



Deal Brief:
Argentine Vineyards

For so long a ‘sleeping giant’ in the wine industry, Argentina is now creating a buzz on world markets. The largest Latin American producer—and sixth biggest in the world—is one of the hottest prospects as its intense, high-altitude wines and competitive costs seduce collectors and supermarket shoppers alike.

Drawing on extensive research and interviews with industry experts, this ‘deal brief’ will examine why the international wine community is focused on Argentina right now, how this is stirring interest in vineyard real estate in the South American giant, and what are the different assets available for investors.

The Heady Rise of Argentine Wine

Despite nearly 500 years experience of vine cultivation, Argentine wine only really started to appear in the mainstream US and European markets in the last decade. The economic crisis and mega-devaluation that stung the Latin American country in 2001-2002 suddenly opened up an export market that had long been considered secondary to the needs of domestic consumers.

A wave of foreign investment—bringing both increased capital and the transfer of expertise from successful New World producers like Napa Valley and Australia—accelerated Argentina’s rise into the big league of global wine producers.

The statistics tell the story

Over the last decade, its share of the global wine market more than quadrupled (from under 1% to 4%).

Imports of Argentine wine into the US rose an astonishing 88% between May 2007 and August 2010. Argentina is now the fifth biggest importer into the States and its share

of the US wine market has been growing at a healthy rate for the past three years. Sales in dollars rose 38% year-on-year in the twelve months running up to April 2010, despite the recession.

Key to Argentina’s recent success is its ability to sell popular wine of comparable quality to Old-World European producers at knock-down prices—a factor that took on added significance during the global economic crisis, when Argentine wine developed a loyal following among increasingly frugal consumers.

According to wine expert Professor Liz Thach, bottles of Argentine wine in the US are typically sold at an attractive price point at around \$8-\$10. This undercuts wine from traditional European suppliers like Italy and France, but doesn’t fall into the ‘cheap’ category, which can generate its own problems. Chilean wineries, for example, are now struggling to rebrand themselves as premium producers after successfully targeting the low end of the market for over two decades.

The other driving force behind Argentina’s rising status in international wine markets is the remarkable critical and commercial success of its signature variety: Malbec.

Mighty Malbec

A few years ago, one of the world’s premier wine critics, Robert M. Parker Jr., made a bold prediction about Argentine Malbec: “Both inexpensive, delicious Malbecs and majestic, profoundly complex ones from high-elevation vineyards are already being produced... and by 2015 this long-ignored grape’s place in the pantheon of noble wines will be guaranteed”.

Since then, the delicate French grape, which found the ideal home in the high-altitude vineyards nestled against the Andes

Mountains, has become synonymous with Argentine wine and is spearheading the country’s viticulture revolution.

Its intense, fruity flavours, coupled with its exotic origins and novelty value, has turned Malbec into the wine du jour among the young, open-minded consumers that are driving a renaissance in the US wine culture. As a result, in 2009, Malbec varieties accounted for almost four fifths of Argentine wines sold in the US, with sales in that year alone increasing by around 50%.

Yet, despite Parker’s assertion, this exponential growth has caused many to fret over the sustainability of



Source: ACNielsen Scan Data by Dr. Cuellar, 2010

the 'Malbec craze'. Professor Thach expects Argentina's signature drop to survive the fickle cycle of fashion and become a long-running success as a 'classic' red wine.

Still, the key challenge for winemakers in Argentina now is to convert Malbec's moment in the limelight into a long standing appreciation for all of the country's varietals, a process that is already underway. Although still relatively unheard of in the US and Europe, Torrontés is already being hailed as the country's flagship white, while Bonarda, which for decades was produced in bulk as table wine, is benefiting from the more sophisticated techniques and higher standards now established throughout the industry. Both are well positioned to follow up on Malbec's success, though it will be some time before any have quite the same cachet.

Experts like Professor Thach agree that even more traditional varieties like Cabernet Sauvignon and Pinot Noir have considerable potential in Argentina, where the unique geography, climate and soil can combine to create interesting versions of these classics.

The Vineyard Attraction

The buzz around Malbec, and Argentine wine in general, has created a flurry of interest in the land on which it is grown. Investments by foreigners in Argentine vineyards—particularly in Mendoza, the country's wine stronghold—have grown considerably in the last five years, with people drawn for a variety of reasons.

Lifestyle

For many, the romantic notion of waking up on their own private vineyard and drinking home-made wine is enough of a draw. Argentina's principal wine regions are clustered on the foothills of the Andes Mountains, where the pure air, breath-taking views, and year-round sunshine make for an attractive holiday home destination.

Asset diversification

Scott Mathis, CEO and President of Algodon Wine Estates, says an increasing number of people interested in buying a vineyard are motivated by the simple prospect of obtaining an asset away from the increasingly shaky US dollar and euro holdings. While emerging markets—and especially the BRIC countries—are becoming increasingly important in US asset portfolios, it can be difficult for individual investors to penetrate the numerous barriers to entry and find something tangible. Property is one of the easier ways in, and with credit financing virtually non-existent in Argentine real estate, the risk of holding land is lower in the current climate than in highly leveraged markets.

Market potential

Though Malbec is currently taking the US by storm, Argentine wine accounts for less than 7% of the total import market, and still trails New World producers such



as Chile and Australia in sales volumes. There is also huge potential for growth in Asia, and China in particular, as the increasingly outward-looking middle class develop a thirst for wine. Neighbouring Brazil arguably represents an even bigger opportunity due to its size, proximity and blistering economic growth.

Aside from wine production, Argentina's rising fame as a wine producer is spurring activity in complimentary sectors. The rapid development of wine tourism, for example, presents business opportunities for vineyard owners, especially as the government is backing the expansion of this sector via publicity campaigns and infrastructure upgrades.

Price

Whatever the initial motivation, the main advantage Argentina has when it comes to investing in vineyard real estate is price. Even though costs have risen sharply in the last five years, buying a vineyard in Mendoza or Salta will still cost a fraction of a similar purchase in Napa Valley or Southern France, where the investment will invariably run into tens of millions.

Real estate values compare favourable even to other New World wine producers, such as Chile. The government policy of maintaining a competitive and stable exchange rate (currently hovering close to 4 pesos per \$1) to stimu-

late exports makes buying a plot of fertile land, or even an established vineyard, far more accessible for individuals.

Possible Investments

Investors aroused by the investment opportunity and the lifestyle that comes with the capital allocation, have three types of assets available in the Argentine vineyard market and particularly in the province of Mendoza: (i) estate vineyards, also known as “boutique bodegas”; (ii) vineyards; (iii) boutique turnkey vineyards.

The first two options are targeted mainly by investors with a visible passion for wine, a long term investment horizon and a will to commercialize internationally their own high quality brands of fine wine. These are high net worth individuals willing to pay the purchase price and also commit an extra amount of capital to maximize the productive capacity of the asset (from conducting further soil studies, to preparing the land and hiring whatever extra workforce may be needed).

These investors must enter the market with legal and financial advisors as their investment will require commercial and legal due diligence processes (please refer to Moving forward for an illustrative guideline of the aspects involved in a due diligence process) which are followed by financial projections and modelling. They will be also advised by wine production and commercialization experts as any financial projection will be based on the execution of a carefully structured international marketing and distribution strategy and on the analysis of the cost structure of the enterprise.

In these cases the seller can be looking to divest or for a new partner. Whichever the case may be, it usually advised to an investor buying into a Latin American business to manage the due diligence and price negotiation process with care and patience as many family-owned companies might have never felt the need to maintain sophisticated accounting systems or perform complex marketing analyses.

As for the third type of asset available to investors, this is most sought after by investors who are also passionate for wine and are mainly looking for a capital appreciation investment. The lifestyle element that these new real estate developments manage to offer also appeals to these investors.

Estate vineyards

Our research has shown that the purchase price for these assets of typically more than 100 acres, is usually,



as was previously stated, very attractive when examined against comparable assets in the US or Europe. It should be stated also that the initial investment generally needs to be supplemented by further capital infusion to fully take advantage of the resources acquired.

The income of these vineyards can derive not only from the commercialization of their production but also from the annual operations of boutique hotel, a restaurant, and other activities linked to oenological tourism.

The state of the wineries vary, investors might find themselves with a few hundred thousand liters of wine in storage and state of the art technology or they might need to do some recycling of the winery infrastructure.

Vineyards

These are properties of more than 70 acres because less is uneconomical. As what happens with the estate vineyards the initial purchase is usually followed by further capital allocation needed for the optimization of the asset's productive capacity.

While these properties come with some “brick and mortar” real estate for the workforce to live in and for equipment storage, they might have also potential for the construction of a boutique hotel and/or a restaurant to seize some of the increasing flow of tourists in the region.

The Turnkey Option

As was said, after the initial purchase, running a vineyard is costly, time consuming, physically demanding and requires a great deal of specific expertise.

But innovative entrepreneurs have developed a fast track into the industry for wine lovers without any experience in vine cultivation. Boutique turnkey operations divide a large vineyard estate into smaller lots which are then parcelled off to individual investors. Each lot comes with the community's team of oenologists, accountants, and farm workers that work from the initial survey of the property to the harvest and assist with the day-to-day upkeep of the land and vines, thereby sharing the collective operational and administrative costs.

These developments usually have a state of the art winery where the harvest of the lots is taken to and high quality wine is produced.

Moving Forward

The following is an illustrative guideline of the aspects involved in a due diligence process:

- commercial information provided by the seller;
- vineyard layout;
- survey of the property v. title deed – appraisals;
- vineyard infrastructure (soil condition, irrigation and water canals, rows, posts, wiring, grapevine protectors);
- winery infrastructure (equipment and procedures, sanitary operations, facilities and controls).
- environmental regulations;
- access to the property;
- various legal issues such as encumbrances affecting the property, employees' status, litigation, corporate documents, inter alia.

Final thoughts

The scenario for investments in vineyard related assets is certainly very appealing. It is clear though that allocating capital in these cases requires a respectable amount of time and resources yet the international markets have started to show solid interest in the wine coming out of Argentine bodegas and few things are more alluring for a wine aficionado than the production of his/her own fine wine.

We have assembled a team to help you and your team dissect and analyze every aspect of investing in an Argentine vineyard. We look forward to your questions and/or comments.



Respectfully yours,

*Patricio Abal
Director of Business Development
Capricorn Research Group*