

The *Doubtless* Letter

Analysis of Business Issues Affecting Strategy & Value

September 2004

There can be no real argument with the assertion that Marlborough sauvignon blanc has put New Zealand wine on the global map in a way no other wine produced here has done. For better or for worse, the wine consumers of Europe and North America identify New Zealand wine with the crisp distinctive style of wine made from this particular grape in this one region.

This is important in a number of respects. It creates an image for a distinctive style of wine, and offers notions of what could be for other styles as well, but it also has the potential to shackle producers into a stylistic and economic strait-jacket caused by the global demand for a specific wine from a specific area that not everyone is capable or inclined to deliver.

It is also important to reflect on the nature of the world market for sauvignon blanc as well as for the other wine styles produced in New Zealand.

Selling to a Sauvage World

A Question of Style

If the New Zealand (and particularly Marlborough) style of sauvignon blanc is recognised for its vibrant flavours and acidity, is this the global image of our other styles? Are these characters the distinctive signature for New Zealand chardonnay, riesling etc.? If not, then why not? In many cases the only answer would appear to be confused – for every chardonnay which does suggest such a signature, there is another totally different wine from the buttery oak framework.

The answer with regard to Pinot Noir may well be yes. While many pinot noir makers elsewhere seek to replicate a more specifically Burgundian style, it increasingly appears that one region, Central Otago, delivers a style of wine endowed with analogous characteristics to Marlborough's sauvignon blancs.

However, whereas the market for sauvignon blanc has potential beyond simply a small market niche, the same cannot necessarily be said for pinot noir in a global marketplace where the mass market demand is for warmer reds. In a marketing sense, pinot noir perhaps lacks an entry level. This may be attributable to the fact it is not easy or cheap to make. So there are unlikely ever to be oceans of attractive and bargain priced pinot noir to create large numbers of new drinkers.

Achieving potential probably means a lot of hard work attracting attention outside of the existing niches: promoting New Zealand pinot noir as a distinctive and exciting alternative red wine, not as the latest (or closest) attempt to mimic the wines of Burgundy.

Nor do New Zealanders experimenting with new varieties (especially whites) seem to have the confidence to try and impose “New Zealand-ness” upon them. Surely there are other interesting European varieties that could be transformed into new fashion statements with a distinctive New Zealand label. If sauvignon blanc has responded to a particular environment because of New Zealand's latitude, temperatures, sunlight, rainfall and soils, it would still seem surprising if it was the only variety that could respond in such a way.

The Marlborough experience would seem to be that the varieties New Zealand ought to be trying are those from slightly warmer climates where there is a struggle to retain adequate acidity and a consequent trade-off in fruit flavours. This may suggest that those producers looking at Southern European and Mediterranean varieties to trial may be more likely to open new vistas than those focusing on Northern European varieties, for example, except in the south.

The One Real Story (so far)

In the meantime, however, there is still only one real New Zealand story that matters to the wider world: sauvignon blanc.

In truth, the success of Marlborough sauvignon blanc has benefited the wine consumers and industry in New Zealand in a number of ways, not least of which have been the attraction of overseas investment capital and the strength and motivation to explore new and better technology and new varieties. On the back of Marlborough sauvignon blanc the industry has developed a strong research and development focus that will be critical in years to come if the industry is to maintain leadership with this product.

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However, the growth of production now creates new marketing issues. Those issues become clearer when New Zealand production of sauvignon blanc is placed against the context of global plantings of the grape (the majority of which will find their way into varietal labels or labels identified with the sauvignon blanc grape).

<i>New World Sauvignon Blanc</i>	<i>Hectares</i>	<i>Year</i>	<i>% share</i>
Chile	7,041	2002	23.9%
South Africa	6,843	2003	23.2%
California	6,197	2003	21.0%
New Zealand	5,641	2004	19.1%
Australia	2,914	2002	9.9%
Argentina	850	recent	2.9%
Total "New World"	29,486		

It is interesting to note that according to vintage reports from several of these countries, wineries reported that sauvignon blanc grapes are in short supply.

The key question is what is the market size of the premium pricing niche to which New Zealand sells. Is this niche larger than 20% of the market (which would seem extraordinary). If it is less then the message is very clear that a significant portion of New Zealand's export volumes will need to be targeted at lower priced market segments. The challenge is to do so without losing regional distinctiveness and quality image.

Of course it is not sufficient to focus solely on New World plantings. This tends to disguise the size of plantings elsewhere, including approximately 20,000 hectares planted in France and another 32,000 hectares elsewhere in the Northern Hemisphere. The fastest growth in recent years has probably been in parts of Eastern Europe, most notably in Moldova (11,000 ha), as well as Hungary, Slovakia, Slovenia and Bulgaria. It is clear that not all of these harbour the ambitions of the likes of Chile and South Africa to shift up into higher price brackets than they have traditionally sold to.

Does New Zealand behave like a quality producer?

Judging by yields the answer might be questionable.

Based on published data (extracted from country specific production and planting reports available over the internet) for the main New World sauvignon blanc producers, current production yields per hectare are as follows:

<i>Country</i>	<i>tonnes/ha</i>	<i>Vintage</i>
Chile	11.4	2003
South Africa	6.9	2003
California	13.3	2003
New Zealand	12.0	2004
Australia	11.0	2004
Argentina	12.9	2003

Given that one of the mantras of quality wine production is that yield control coincides with improved ripeness and flavour concentration, it is intriguing to see many of the Southern Hemisphere competitors, which we typically expect to see in lower market price points in the key export markets, seemingly have lower grape yields - also consistent with higher grape production costs.

It is also interesting to look at the 2004 vintage New Zealand yield by variety:

<i>Variety</i>	<i>Prod Hectares</i>	<i>Tonnes /ha</i>	<i>Tonnes /acre</i>
Chardonnay	3,787	9.4	3.8
Sauvignon Blanc	5,641	12.0	4.8
Riesling	692	8.2	3.3
Semillon	259	13.6	5.4
Pinot Gris	397	4.8	1.9
Cabernet Sauvignon	724	5.6	2.2
Pinot Noir	3,120	6.5	2.6
Merlot	1,398	6.7	2.7
Syrah	178	3.9	1.6
"Bordeaux" varieties	2,493	6.2	2.5

There are other questions raised by the statistics. While the numbers (based on the 2003 New Zealand Vineyard Survey) show that 86% of New Zealand producing sauvignon blanc vineyard are indeed grown in the district best known for it, Marlborough, as well as a further 5.8% in the stylistically complementary areas of Nelson, Waipara and Wairarapa, none of these was forecast to be the highest growth area to 2006. That area is Hawke's Bay which is expected to increase its producing area share from 6.5% to 7.3% on the back of a 39.2% increase in productive sauvignon blanc area (much of which is presumably already planted).

The expansion of volumes in the New Zealand 2004 vintage was, of course, not simply sauvignon blanc. The production of other varieties was also at record levels, and statements about shortage and the need to

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allocate wine to offshore buyers in the past do not necessarily apply to many of these other wines, although the degree of cause for concern is quite varied.

Variety	2004	Change/ prev high
Chardonnay	35,597	5.1%
Sauvignon Blanc	67,773	84.5%
Riesling	5,647	12.1%
Semillon	3,511	15.0%
Pinot Gris	1,888	55.5%
Cabernet Sauvignon	4,045	-7.5%
Pinot Noir	20,145	93.7%
Merlot	9,330	43.5%
Syrah	691	74.1%
"Bordeaux" varieties	15,339	23.4%

This table shows the total tonnage in 2004 plus the percentage increase from the previous highest production year (in most cases 2002).

Among the white grape varieties it may be reasonable to surmise that a proportion of the increased production of chardonnay will be going into sparkling wines for which there is already evidence of increased demand. This means that the bigger issue is probably among other aromatic varieties, but volumes are largely from such a low base that the immediate impression is of a manageable problem.

Red grape production is a bigger issue given the nature of global competition. While the increase in syrah from such a low base will barely meet rising demand,

expanded international demand for pinot noir is not yet assured and New Zealand has simply not yet created a marketable image as a producer of high quality Bordeaux varietal blends competitive in the price brackets we aspire to sell to.

And the real test...

Vintage 2004 was not just one large production year – it was a pointer to the future norm. The real test is whether the industry proves to have the ability to shift larger volumes year in, year out, as similar or larger volumes come through in 2005 and beyond. Inventory clearance will be critical for the financial health of the industry, just as the price at which that product can be cleared. This is why the real crunch for many companies has not yet arrived.

What does this all mean? The key message is that good business decisions are based on good information. In New Zealand we often lack perspective on our competitors. However it is clear that the key volume issue affecting the industry is sauvignon blanc.

The industry is made up of a mix of strong and weak, smart and otherwise. For example, smarter producers will have used the opportunities to be selective with contract grapes and/or bulk juice, in order to boost production but avoid quality dilution. Clearly some companies are also realising that in order to make the most of the market opportunities they will need to boost strength through resources, including capital and assets. There are decisions to be made.

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