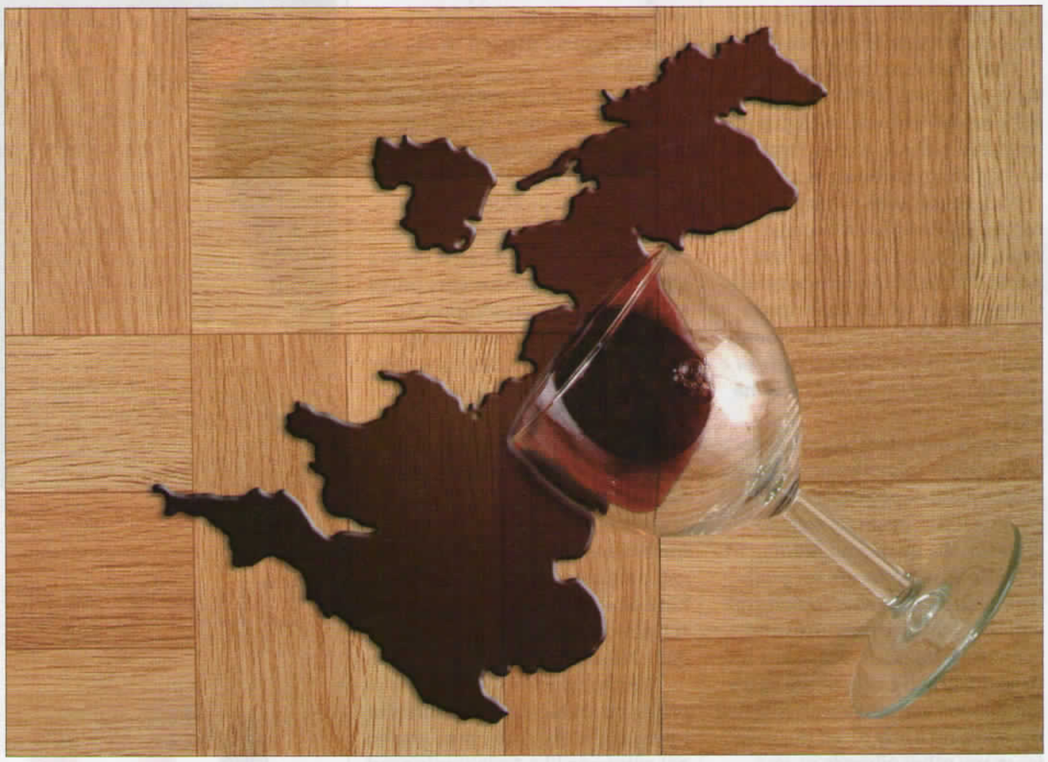
analysis WINE

What's in the stars for UK now Constellation's gone?

Constellation's exit presents a gloomy prognosis for low to mid-tier wine. What went wrong, and will there be more casualties, asks **Anna-Marie Julyan**



In 2003 Constellation paid A$1.85bn for the BRL Hardy's wine business. By the close of this month that business will be sold, along with virtually all Constellation's Australian, UK and South African brands, wineries, facilities, vineyards and a 50% interest in wholesaler Matthew Clark in a deal worth AUS$290m.

It doesn't take a maths GCSE to work out that the company has paid a hefty price to exit the UK. Figures released last week show sales at Constellation's Australian and European wine business (CWAE) fell 12% in the third quarter of last year, and to many in wine the move came as little surprise. But when the world's largest winemaker leaves the UK, it begs the question: how did Constellation reach this point, and what does it mean for the UK wine industry?

The US company is not alone in reconsidering its UK wine operations. Gallo has rationalised its brand portfolio and restructured to cut costs, while the world's second-largest wine producer, Foster's, is spinning off its struggling wine division from its more profitable beer business.

Sources close to Constellation blame poor profitability for the sale of 80% of CWAE to Sydney-based private equity firm Champ.

"The US business has been doing very well," notes one senior industry figure. "It has a big infrastructure, but is selling premium brands at premium margin. In the UK and Australia there is also a fairly hefty infrastructure, but they have been selling at entry-level prices. Margin was very low and costs were very high and they were losing money. The US business has been saying, 'We can't sustain this. We want to offload this business'."

Constellation simply wasn't making any money in the UK, agrees another senior source, who speculates that 90% of its brands are sold on promotion as part of "half-price" or 3-for-£10 or £12 deals.

Despite suggestions that volume was being driven to generate cashflow to pay down debt, he says Constellation failed to address the real issue – the need to streamline the business. "If it had rationalised the portfolio and cut out overheads a while ago, it would have made a difference." he argues. "Gallo took more than half of its people out 20 months ago. Constellation should have been tougher."

Constellation admits that profitability has been a problem. "The UK is a tough market for wine, with a number of factors affecting its profitability," says James Lousada, commercial general manager CWAE. "We have taken a number of positive steps to increase our efficiencies and margin potential here in the UK. We are committed to continued investment in the UK. Despite tough industry conditions, there is potential for growth."

Whether jobs go or not, its actions are likely to prompt others to reassess their UK interests, says Mark Tinsley, UK and Ireland sales director for E&J Gallo. "I think people are going to look at investment decisions in the UK and make difficult choices. We did, and are much better for it."

Only by reducing the number of SKUs and promotions and focusing on quality is it possible to be profitable in the UK, he says. "But of course we can afford to play the long-term game, being a privately owned company without shareholders' interests to deal with."

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The good news is that Champ thinks the UK and Australian markets have prospects, although one source describes it as a "gutsy call" given the oversupply issues that still dog Australia.

Of course, it's a global oversupply of wine that has allowed retailers to shop around. Wine prices are low and lower-end high volume wine suppliers continue to struggle. And multinationals with high fixed costs now find it difficult to run profitable wine businesses in the UK, according to Peter Darbyshire, managing director of the UK's biggest independent wine supplier PLB.

It will be survival of the fittest over the next couple of years, he says. "The efficient producers will thrive. Those with high fixed costs will have ongoing headaches." In short, Constellations is unlikely to be the last casualty.