

THE EVOLUTION OF THE RUSSIAN WINE MARKET

After the fall of socialism, writes Eleonora Scholes, Russia was opened to numerous new luxury goods, including wine – and the past fifteen years have witnessed the emergence of a highly competitive wine market with key players, thousands of brands and constantly changing consumption patterns.

For that reason, the Russian wine market remains, largely due to the lack of hard data and the age old stereotype of Russians drinking nothing but vodka, a curiosity to many observers. In absolute figures, vodka and spirits still account for two thirds of the alcoholic beverages consumed in Russia, with another quarter being done for by beer. Which leaves only 10 percent for wine.

Stereotypes aside, though, Russia is statistically far from being a hard drinking nation. In 2003 its alcohol consumption peaked at 9.3 litres per capita, placing it 19th on the world list, behind France, Ireland and the Czech Republic.

Further, Russia's relatively stable economy over the past few years is leading to a new reality. Higher disposable incomes are reversing the trends and leading to a better appreciation of wine. The beer market, in the meantime, has neared its saturation point. Its growth fell from 10 to 5 percent over the past year and appears to be slowing even further.

Only thirty years ago Russians were drinking 17 litres of wine per head each year. Gorbachev's anti-alcohol campaign of 1985 and the ensuing economic turmoil, which caused a sharp drop in personal income, nearly annihilated the wine market. By the mid 1990s wine consumption had plummeted to 2.5 litres. Vodka and spirits were seen as 'better value' alcoholic drinks. A slow recovery of the wine market began after the 1998 economic crisis. Current consumption is estimated at 5.1 litres per capita, with figures for wealthier cities such as Moscow, St. Petersburg, Ekaterinburg, Kazan or Novosibirsk considerably higher.

Currently wine is the fastest growing segment of the Russian alcohol market and is estimated at 730 million litres, having posted steady annual increases of 8% by volume and 15% by value over the past years. The Russian Winegrowers and Winemakers' Association evaluates the total wine market at 2 billion US dollars.

Despite Russia's image as a non wine producing country, it has vineyards in the south-western part of the country

between the Black and the Caspian seas. Last year they reportedly accounted for over 190 million litres of wine. Since most Russian-bottled wine is blended with imported bulk product, it is hard to define what is and isn't genuinely Russian wine. Moldova, France and Spain have traditionally been the key suppliers, but the current ban on Moldovan wines is shifting the focus to Spain, new European suppliers

and Central Asia. New World countries, notably Chile and Argentina, are losing this segment of the market, but gaining in sales of bottled wine. Total imports of bulk wine increased last year by nearly 5% to 128 million litres. Total volume of bottled Russian wine is 320 million litres. It sells mainly in the lower price bracket, at up to 150 roubles, or (€4.5).

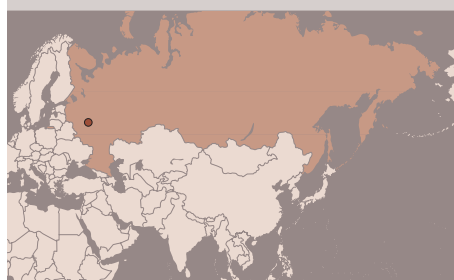
The biggest success story on the Russian market, however, is that of imported wines sold in bottles. With the exception of a short period following Russia's economic crisis in 1998, this segment has over the past 15 years enjoyed dynamic growth in terms of both volume and value. With a 25% increase over the previous year, the total volume of imported packaged wine reached 400 million litres in 2005.

Moldova, Bulgaria, Georgia and France have led the wine import charts for a number of years. The picture, however, will dramatically change after 2006 as Moldovan and Georgian wines were banned from the Russian market earlier this year, ostensibly for health reasons.

A new round for imports

Still light wines dominate the market for imported packaged wine, accounting for 93 percent of total volume. Until 2006 Moldova was the absolute market leader and supplied as much as 70% of all bottled wine. Cheap production, historic ties and favourable economic conditions have long made Moldova the prime source for the lower end of the Russian wine market. After the ban on Moldovan wines, other countries have jumped at the opportunity to fill the void, but there are limitations. New producers will have to

1	Benchmark Data	www.ru
Inhabitants:		142.4 million
GNP:		\$ 755 billion (€ 591 billion)
Currency:		RUB (100 Rubel = € 2.93)
Per capita wine consumption:		5.1 litres
Total wine consumption:		730 million litres
Legal drinking age:		18



MARKET WATCH

compete at the highly sensitive price points of 50 to 100 roubles (€ 1.50 to 3) retail, which do not leave much room for quality offers. Good prospects have thus arisen for production facilities with bottling plants inside the country as well as for the less costly wines of Eastern Europe, table wines from France, Spain and Italy and entry level ranges from Chile and Argentina.

Imported bottled wines have firmly established themselves in the medium (150 to 300 roubles or € 4.50-9.00) and premium (>300 roubles or > € 9) price segments. While the former features inexpensive wines from European and New World producers, the latter range is as good as in any other serious wine market. It thrives on the names and labels of the world's top producers, from Bordeaux first growths to New World cults.


The sparkling wine category enjoys a significant share of the Russian market, but most of that volume is produced and bottled in Russia in tanks, with imported bulk wines often blended in for good measure. Average shelf prices range from 100 to 150 roubles (€ 3-4.50). This makes Russian sparklers an affordable and highly popular drink. Imported sparkling wines, on the other hand, play only a small part in the overall category with under 10% over the past several years. In 2005, Italy was the second largest exporter after Moldova, thanks largely to Asti wines with their good visibility and adequate promotional support. The Ukraine came third with its Crimean production, while France takes fourth place, largely represented by the leading champagne brands.

Russian consumers drink 70% red wine; white wine takes about a quarter of the market, with the rest going to rosé. One particularity of the Russian consumer is that he still opts for off-dry or semi-sweet flavours, even in red wines. Dry wines play an important role only in the premium and ultra-premium categories, reflecting the more sophisticated drinking culture of this wealthier consumer group. A recent study of wine sales in Russia done by the Business

COMMENT

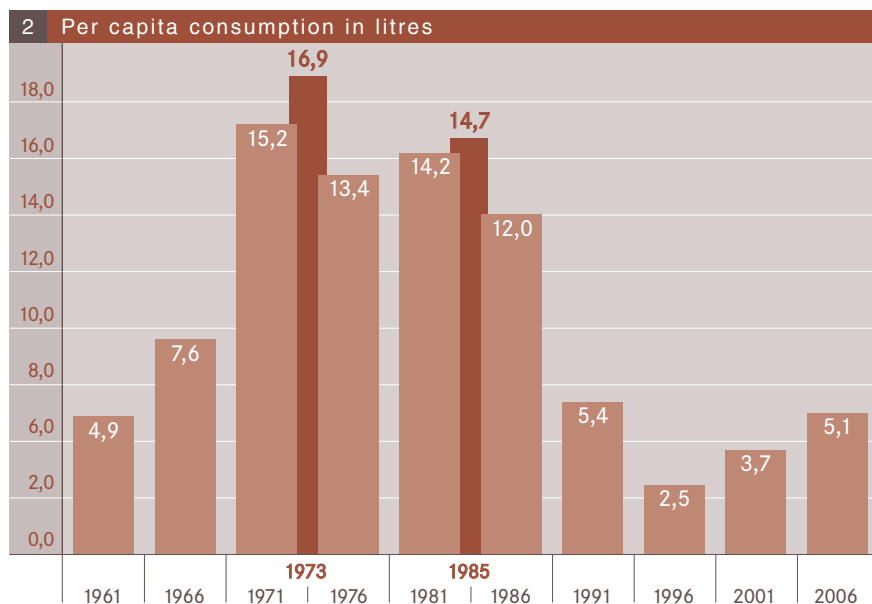
»» The market can be considered fragile, being highly susceptible to arbitrary government policy. ««

Eleonora Scholes



Russia is an exciting market, but it must be approached with caution. Too many people, from winemakers to journalists, base their expectations solely on population figures and anecdotal evidence of extravagant purchases by wealthy oligarchs. However, the reality is far more complex. It is only in Moscow and a handful of other population centres that wine sales register beyond the insignificant. Furthermore, just to get wine into the country requires navigating a mind boggling system of customs regulations that seems designed to deter even the most dedicated exporter. The market can be considered fragile, being highly susceptible to arbitrary government policy - witness the recent crisis caused by the introduction of the unified monitoring computer system. Only those with deep reserves of patience, commitment and financial resources will succeed long term in building their business in Russia. On the brighter side, the expanding middle classes are developing an interest in wine, leading to growth in sales and consumption. At present wine is the most dynamic segment in the overall market of alcoholic beverages. The initiative to provide the first legal basis for Russian quality appellations is also a sign of the growing sophistication of the sector.

Eleonora Scholes writes regularly for Magnum, Gastronom and Vinnaya Karta, where she is also on the editorial board.



3 Price Points Russia

Category	Price	€	Change
Premium	> 300 roubles	> 9.00	7%
Medium	100-300 roubles	3.00-9.00	37%
Low	80-100 roubles	2.50-3.00	13%
	50-80 roubles	1.50-2.50	28%
	< 50 roubles	< 1.50	15%

Russia's wine consumption peaked in 1973, but remained relatively high until Gorbachev's anti-alcohol campaign of 1985 and the ensuing economic turmoil nearly annihilated the market.

Analytics research agency revealed that over 50% of all sales come from the lowest segment of the market, below 100 roubles or € 3. The niche of premium and ultra-premium products remains small as well, at only 7% of the total market. Although a country with a population of 143 million, the actual income per capita is low, with the average Russian earning only 2,610 USD (€ 2,088) per year according to the World Bank. The situation is different in Moscow, St Petersburg and other key cities. Drinkers there, with much higher disposable incomes, spend more on fine wines. Moscow and St. Petersburg have the highest concentration of premium wines in their markets, reflecting the purchasing habits of a new class of wealthy consumers – and as long as world oil prices remain high, the Russian fine wine market will continue to grow.

The maze of pricing from a cellar in Western Europe to a shelf price in Moscow is kept opaque by the complex customs duties, transportation and certification costs as well as margins at the various levels of the supply chain. The excellent price plus transportation costs must be declared at customs, where 20% import duty, varying excise and 18% value added taxes are paid. Further, each label must be certified to comply with Russian wine regulations. An importer must also possess a valid license that allows him to import alcohol. A single license costs up to 100,000 roubles (€ 3,000), a general license 1.5 million roubles (€ 44,500).

Importers' margins are generally dictated by the type of wine being sold. Products for the low end of the market generally have a higher turnover, and thus the margins stay lower at 10-30%. Wholesalers add another 10% to importer's price. The pricing for premium wines is, however, different. The importer's mark-up is generally 25-35%, sometimes up to 50%. Shops add another 50%, while a restaurant can multiply the wholesale price by 2 to 3 for expensive bottles, and up to 6 for entry level wines. ■

»» The market for fine wine is bound to the world oil and Russian real estate prices. ««

Dmitry Pinsky, DP-Trade

Before 1991 export-import operations were restricted to state owned companies. By 1994, when we entered the wine business, there were but a few companies importing mostly big brands. In the fine wine sector we counted only three competitors. Since the import taxes were very high, they were almost all illegal. Excise tax, for instance, was 46.5% on the declared invoice value.

In August 1994 the authorities changed the system of import taxation and introduced more specific import duties. Instead of the ad valorem system, import duties were then derived as a percentage of pure alcohol, making them negligible for still wines. Excise taxes became more specific and were as small as the import duty. However, in 1996 the ad valorem system was reintroduced and the import duty was increased to 20%. Excise taxes remained small.

The next crucial point came during the financial crisis in 1998. The rouble was devaluated four times against dollar, which greatly distorted the development of the wine market. Demand was strongly reduced. The market remained slow until 2001. Since then it had been steadily developing until the recent introduction of the new excise stamps and unified monitoring computer system (EGAIS), with the well known effects. My general forecast for the Russian market of fine wines is inextricably bound with the world oil and Russian real estate prices. They, in turn, are directly linked to the global economy – and to the Russian elections in 2008. Any forecasts are thus highly unpredictable.



4 Bulk imports by country in litres

Country	2004	2005	Change %
Moldova	55.11m	41.81m	- 24.1%
Spain	18.96m	37.98m	+ 200.3%
France	22.52m	23.01m	+ 2.1%
Uzbekistan	1.48m	11.37m	768.0%
Argentina	15.23m	11.14m	- 26.8%
Italy	-	1.51m	-
Ukraine	5.03m	0.93m	- 81.5%
Hungary	0.02m	0.09m	450.0%
Chile	1.39m	0.07m	- 95.0%
Australia	2.10m	-	-
Others	0.16m	-	-
Total	122.01m	127.92m	+ 4.8%

5 Packaged wines by type in litres

Type	2004	2005	Change
Still wines	299.27m	376.50m	+ 25.8%
Sparkling wines	11.73m	12.25m	+4.4%
Aromatised wines (vermouths)	15.33m	17.13m	+11.7%
Total	326.33m	405.88m	+24.4%

As Moldova and Georgia are eliminated from the market, next year's statistics will look quite different. Bulgaria will be one of the winners, but who else?

6 Bottled Imports

Country	2004	2005
Moldova	58.9%	51.3%
Bulgaria	12.3%	16.6%
Georgia	7.8%	8.9%
France	5.2%	5.8%
Spain	3.7%	3.5%
Ukraine	2.5%	2.8%
Argentina	1.6%	2.3%
Germany	2.2%	2.2%
Chile	1.5%	1.9%
Italy	1.6%	1.8%
Others	2.8%	3.0%

RUSSIAN IMPORTER WANTED

Although there has been steady growth in wine consumption over the past years, the modern history of the Russian market is a story of survival for those who dared to import quality wine into what was a vodka drinking country. Only a few of the strongest have survived and they are still making the wine world go round. By Igor Serdyuk.

Wines and spirits are brought into Russia by 126 importers, of whom just 16 control 65% of the total volume. An already visible trend in the consolidation of imports was fostered by the government, which was actually looking for a means of stricter control of the wine and spirits market; but as legislation has made it too expensive and bureaucratically complicated to be an importer, the new regulations have pushed the market towards even further consolidation. Since the new laws were enacted, several importers and wine merchants have decided to sell their businesses.

While most major importers have their own distribution systems in Moscow and St. Petersburg, they prefer to work with local distributors in other cities. Although Ekaterinburg, Krasnoyarsk, Novosibirsk, Kazan, Rostov, Krasnodar, Samara and Nizhny Novgorod are promising markets, Moscow still accounts for half of the premium wine and spirits consumption in the country. Normally, each of the regional markets is divided between 2 or 3 companies, but sometimes only a single wholesaler enjoys a de facto monopoly on his local market. This has led to a paradoxical situation where imported wines are visibly overpriced in regional markets with lesser buying power. Very few capital-based companies have tried to overcome local protectionism and build their own distribution in these regions. Rusimport is, in that sense, an exception. The firm has been aggressive in offering regional markets a complete range of brands at lower cost.

Importers can basically be divided into several categories. First, there is a group of large international companies like Diageo, Pernod Ricard or Bacardi Martini, which have offices in Moscow and work with a selection of large wholesalers, like Rotor House, AST or the like, who are themselves starting to import other brands. Moët-Hennessy has recently launched a joint venture with its former exclusive importer, Whitehall, as the latter continues to import and distribute an ever larger portfolio of wines and spirits. Secondly, there is a caste of major importers who have the lion's share of the premium wine segment, but sometimes combine quality products with faster moving, more affordable wines and spirits. Some of them, like DP-Trade, Simple, MBG, United Distributors or Veld-21, have an elitist image; whereas others, like Vinikom, Alianta or Rusimport work with a wider range of products. Then, there are niche importers like Vintage-M, Vinoteka or Palais Royal who are quite

comfortable serving a smaller number of restaurants or private clients with their boutique wines.

Importers create advertising and marketing budgets using both their own margins, which occasionally reach 100 %, and budgets coming from suppliers. A large part of these monies, though, are not spent on what would normally be called marketing or advertising. The rules of the game oblige importers and distributors to pay ever more for the so-called "entry tickets" or listing fees, offering the right to place their bottles onto the supermarket shelves or to include them into the restaurant wine list. Very few retail chains have a specialist wine buyer assigned to select their products, preferring instead "special deals" with suppliers. The on-trade segment essentially works in the same way. In theory, consumers should vote with their purchases for the best value for money, whether in shops or on wine lists, but legal restrictions on wine and spirits advertising make consumer education difficult and slow.

According to law, advertising any alcoholic drink, with the exception of beer, is prohibited anywhere but in the places where those drinks are produced or sold. This law leaves the operators the opportunity to publish their ads in specialized publications that are distributed mainly in shops and restaurants; but at the same time it limits the expansion of the specialized press, which does not yet have a critical impact on mass consumer habits. Some of the glossy magazines with larger print runs nonetheless ignore these restrictions and accept advertisements from brands in one or two issues each year. When doing so, they include the expected fine into the price of an ad, but risk at the same time losing their publishing license.

Promotional tastings instead of advertisements

Under these conditions, tasting sessions remain the main form of promotion for premium wines and spirits in Russia. Importers use them quite often, but most are reserved for a limited number of professional sommeliers, wine merchants and journalists. Although many wine merchants organize tasting events for their best private clients as well, a major wine event for consumers has not yet been held. The first Moscow Wine Open Air festival, which had planned to attract a few thousand wine lovers over two days, was scheduled for last summer, but it was postponed until next May because of the excise banderols crisis.

French wine producers have historically been the most active in promoting their wares. Although they could not legally import bottles for presentations this autumn because of the shortage of tax banderols, they used diplomatic channels and organized several events in the French Embassy in Moscow. Roussillon was followed by Burgundy, Bordeaux Grands Crus and the traditional Beaujolais Nouveau events.

An increasingly dynamic Italian wine industry is also trying to promote its products here. Impressive two day presentations were organized last spring in Moscow and St. Petersburg by ICE and Veronafiere. Spain is a far younger participant on the market, but a series of Brandy de Jerez promotions across Russia as well as the Spanish Wine and Food Show in Moscow were a good start. The California Wine Institute has run an important professional tasting at ambassador's Residence in Moscow. A similar programme was tested by the ProChile organization, but, according to importers, it did not have much relevance because the market was already oversaturated.

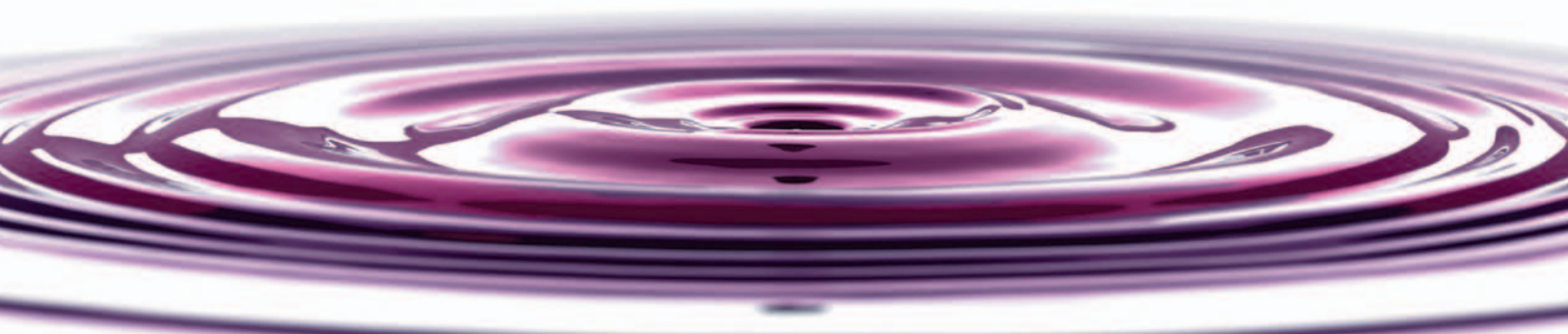
Failing to overcome numerous technical and logistical difficulties, the Moscow Wine Fair was cancelled this year, but two of the remaining wine and spirits trade shows scheduled for this autumn, were still held. Interdrink took place on November 7th to 9th at the Expocenter, and was followed by Drinks Industry on November 21st to 24th at Crocus Expo centre. The more consumer-oriented Food

COMMENT

»» **Russia never had enough vineyards to provide wine lovers with sufficient decent wine.** ««

Alexander Sharikov, CEO, Vinikom

Having created a diverse portfolio of internationally renowned brands, from Louis Roederer and Mouton Cadet to Freixenet and Tenute di Toscana, Alexander Sharikov has led his company from the purist image of a refined importer on an uneasy path to wine producer. Vinikom owns a winery near Anapa, on the Black Sea coast, and the Russlaya Loza - Russian Vine - brand, which became a national best-seller in 2005. Sharikov believes that he has found truly unique soils where he can produce world-class wine and has plans to build a modern winery near the vineyards he planted four years ago. „Russia never had enough vineyards to provide wine lovers with sufficient decent wine,“ he says, „so our market has always been dominated by imports. However, if Russia joins the WTO it will probably kill the domestic wine industry, which cannot yet compete with imports.“



A lovely drop of wine.

MARKET WATCH

Show, which is to take place on December 1st to 3rd in Gostinny Dvor, also counts on the participation of wine and spirits companies.

With the exception of certain niche players, most importers divide their assortment into the on-trade and off-trade parts. Although the off-trade sells over 70% of wines and spirits in Russia, bars and restaurants are steadily increasing their share, especially in premium and super-premium categories. Logically, at least in Russia, the higher the price of the product, the better it sells in restaurants. Some importers try to reserve their best brands for on-trade only, but very few of them can resist the temptation to move volumes off-trade. For that reason, even Sassicaia is often seen on supermarket shelves.

However, the truth is that supermarkets differ widely in Russia. Even in a single chain like Perekrestok, or 7th Continent, there are better located, more expensive stores with margins of up to 70 to 80 per cent and inexpensive stores with more affordable 30 to 50 per cent margins and the corresponding range of goods. Other supermarkets, like Azbuka Vkusa, Megacenter Italia or Stockman are targeting wealthy, more sophisticated consumer, whereas still others, like Kopeika, are discounters. A newer, fashionable category of retailers – luxury grocery stores – is represented by Globus Gourmet chain, which sells brands like Hediard, Fauchon, Fortnum & Mason as well as some local specialities.

COMMENT

»» Wine is becoming less attractive a theme for occasional adventurers - that will help the consumer. ««

Valery Filatov, CEO, United Distributors

Valery Filatov started his business as one of the most successful grocery wholesalers, but soon realized that wine deserved a special business division. He has since built a collection of fine wines and spirits for the on-trade sector and high-end retailers, including Champagne Billecart-Salmon that he has taken to almost prestige status. His business – including his strong Australian portfolio – suffered from the consequences of the new regulation system, just as did everybody else's, but he is convinced that consolidation will make the market healthier and more transparent. „Wine is becoming less attractive a theme for occasional adventurers,“ says Valery. „That will help a consumer to feel more comfortable, more confident about his choices.“ To that end he will soon be launching a high profile consumer magazine.



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One of the most remarkable phenomena in the on-trade sector is the success of the first Moscow wine bars, which are positioned in a booming middle price segment. However, more expensive restaurants and fashionable lounge bars remain dynamic and continue to be an attractive point of sale with a nice showcase for fine wines.

The major chains of wine boutiques are often affiliated to the importers, such as Whitehall (Kauffman Collection), DP-Trade (Magnum, Vinum et cetera), Veld 21 (Vinoteca Paradis), Simple (Grand Cru), MBG (Intendant). Interestingly, some independent wine retailers such as Kollektiya Vin (Wine Collection) or Aromatny Mir (Aromatic World) have also started to import some products, considering exclusivity as their best possible marketing advantage.

Despite very high rents, launching a wine boutique has long been a good investment. Well-managed, it begins to pay back in about a year. Importers, however, who own such shops, consider them not only as business units, but also as promotional space for marketing actions. As a wine boutique attracts consumers' attention and thus brings value to the image of the wine importer or merchant, several have started thinking about the branding of their companies, realizing that their old names did not carry any message to the final consumer. Whitehall company owner Mark Kauffman was the first who created a new brand, Kauffman Private Collection, putting this logo on his wine boutiques and on the selection of fine wine and spirits from the company's portfolio.

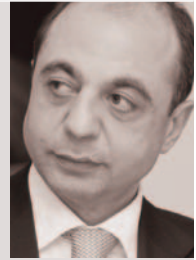
Wine and spirits importers are rethinking not only their marketing messages, but also their portfolios, trying to replace banned Moldovan and Georgian wines with affordable values from southern Russia or other countries. Most Russian wineries, however, have yet to recover from a series of dramatic collisions, from Gorbachev's prohibition of mid-eighties to the hyperinflation of the early nineties. They await not only new equipment, but also a new generation of winemakers with quality-driven mentalities. When all is said and done, though, it is the Russian wine consumer who decides. While local wine production at the low end of the segment decreased by 18% in 2005, imports in the middle range and high end grew by 25%. In addition, the cold winter of 2005 to 2006 ruined some of the vineyards, so the decrease in Russian wine production may continue in 2006.

According to official statistics, the local production of wine in Russia is about 320 million litres - but a significant part of that is made from imported bulk wine. Official imports are 380 million litres, but are likely to be underestimated. The value of imported wine and spirits grew more than 35% and reached \$1.3 billion in 2005. Imported wine accounted for about 41% of this volume. Before 2006 more than 50% of that volume was imported to Russia from Moldova. The Georgian accounted for 8-10%, similar to the French market share. ■

»» It is our challenge to introduce wine to consumers who are curious, but not yet wine lovers. ««

Armen Grishkian, CEO, Alianta Group

Armen Grishkian was one of those who began to reconsider his company's portfolio about three years ago, adding premium brands to cheap Moldovan wines. He was one of the first in Russia to endorse South African wine and has been quite successful. That was prescient. When Moldovan and Georgian wines were banned last spring, he replaced them quickly with entry level price points from both Europe - where he is particularly strong with his Spanish portfolio - and the New World. He is now devising a concept for a new wine retail chain based on a selection of accessible wines at consumer friendly prices. „Russian consumers should not be afraid of wine,“ says Grishkian. „It is our challenge to introduce wine to consumers who are curious, but not yet decisive enough to identify themselves as wine lovers.“



HEADING EAST

That Eastern Europe's once flourishing wine culture is again on the rise, is clear to anyone who has spent time in Moscow or Warsaw; but it is not only there that change is taking place. A fresh wind is blowing through the Ukraine, the Baltic States and the Czech Republic as well. As in the markets of their larger neighbours, the populations of these countries are seeing their disposable incomes growing, too. Those countries and producers who neglect these markets today may well pay the price a few years down the road.

Similarly, the wine industries of Hungary, Romania, Bulgaria, Slovenia and Croatia have begun to bottle wines worthy of their peers further west. Until today, most attention has been focused on value for money, but already numerous estates are able to compete in the first league. It will take time for them to corner market share beyond their domestic sales, but their significance should not be underrated.

In coming issues follow articles on the Ukraine from by Evgeniya Rodionova, on Lithuania by Algirdas Pateckas, on Hungary by Mario Scheuermann and Norbert Bordokos, on Slovenia by Robert Gorjak, on Croatia by Zeljko Suhadolnik and Bulgaria by Elissaveta Velianova, to name but a few. With highly experienced, well-respected eyes and ears based locally across Eastern Europe, we shall continue to keep you abreast of the important developments and trends in their markets. ■