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China's near-$1bn thirst for Australian wine

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With the value of Australian wine exports to China rapidly approaching $1 billion per year, it is no small mystery thousands of Australian businesses are clamouring to capitalise on the exponential growth in demand.

Data from Wine Australia showed the total value of Australian wine exports to China, including Hong Kong and Macau, grew by 42 per cent in the 12 months to September 30, to total more than $853 million.

It is an enormous slice of the total Australian wine export value of $2.44 billion, nearly doubling the value of exports to the US, which came in at $461 million to be second-ranked among importers of Australian wine.

And to put the growth into context, a decade ago Australian wine exports to China were valued at just $27 million.

Currently only France exports more wine to China than Australia, making up 45 per cent of the import market, but Australian winemakers have achieved the highest average value per litre.

Several factors are driving the growth in demand, not the least of which is the continued growth of China's middle class.

Forecasts by Research group Wine Intelligence project there will be up to 160 million upper-middle-class drinkers of imported wine in China by 2025, up from 19 million in 2010.

The export growth experienced in Australia is shared by 2,102 active exporters, Wine Australia said.

These range from established large-scale operations like ASX-listed Treasury Wine Estates to individual wineries and wine regions, as well as a wide range of export-focused businesses.

TWE reported a net profit of $269 million for the 2016-17 financial year in August, shortly after reaffirming its confidence in the outlook for the imported wine market in China and the company's opportunities.

But while demand is staggering, and growing at a rapid rate, getting into the China market is not strictly a simple proposition, according to Watershed Premium Wines founder and managing director Geoff Barrett.

Mr Barrett has been exporting wine to China since 2004, with Watershed the largest exporter of wine to China based in the Margaret River region.

"Firstly, doing business in China is firstly about relationships and not about doing business," Mr Barrett told *Australia China Business Review*.

“A lot of Australian wine producers don’t get that, they go and sit down with a potential importer and within the first 15 minutes they are asking him how many bottles of wine they want to order.

“That’s not how you go about doing business in China – you have to build a relationship and sometimes that can take months.”

That process of building relationships, Mr Barrett said, could also be expensive.
“It involves going to China, and that therein knocks out all of the small producers which don’t have the fiscal capability to travel up there and come back with nothing.

“They tend to rely on wine associations or Austrade and groups like that, and you don’t achieve anything going down that path, you actually have to go out into the market.

“I’ve been there close to 30 times now, to all parts of China. It involves an extensive financial commitment over many years, and it’s only now that all of those hard years of work are starting to pay off.”

Mr Barrett said the other big challenge for Australian producers, particularly those from the Margaret River region, was having enough scale to satisfy orders.

“There is no point going there if you produce 1,000 cases per year and hope to sell 200 a year for the next 10 years,” he said.

“Because if you succeed in selling the 200, next year it’s 400, then the next year it’s 1,000, so all of a sudden you can’t supply

“Now in the context of Margaret River, what knocks most Margaret River producers out of the Chinese market is they simply don’t have the scale to enter into it in the first place.
“You’ve really only got five or six wineries down here that have the capacity to enter the market.

“And you’ve got to be able to offer ranges at a variety of price points, but some wineries down here are not interested in that process, because they don’t have a number of different vineyards and costings from their vineyards to be able to play in that market.”

Over the 13 years since 2004, Mr Barrett said Watershed had developed a comprehensive strategy to get its wines into the Middle Kingdom.

Part of that strategy was a partnership with Chinese importer Margaret River Wines, which is led by Austin Computers co-founder Li Huang and is opening a series of retail stores in China exclusively stocking Margaret River-produced wines.

Alongside Watershed there are 14 other Margaret River wineries which stock products in the retail stores – Cape Grace Wines, Flametree Wines, Wills Domain, Happs Wines, Deep Woods Estate, Churchview Estate, Hay Shed Hill, McHenry Hohnen, Forester Estate, Edwards Wines, Amelia Park Wines, Arlewood Estate, Ashbrook Wines and Woodlands Wines.

The first of Margaret River Wines’ stores opened in Beijing in January, followed by another outlet in Zhongshan, Guangdong Province, in March.

Margaret River Wines initially planned to have 10 outlets in China opened by the end of this year, but *Australia China Business Review*understands only six are currently operating.

Watershed also recently signed a partnership with another Chinese importer, which plans to open six wine stores, called Oz Rainbow, in Jiangsu Province over the next six months.

The first Oz Rainbow store opened recently. Mr Barrett said 100 per cent of the wine on its shelves was produced by Watershed.

“We have a number of other ranges outside of the Watershed range, so they have the opportunity to have quite a diverse-looking range of wines, without having it look like they have all come from the same producer,” he said.

“That’s another initiative that we’re involved in, and that’s where our client has seen fit to start opening their own dedicated wine outlets.

“It’s interesting, the shopping centre they are in, a million people on a Saturday and a million people on a Sunday go through that shopping complex, which is beyond our comprehension.”

But with the vast majority of Chinese consumers purchasing their wine online, either at dedicated marketplaces, or increasingly via social media super-app WeChat, Mr Barrett said the retail stores were not necessarily targeted at individual shoppers.

In the case of Oz Rainbow, Mr Barrett said his import partner had a significant presence on WeChat, tapping into the Chinese consumer’s preference to order online and take advantage of low costs of delivery.

“The market continues to evolve, the supply chains to consumers are far more diverse than what they are in Australia and in China, when they open a physical outlet, that’s merely a shopfront for their business – that's where they will bring in wholesale buyers," Mr Barrett said.

"They use that bricks and mortar location to demonstrate they are of substance, and as their shopfront for their business, more so than direct sales to consumers off the street.
"Because in most cases, those physical locations are not in shopping centre complexes or immediately adjacent to shopping centre complexes.

"If we were talking in an Australian context, it's more a business head office, which becomes a showroom for your products."

A strictly online approach has been the strategy of Perth-based export business Dawine, which listed on the Australian Securities Exchange in March, through a reverse takeover of dormant company Brand New Vintage.

Dawine operates a digital platform to sell wine into China, specialising in mid-level French, Australian and Chilean varieties.

Co-founder Piers Lewis, a corporate advisory specialist, said he was first made aware of the opportunity when he was approached by his now business partner Norman Lip, who had already been exporting Margaret River wines into China.
"The business was going well, and he came to me to write an information memorandum to raise some more funds for what he was doing," Mr Lewis told *Australia China Business Review*.

"We sat down, as I usually do to understand a business, what they are doing and what the opportunities are, and we got chatting about what he was making out of the deal, who he sold it to and how much they were making.

"We quickly found out that who he was selling to was making a lot more money than he was.

“That piqued our interest into the business model of wine into China, so we set up Dawine.

“It’s actually quite amazing how many people are there and in a pretty reasonable disposable income position, which is probably where wine comes into it,” Mr Lewis said. “It’s a luxury item to a degree, but an affordable luxury. I was pretty surprised by the size of the opportunity, and it’s just grown.”

Dawine’s online marketplace, its app and its WeChat channel were officially launched in June, with the company also tapping into the world’s biggest shopping spree, the 11.11 Global Shopping Festival (formerly known as Singles’ Day).

But Mr Lewis said Dawine’s strategy differed from other operators in that the company advocated a curated approach, stocking between 25 and 50 different wines at any one time.

“We only put wines on our site that we recommend strongly, and we do a lot of work on each wine that we sell, there’s quite a bit of information about each winery, the winemaker, the region and the variety,” he said.

“We put a bit more care and effort into giving information to our clients about what we’re selling.”

Mr Lewis said the extra effort was to provide an educational service alongside the export business, tapping into the growing sophistication of the Chinese consumer.

While Wine Australia data showed red wine was the dominant export in 2017, Mr Lewis said Chinese consumers were becoming increasingly adventurous in their choices, branching out beyond traditionally well-known styles and labels to lesser-known products.

And Mr Lewis said Australian producers would be well placed to take advantage of that shift in buying behaviour, particularly over the next 12 months.

“The next year will be interesting,” Mr Lewis said.

“There’s been a tightening of supply across the world with Napa Valley burning down, and France, Italy and Spain, to a degree, had low yields.

“With China’s thirst for wine growing, I’m anecdotally hearing around the traps that stock levels are reducing around Australia.”

It is not only Australian companies seeking to tap into the growing demand for Australian wine, particularly after the Australia-China Free Trade Agreement was ratified in December 2015. Part of the ChAFTA arrangement was a sharp reduction in tariffs on wine exports, which will drop to zero by 2019, after being around 14 per cent previously.

Since ChAFTA was announced, Chinese entities have been increasingly active in acquiring Australian vineyards, the most notable being the country’s third biggest winemaker, Weilong Grape Wine Company, unveiling a $120 million plan in September last year to purchase vineyards in New South Wales and Victoria.

All the wine produced at the vineyards bought by Weilong, which sells wine under the Grand Dragon label, is expected to be exported to China.

In Western Australia, an early mover in the wine space was Chinese entrepreneur Xibo Ma, who bought the operations of the collapsed Palandri Wine Group in 2008 in a deal reportedly worth around $30 million.

Palandri’s estate near Cowaramup has since been rebranded as 3 Oceans, while a Frankland River estate known as Wilkes Vineyard was also part of the deal.
The company now exports more than half of its production to China, as well as servicing the local market.

In 2011, Ferngrove Vineyards, also near Frankland River, was purchased by diversified Chinese manufacturing and food company Pegasus, owned by Xingfa Ma.

Like Palandri, Ferngrove had been experiencing significant operating losses, until an injection of capital from Hangzhou Wine Group, a subsidiary of Mr Ma’s Pegasus.
There are now more than 60 Ferngrove-branded stores operating in China, with the winery 100 per cent owned by Pegasus.

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