent value behind a quality story, backed by smart marketing and brand building then we will be damned to be at the eternal beck and call of currency fluctuations.

We must charge full price for our wines but can only do so if the quality justifies it.

A sustainable value chain is critical for long term success. The growers and farmers need to make a return, the retailers should make an acceptable cash margin, and the consumer (based on our research) is prepared to pay more for a wine brand that constantly delivers on quality and brand image.

The quality mantra for wine is therefore both a complex and balanced offering. It must provide an experience, and a real sense of enjoyment and it should not hide from commanding a price that reflects what it delivers.

All the evidence demonstrates that consumers know quality, and when they recognise it they will pay more. Accordingly we must never compromise on quality.

Above all we must stop thinking of wine as a commodity, and start thinking of it as a premium offering that consumers will, and should, pay more for the hand crafted product it is.

There is no benefit to our industry in chasing multi-buy offers, and we must never be ashamed to charge full price for a fantastic product.

On the contrary we must be unrelenting advocates for the quality and value of our wines; explaining to the consumer the investment, the passion and technical skill that goes in to the creation of top quality Australian wine.

Wine has a high cost of capital, significant R&D requirements and underpins vast swathes of employment upon which many rural communities depend.

It is an industry of which we can be justifiably proud.

As indicated earlier, I am far from dismissive of those who work in other parts of the drinks industry. Indeed I am envious, and encourage winemakers to learn from, the brand building excellence displayed by many in the spirits sector and, dare I say it, the beer sector.

I am particularly dismayed by the 'Cleanskins' offering from our own industry – the ultimate, sanitised, commoditised wine offering.

In my opinion, no one wins on cleanskins. It is not sustainable for the growers, and the consumer is faced with huge fluctuations in quality. In short, it damages the entire wine industry.

Why would anyone with a love of wine want to produce such a product? And can anyone sustainably and fairly deliver profit and value from such a model?

My belief is that rather than seeking to attract consumers by stripping out value from our products we should be looking at each and every opportunity to build perceived and real value in Australian wine.

So what does premiumisation and luxury in wine really look like?

Well, given my strength of feeling on this issue you won't be surprised to learn that we are doing a few things at TWE:
- a ground breaking partnership with leading fine wine supplier Bibendum in the UK
- a serious and ongoing investment program in raising the calibre of our grape intake through Project Uplift
- establishing TWE, and Australian wine, as an international force in Global Travel Retail.
- and, as previously mentioned, the unveiling of our incredible Penfolds Ampoules

Consumption trends continue to reinforce the need for Australian wine to move up the quality and value curve.

First growth, rare and collectible wines that can be enjoyed now, in the future, or on special occasions are increasingly highly sought after.

And consumers are prepared to pay more, to borrow a phrase from a well-known premium consumer brand, because 'they're worth it'.

Part of the journey we need to take in wine if we are to foster a culture of quality and premiumisation is the need to address the tall poppy syndrome that exists in sections of our industry.

There is nothing wrong with being big, premium and successful. Some in wine, and no doubt even some in this audience, still wrongly believe that 'big is bad'.

Yes there are a plethora of niche luxury brands but those who dominate the luxury space are actually large, commercially successful, organisations.

Brands like Louis Vuitton, Johnny Walker, and Gucci are all big; all incredibly successful and all are growing rapidly.

The immense opportunities presented by China provide the clearest example of why Australian wine should relentlessly pursue a strategy of quality and premiumisation.

Chinese luxury consumption is predicted to grow 18% year-on-year, and with China already accounting for over 20% of world's luxury consumption. It also recently exceeded Japan as the top country with the highest spending on luxury goods.

So the size of the prize remains huge, despite economic turbulence and a more austere Government approach. However other luxury brands are already moving (and are well ahead of wine):

- In 2005, Louis Vuitton has 10 stores; today it has over 36 stores in 29 cities.
- Gucci started with 6 stores in 2006 and had grown to over 40 stores by 2011.
- China, already the largest car market in the world, and is now one of the top 3 markets for Rolls Royce, Bentley, and Porsche.
- In 2005 a total of 857 Porsche cars were sold in China, last year that number had reached over 30,000.

TWE's own research on wine in China has reinforced these trends, clearly showing that luxury and premium brands remain paramount in Chinese consumers' minds.

The Chinese consumer is also considerably more sophisticated and educated on wine, and wine brands, than most in Australia give them credit for.

The Chinese consumer likes order, and this needs to be factored in if we are to make Australian wine a sophisticated offering that brand conscious Chinese consumers are willing to pay a premium for.

We need to make it easier for Chinese consumers to identify the hierarchy of our brands – to help them find both an entry point and our premium offerings.

Unfortunately some winemakers need a reality check on China and the Asian consumer.

In my humble opinion you can't take an unknown brand to China and expect it to succeed just because it's a big market with growing demand. You also can't inflate your prices and kid the Chinese consumer that a $20 wine is now worth $200. The Chinese consumer is too knowledgeable for that.

Open your eyes. The Chinese are great travellers and over 42 million Chinese are forecast to travel overseas this year. We also have long-standing Chinese communities in most major Australian cities. So Chinese consumers see what is presented in airports around the globe, and know what is served and tasted in the great restaurants and hotels of the world.

They are voracious explorers of wine education materials (particularly online). So they know when they are being sold a pup!

My worry is that when Chinese tourists arrive in Australia they pick up daily newspapers containing page after page of wine discounts. Yet wine remains an important driver of liquor retail profit, so this deflationary approach impacts both the image of Australian wine and retailers own returns.

For those of you that have had the opportunity to directly experience China, you will know that what really matters is quality - that the wine you are purchasing is the 'real deal'.

Assurances that the wine is genuine and of high quality are paramount; as is the endorsement of a friend or flagship brand that you already trust.

And it is not just China, it is many emerging markets and more frequently in developed markets too. Wine in Australia, USA, Canada etc. is growing at premium price points faster than it is at commercial/entry level. Consumers are working it out that by paying more their experience and enjoyment is greatly enhanced.

I don't believe I'm being overly dramatic to state that our industry stands at a crossroads.

After years of a global supply imbalance the fundamentals are looking much more positive.

And wine demand is growing in both developed and developing markets.

Put simply, the industry we all love now faces a stark choice: is Australian wine to become yet another commodity resource in a 'sea of sameness' or a premium, luxury product that commands price, prestige and brand loyalty on the global stage.

I know which scenario I'd prefer.

So let's go make it happen

Thank you.