



**BANK OF GEORGIA
RESEARCH**

Georgia's Wine Sector

Wine is Bottled Poetry



Georgia | Consumer Cyclical | Wine

Industry Overview

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Ekaterine Gazadze

Head of Research | egazadze@bog.ge | +995 32 444 444 ext. 3760

Giorgi Nakashidze

Senior Associate | gnakashidze@bog.ge | +995 32 444 444 ext. 3751

"Wine is bottled poetry" – Robert Louis Stevenson

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Terms and Definitions

AOC – Appellation of Controlled Origin (Appellation d'Origine Contrôlée)

CIS – Commonwealth of Independent States

FAO – Food and Agriculture Organisation

FAS – Foreign Agriculture Service

GeoStat – National Statistics Office of Georgia

GI – Geographic Indication

GNTA – Georgian National Tourism Agency

GWA – Georgian Wine Association

IWSR – International Wine & Spirit Research

IWTC – International Wine Tourism Conference

MESD – Ministry of Economy and Sustainable Development of Georgia

New World – Indicative Classification of Wine Producing Countries including USA, Australia, New Zealand, Argentina, Chile and South Africa

NWA – National Wine Association

OeMv – Spanish Observatory of Wine Market

OIV – International Organisation of Vine and Wine

Old World – Indicative Classification of Wine Producing Countries including France, Italy, Spain and Germany

PAP – Preferential Agrocredit Project

PDO – Protected Designations of Origin

TDA – Trade and Data Analysis

TRIPS – Agreement on Trade Related Aspects of Intellectual Property

USAID – United States Agency for International Development

VINEXPO – International Wine and Spirits Exhibition

WB – World Bank

WFW – World of Fine Wine

WIPO – World Intellectual Property Organization

WTO – World Trade Organization

Executive Summary

Georgia has a rich, 8,000-year history of wine-making and is home to over 500 unique grape varieties. Currently, 40 indigenous types are used commercially and the most popular of them – Saperavi (red) and Rkatsiteli (white) – produce some of the country's most recognized and sought-after wines, like Kindzmarauli, Mukuzani, and Tsinandali. In the recent past, Georgian wine production was directed mainly at Russian-speaking markets. This led semi-sweet wines, which are not widely consumed in Georgia, to account for about half of Georgian wine exports.

Georgia has the potential to produce over 500mn liters of wine annually, ten times higher than the current volume. This can be achieved if all historically utilized land for vineyards is re-planted and grape yields increase to 5.5t/ha (as in 2007). Over the past 30 years, Georgia's total vineyard area nearly halved from 90,000ha to 50,000ha and volume output dropped from 125mn liters to 50mn liters. As the fall of the Soviet Union brought an end to government subsidies, demand dropped and infrastructure deteriorated, causing farmers to scrap grape cultivation. Current grape yields are also low at 3 t/ha, around 1/3 of the global average. Technologically unsophisticated production methods, the low yields, and a lack of consistency in price and quality resulted in an underutilization of the country's wine-producing potential.

A number of semi-sweet and Saperavi-based reds and unique dry whites produced in ancient qvevris (ancient clay casks) have high commercial potential. Semi-sweet reds like Kindzmarauli and Khvanchkara accounted for 60% of all wine exports in 2013. They are especially popular in Russian-speaking countries after having gained a foothold during the Soviet period. In December 2013, the traditional Georgian qvevri wine-making method won a place on UNESCO's Intangible Cultural Heritage of Humanity list. Qvevri wine, made according to old Kakhetian or Imeretian winemaking traditions, leaves higher tannin content and is considered a natural antioxidant.

Following the Russian embargo in 2006, the Georgian wine industry made major progress in entering more competitive and non-traditional markets. As a result, the wines' quality and image, as well as the industry's infrastructure and regulations, improved sharply. Wine exports to Ukraine, Latvia, Poland, and China grew at 19%, 19%, 30%, and 49% CAGRs, respectively, in 2005-2013. These 4 countries accounted for 32% of all wine exports in 2013, leaving room for further growth. In addition, the re-opening of the Russian market in 2013 provided a boost to the Georgian wine industry: up to 23mn bottles (c. 17mn liters) were exported to Russia in 2013 (49% of total wine exports).

The domestic market for bottled wine is another growth driver, with consumption having more than doubled in 2013 to US\$ 46mn from US\$ 22mn a year earlier. Growth factors include a shift in consumer preference towards bottles over jugs and an increase in the number of international visitors (5.4mn in 2013, up from 1.5mn in 2009). Tourists in Georgia normally drink bottled wines in restaurants and also buy some to take home. Wine tourism has the potential to be a year-round activity that would provide an additional revenue stream for wineries. We conservatively expect 270,000 wine and food tourists to arrive in Georgia's annually as of 2019, up from 110,000 currently. In March 2014, Tbilisi for the first time hosted the International Wine Tourism Conference, attended by over 250 industry representatives from over 25 countries, and Georgian wine is starting to gain real international recognition and critical acclaim.

The wine sector is once again becoming an attractive part of the Georgian economy, with the value of wine exports doubling y/y in 2013 to US\$ 141mn. Wine accounts for 5% of all Georgian exports and holds real potential to grow further. On the demand side, increasing tourism and changing local consumer tastes are pushing demand for bottled wine domestically. Exports will remain strong after Russia re-opened its market in 2013 and as other markets (e.g. Ukraine, China, and the Baltic states) continue to show robust demand. On the supply side, there is significant room to increase production and meet higher demand by re-planting vines and improving grape yields through more advanced farming techniques.

The Georgian Wine Sector

Georgia has a long and rich history of wine-making, with over 500 unique grape varieties. Only 40 of these are used for commercial wine-making and many have gained recognition in Western markets, including Rkatsiteli, Kakhetian Mtsvane, Saperavi, Tsolikouri, Alexandrouli, Mujuretuli, and others. Georgia's latitude (parallel 42° N) places it in the same circle with some of the famous winegrowing areas in the US (California/Oregon), Italy (Tuscany), and Spain (La Rioja).

Georgia has a favorable climate for wine production. However, climate conditions, notably precipitation patterns, result in an uneven distribution of production. Eastern and southern regions depend on irrigation, while western regions need drainage. Kakheti, in the east, has always been the most important viticulture region, supplying around 75% of grapes for wine production, producing over 68% of wine by volume, and boasting the largest area of arable land. Georgia also has 18 zones of Protected Designations of Origin (PDO), an equivalent of the French Appellation d'Origine Contrôlée (AOC). The rules of production are stricter in these areas, but the resulting wines can be sold at a premium. Of the 18 zones, 14 are in Kakheti, 2 are in Racha-Lechkhumi, 1 is in Imereti, and 1 is in Inner Kartli (pg. 24-25).

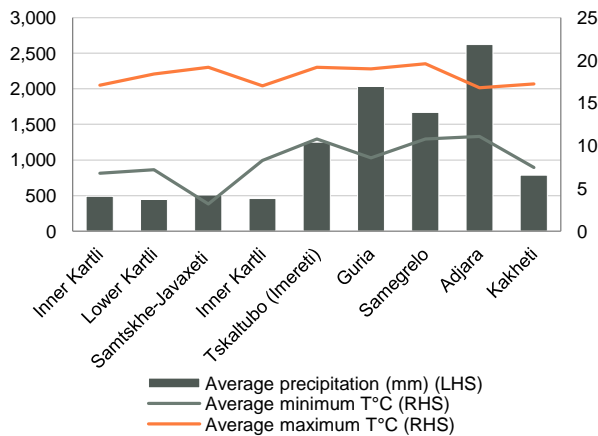
Map 1: Most common grape varieties by wine-making region



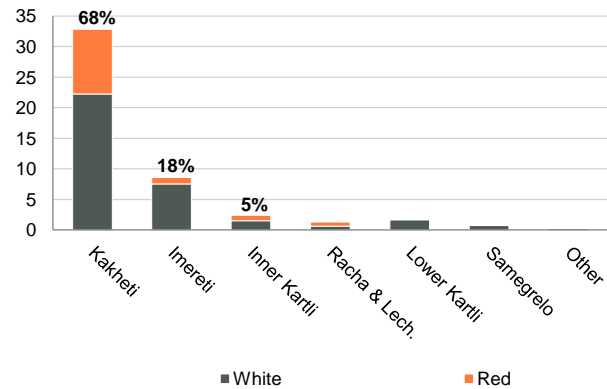
Note: Currently vines in Meskheti region cover a very small area with Natenadze's Wine Cellar being the only producer making small quantities of Meskethian wine

Source: Georgian Sommelier Association; "Georgian Wine Guide" by Malkhaz Kharbedia

Precipitation rates are highest in the western part of the country. Climate zones are determined by distance from the Black Sea and by altitude. In the west, at higher elevations, precipitation is sometimes twice as high as in the eastern plains. Droughts during the growing season are not uncommon, occurring every 3-4 years. Irrigation helps ensure uninterrupted agricultural productivity. Hail is also characteristic in all parts of the country but is more common in the east. There are 5 to 15 hail storms annually, damaging 0.7-8.0% of agricultural lands. As grape-growing requires significant amounts of sun, the areas with the highest precipitation are naturally not the largest grape producers in Georgia.

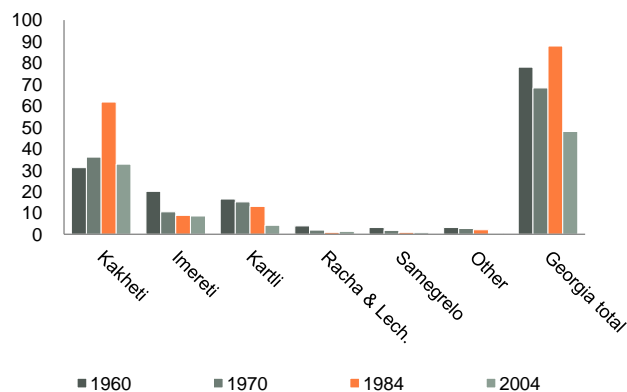
Figure 1: Precipitation and temperature by region


Source: MoA; BoG Research

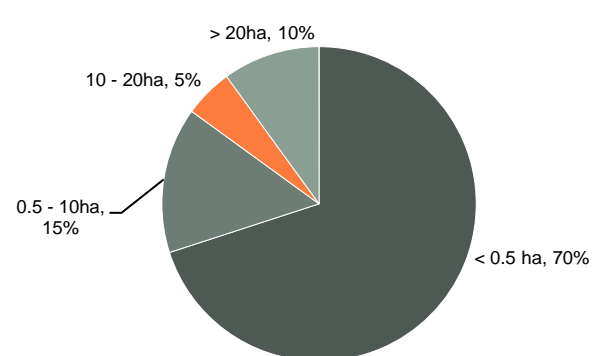
Figure 2: Vineyard area by type and region ('000 ha), 2004


Source: GWA

Georgia's total vineyard area declined from 90,000ha to 50,000ha over the past 30 years. The decline in vineyard area is mainly attributable to a lack of resources, as it became commercially unviable to continue cultivating grapes after the collapse of the Soviet Union. An end to subsidization, a decline in demand, and infrastructural deficiencies all dis-incentivized farmers from growing grapes. In addition, the age of the vineyards in the 1990s was a significant contributor to the decline, as old Soviet vineyards, some of them up to 50 years old, couldn't cover costs due to weak yields.

Figure 3: Vineyard area by region ('000 ha)


Source: GWA

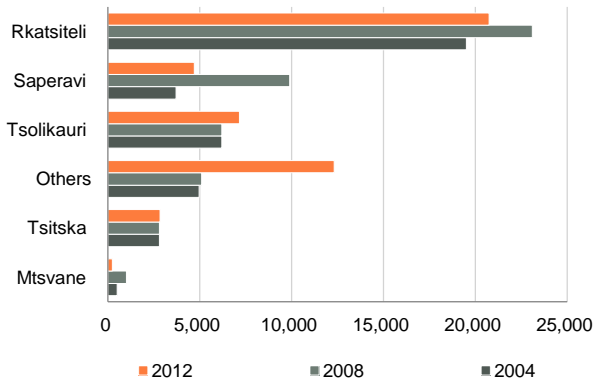
Figure 4: Breakdown of Georgian vineyards by size


Source: FAO

The wine growing sector is fragmented. Around 70% of vineyards are smaller than 0.5ha. Most of these are unsophisticated vineyards that have low yields, where farmers grow grapes for personal consumption or to sell to large wineries. This fragmentation compares unfavorably to average vineyard sizes in the New World (e.g. 86ha in the US) and even Old World (e.g. 3ha in France) wine-producing countries.

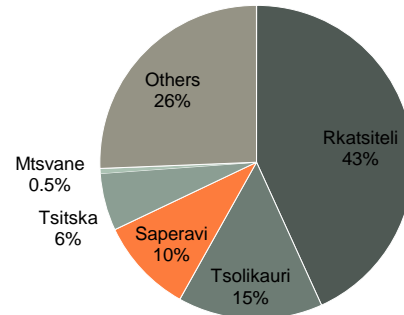
Small-scale grape-growers are dependent on large wineries and the government in terms of grape prices and purchases during the harvest. After the Russian embargo of 2006, when large wineries were unable to buy grapes due to weaker external demand, the government stepped in to become the largest grape buyer in the country. It even created its own winery. Currently, the majority of farmers only sell grapes and do not produce wine. At most, they sell bulk white wine to the hotel, restaurant, and catering sectors.

Figure 5: Vineyard area by grape variety (ha)



Source: USAID, GWA, NWA

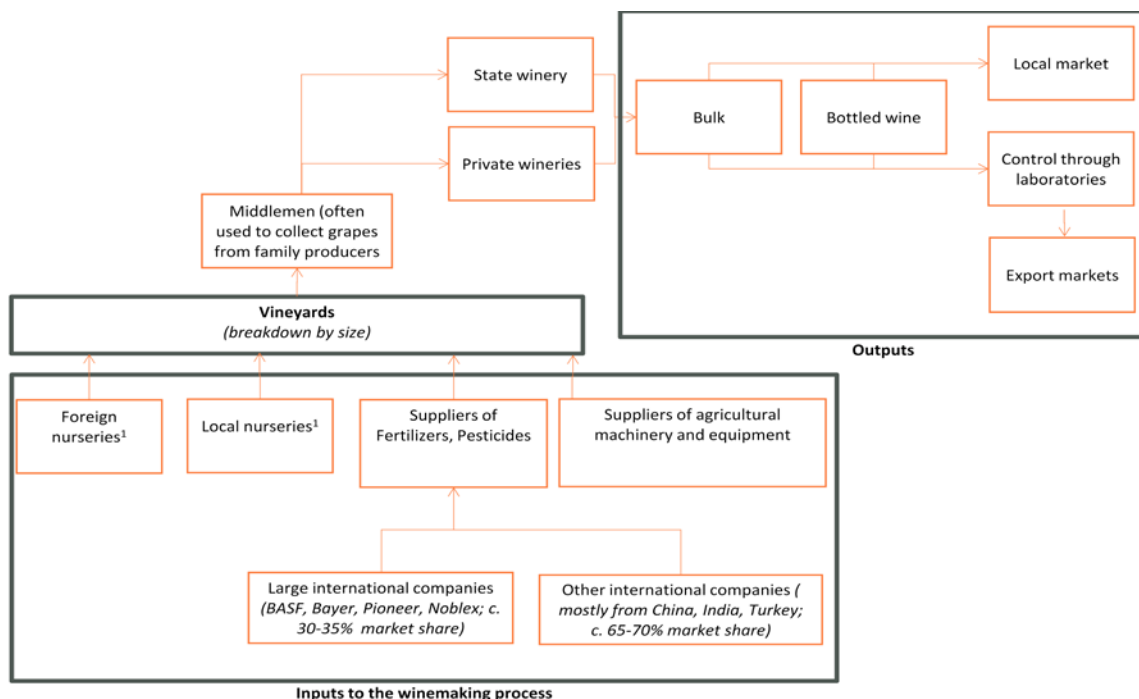
Figure 6: Vineyard area by grape variety in 2012



Source: GWA

Larger wineries purchase grapes from an average of 10-20 mid-size farms, which makes them dependent on a number of suppliers for consistency in price and quality. In recent years, large wineries began planting their own vineyards on plots of 100ha or more to create internal production bases and move away from the dependency on small farmers. Medium-sized farmers are normally less sophisticated in their practices and varietal selection. As a result, productivity and quality are usually inferior.

Diagram 1: Value chain of the grape and wine sector in Georgia



¹ Nurseries are facilities where plants are propagated and grown to usable size
Source: FAO, BoG Research

There are around 180 wine producers in Georgia, of which 100 were engaged in export in 2013. Producers follow several different strategies (Table 1). The largest wineries, including Tbilvino, Teliani Valley, and Telavi Wine Cellar, are large-scale wineries that produce wine using contemporary technology and mass production methods. However, some of these large wineries are also experimenting and diversifying into other segments such as organic, hand-made wines, and traditional qvevri wines.

Table 1: Categories of Georgian wine producers

Category	Characteristics	Producers
Large wineries	<ul style="list-style-type: none"> Produce 100,000-1,000,000 bottles a year Often own vineyards Use mostly stainless steel and less oak barrels and qvevris in production Active exporters 	<ul style="list-style-type: none"> Telavi Wine Cellar Teliani Valley Tbilvino GWS Badagoni Kindzmarauli Marani Kakhuri Khareba
Historical wineries	<ul style="list-style-type: none"> Historical wineries built on historic winery sites Use of qvevris is common 	<ul style="list-style-type: none"> Château Mukrani Chavchavadze's Tsinandali Estate
"Garagistes" ¹	<ul style="list-style-type: none"> Produce 1,000 – 100,000 of bottles a year In some cases, organic grapes are used Use the qvevri method, or Kakhetian/Imeretian winemaking styles Use minimal or no additives 	<ul style="list-style-type: none"> Teleda Schuchmann Vinoterra Alaverdi Monastery Marani Khetsuriani Pheasant's Tears Iago Bitarishvili Soliko Tsiashvili

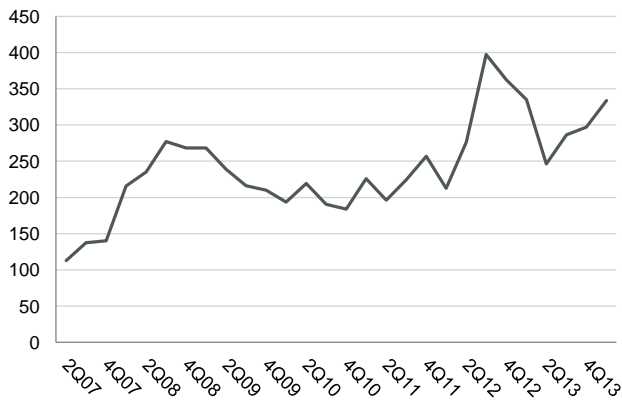
¹ Originally from the Bordeaux region of France, "garagistes" were small entrepreneurial wine-makers who did not adhere to the traditional methods of wine-making
Source: WFW, Georgian Sommelier Association

According to a study conducted in 2011 by USAID, grape production was relatively cheap in Georgia at an average of US\$ 424/t. This compared favourably to US\$ 506/t in the US, US\$ 1,923/t in France, US\$ 604/t in Italy, US\$ 743/t in Australia, and US\$ 783/t in Spain (all at 2008 prices). Only Chile, at US\$ 360/t, produced cheaper grapes than Georgia. Although grape production is relatively inexpensive, grape prices in recent years have been supported by government intervention. Due to the sector's importance economically, the Georgian government has traditionally purchased grapes at above-market prices. The government halted this practice after the Russian market re-opened in 2013 and increased demand from wineries ensured a higher market price.

Prices for grapes popular in Russia increased the most after the re-opening of the Russian market. For example, the price of highly sought-after Aleksandrouli or Mujuretuli grape varieties (used in the production of PDO Khvanchkara) jumped from GEL 5/kg (US\$ 3/kg or US\$ 3,000/t) in 2012 to GEL 8/kg (US\$ 4.90/kg or US\$ 4,900/t) in 2013. The price growth discouraged many companies from buying those varieties and opt instead for more widespread varieties like Rkatsiteli and Saperavi, which had been purchased by the government in 2005-2012 for US\$ 0.3-0.9/kg or US\$ 300-900/t. Since many Georgian wineries do not own vineyards, the high cost of grapes pushed final costs above those in peer countries like Moldova.

Labor costs are very low even though the average monthly agricultural salary increased by 35% between 1Q13 and 4Q13 to US\$ 333. According to a survey by Vinoge.com, a Georgian wine enthusiasts' website, Georgian vineyard laborers earn on average GEL 15-25 (US\$ 9-15) for an 8-hour workday. This is significantly below the US\$ 10 per hour wage in the US (Oregon) and over US\$ 20 per hour wage in Australia for similar work.

Figure 7: Avg. monthly agriculture wages in Georgia (US\$)



Note: Average for agriculture, hunting and forestry sectors as per GeoStat's industry classification
Source: GeoStat, National Bank of Georgia

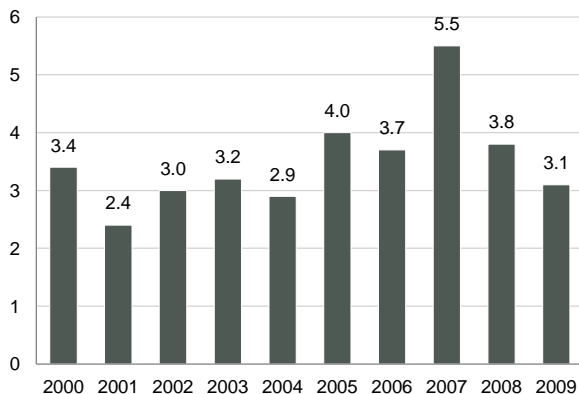
Corks, a key cost item, are mainly purchased from the world-leading Portuguese Corticeira Amorim, which has representation in Georgia. On average, corks costs around US\$ 0.09-0.10 each, but quality corks can go for up to US\$ 0.60-0.70 each. These costs account for around 7-9% of total costs. Normally, it takes around 3-4 weeks for the order to be delivered to Georgia.

The cost of imported wine bottles in Georgia is usually in the US\$ 0.2-0.4 range per bottle including transportation, but can go up to US\$ 0.8-1.0 per bottle depending on the quality. There are no wine bottle manufacturers in Georgia at the moment, therefore most bottles are imported from neighboring Armenia and Azerbaijan as well as from Moldova, Italy and France. For example, an Armenian manufacturer, Saranist, provides wine bottles to the Georgian market for US\$ 0.25 per bottle on average, with the minimum required order at around 35,000 units. A lack of packaging capacities locally puts small- to mid-sized wine producers at a disadvantage, as their annual need for small quantities (1,000-10,000 bottles and corks) does not make overseas orders cost-efficient. To tackle this issue winemakers often attempt to place combined orders for bottles from abroad. The bottle costs account for around 20-25% of total final cost of wine per bottle.

Şişecam, a large Turkish glass manufacturer has been operating in Georgia since 1997 through its subsidiary **Mina**. Currently their focus is on products used in industries other than wine, but Mina used to produce wine bottles in the past. Upon the installation of a second furnace in 2Q14, the company plans to resume wine bottle production with six different varieties. Given the limited selection of bottles and limited price competitiveness over imports, we believe that many winemakers will continue to import. Nevertheless, the sector will benefit from better delivery times and closer supplier contact.

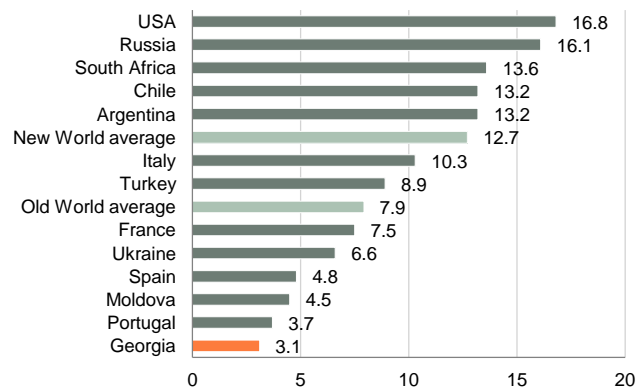


Figure 8: Grape yields in Georgia (t/ha)



Source: Anderson and Nelgen

Figure 9: Global grape yields in 2009 (t/ha)



Note: The Old World average includes France, Italy, Spain, Portugal and Germany. The New World average includes US, Argentina, Chile, South Africa, Australia and New Zealand
Source: Anderson and Nelgen

Grape yields are around 3t/ha, around 1/3 of the global average and significantly below regional peers (Ukraine - 6.6t/ha; Turkey – 8.9t/ha; Moldova – 4.5t/ha). In addition to smaller vineyard size and lower fertilizer use, vines in Georgia are generally planted farther from each other and grapes are hand-picked, resulting in lower yields per hectare. However, yields differ by type of grapes and depending on whether the wine is aimed for mass or premium segment.

Georgia has the potential to produce over 500mn liters of wine annually, 10x that of the current volume. For this, we assume grape yields will expand back to the 2007 level of 5.5t/ha and the total vineyard area will increase to its peak of 150,000ha in the 1970s. In order to reach the maximum capacity, all harvested grapes must be used for wine-making, with 35% wastage. We believe the adoption of more efficient technologies, vineyard consolidation, better education of farmers, and more prolific fertilizer use will increase grape yields and close the gap to regional peers

According to the Georgian Sommelier Association, there are four main styles of Georgian wines:

1. **Dry white wines** produced using the European method of winemaking. In Kakheti, these are mainly wines made by combining the Rkatsiteli and Mtsvane grape varieties, but also with less popular Kisi and Khikhvi varieties. Some PDO-designated wines like Tsinandali and Manavi also fall into this category. In Imereti, these wines are made using the Tsitska, Tsolikouri and Krakhuna grape varieties.
2. **Qvevri-made white wine**, using old Kakhetian or Imeretian winemaking styles. Qvevri-made wine is a combination of two factors: a centuries-old tradition of making wine in clay casks and the Kakhetian-Imeretian style of winemaking, in which white wines are produced the same way as red wines (wine is macerated for several months with the skins, seeds and stems of grapes). Apart from their color (dark, orange, amber, often with a pink tinge), the most distinctive feature of these wines is the high content of polyphenolic compounds, exceeding 2,000 mg/l while a typical concentration in European white wines rarely exceeds 300 mg/l. Polyphenolic compounds contribute to the release of specific aromas in wine. A qvevri, as a clay cask, require a special cleaning process. The recent development of ultrasound cavitation cleaning techniques will help this traditional wine-making method comply with international health and safety standards.
3. **Dry red wines** – Saperavi has been awarded internationally for its quality and it has the potential to become a recognizable type of wine. Saperavi wines are marked by a good structure and aroma. Riedel, an international custom-made wine glasses producer, will produce a special custom-made wine glass for Saperavi in 2014.

4. **Semi-sweet wines** – These wines, including Khvanchkara and Kindzmarauli, have strong demand in Russian-speaking markets, but domestic demand is relatively weak.

Semi-sweet red wines made-up 60% of Protected Designation of Origin (PDO) wine exports from Georgia in 2013. This was followed by dry white (21%), dry red (17%) and semi-sweet white (2%) wines. Along with semi-sweet red wines, the rising export of dry white wines could indicate the increasing potential of these wine types. For example, exports of dry white PDO wines such as Gurjaani and Vazisubani rose 4.6x and 1.8x during 2011-2013. Overall, exports of PDO wines grew by 138% in 2013, mainly driven by demand from Russia (e.g. exports of Kindzmarauli, a very popular wine in Russia, were up 169% in 2013).

Table 2: Exports of Georgian Protected Designation of Origin (PDO) wines in 2011-2013 (0.75 liter bottles)

PDO wine	Wine Type	2011	2012	2013
Kindzmarauli	Red Semi-sweet	1,878,165	2,240,631	6,021,165
Tsinandali	White Dry	1,079,732	1,388,006	2,669,450
Mukuzani	Red Dry	654,439	756,523	2,165,995
Akhasheni	Red Semi-sweet	314,368	341,276	1,344,923
Khvanchkara	Red Semi-sweet	872,937	859,706	1,296,681
Tvishi	White Semi-sweet	208,041	205,365	339,732
Napareuli	Red Dry	69,998	68,382	199,272
Napareuli	White Dry	4,500	4,800	3,885
Vazisubani	White Dry	55,012	64,152	152,604
Gurjaani	White Dry	23,184	28,860	129,102
Kvareli	White Dry	14,600	18,184	22,205
Manavi	White Dry	19,146	13,668	17,382
Kakheti	White Dry	10,010	12,918	11,160
Teliani	White Dry	14,826	15,072	3,762
Total		5,218,958	6,017,543	14,377,318
<i>y/y growth (%)</i>			<i>15.3%</i>	<i>138.9%</i>
Share of exports by type of wine				
% Red Semi-sweet		58.7%	57.2%	60.3%
% Red Dry		13.9%	13.7%	16.5%
% White Semi-sweet		4.0%	3.4%	2.4%
% White Dry		23.4%	25.7%	20.9%

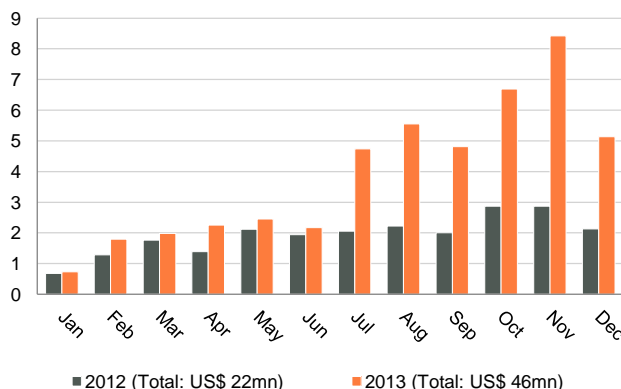
Source: NWA

Local Consumption & Wine Tourism

Georgian-made wines account for 99% of domestic consumption. In contrast, 41% of spirits and 14% of beer consumed in Georgia in 2012 were imported. In the domestic market, there is an increasing preference for bottled wine over homemade wine. This is reflected in the rising value of bottled wine sales while the overall consumption of commercially produced wines declined slightly in the last two years. In 2013, the total market for bottled wine in Georgia more than doubled to US\$ 46mn from US\$ 22mn in 2012. A rise in the number of international visitors (5.4mn in 2013 from 1.5mn in 2009) was another factor contributing to the sharp growth in domestic bottled wine sales as tourists consume bottled wine in restaurants and also purchase some to take back home.

We believe that due to local characteristics the actual consumption figures are significantly higher. We estimate that commercially produced wine ends up accounting for only 5-10% of total consumption in Georgia, as a very large number of farmers produce wine for self-consumption that goes unaccounted for in official statistics.

Figure 10: Georgian domestic bottled wine sales by month (US\$ mn)



Source: NWA

Demand is mainly focused on the non-premium segment (pre-tax price of less than US\$ 2.50/liter pre-tax wholesale price; US\$ 1.9/bottle). In Central and Eastern Europe, the former Soviet Union, and Western Europe's four main wine-exporting countries, only about half of domestic wine consumption is non-premium, compared to over 80% in Georgia. The remaining are premium wines (US\$ 2.5 – US\$ 7.5/liter) with only a small fraction in the super-premium segment (above US\$ 7.50/liter pre-tax wholesale price). However, there is room for domestic consumption of premium wines to rise as disposable incomes and tourism grow.

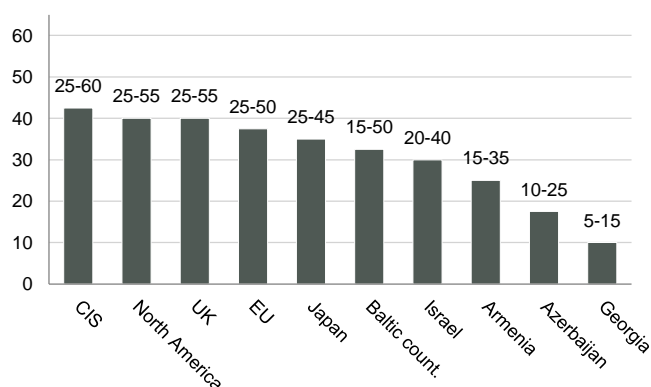
Wine tourism has seen a rebirth over the last decade. Georgia's deep-rooted wine culture, mild weather, historic monuments, charming villages, and accessibility make it an ideal tourism destination. Wine tourism has the potential to be a year-round activity, with a peak from spring to mid-October. The target market for wine tourists includes local leisure visitors, wine experts, expats, regional tourists, and adventure-seeking international travelers. In March 2014, Tbilisi hosted the International Wine Tourism Conference for the first time. The three-day conference featured discussions, panels, presentations, and workshops, as well as the opportunity to taste Georgian wines. More than 250 industry representatives from over 25 countries attended, including many wine journalists.

Table 3: Food and wine tourists in Georgia, forecast

	2012	2013	2014F	2015F	2016F	2017F	2018F	2019F
Number of international visitors, mn	4.4	5.4	6.1	6.6	7.1	7.6	8.2	8.9
Of which Leisure / Recreation / Vacation visitors	2.5	3.3	3.9	4.3	4.6	5.0	5.4	5.9
% growth rate	84%	33%	18%	9%	8%	8%	9%	9%
Food and wine tourists, mn	0.08	0.11	0.14	0.16	0.18	0.20	0.23	0.27
% of Leisure / Recreation / Vacation visitors	3.2%	3.4%	3.6%	3.8%	3.9%	4.1%	4.3%	4.5%

Note: The forecast of international visitors is prepared by BoG Research (please see BoG Research report "Georgia's Tourism Sector - Targeting Diversification" which includes our latest forecast)
Source: GNTA, BoG Research

According to Georgia's tourism agency (GNTA), around 90,000 foreigners came to Georgia for food and wine tourism in 9M13. We believe that food and wine tourists, who currently constitute around 3.5% of total leisure visitors in Georgia, will increase their share in the coming years and reach around 270,000 visitors by 2019 on our conservative estimates. For comparison, a research conducted in New Zealand by the Ministry of Tourism indicated that 7-9% of international tourists visited the country's wineries between 2003 and 2008. Given the potential and emphasis on wine tourism by the Georgian government agencies, we believe this type of tourism will grow significantly in the medium term. According to GNTA, tourists spend on average GEL 659 (US\$ 400) per trip for food and wine. Of this, USAID data suggests 10-20% is spent on wine and wine tasting during meals.

Figure 11: Tourist expenditure on wine and wine tasting (US\$ per person)


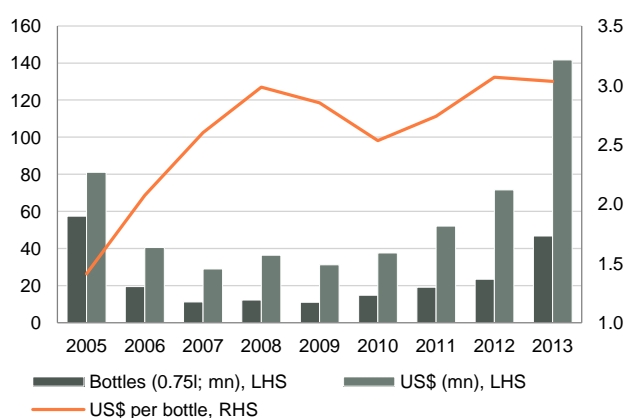
Note: Bar heights represent average spending per person; labels represent ranges
Source: USAID

Wine tourism-related infrastructure started being developed in recent years with some wineries offering accommodation and wine tasting packages. There are also a number of "Château"-type wineries such as Château Mukhrani and Château Mere, which are wine tourism-focused and offer a variety of events and services. In order for the industry to reach its full potential, the hospitality infrastructure needs to continue developing with more highly-trained professional staff entering the industry. In 2013, Lonely Planet, the leading travel publisher, named Georgia as one of the Top 10 Countries for its Lonely Planet's Best Value Destinations.

Target Wine Export Markets

Russia was a key wine export market before it introduced an embargo on Georgia in 2006. It had accounted for 78% of Georgian wine and 72% of mineral water exports. In 2006 Russia imposed a ban on imports of Georgian wine, mineral water, and agricultural products, which negatively affected the sectors. Wine production halved in 2006 while exports fell by nearly two-thirds from 57mn bottles in 2005 to 19mn bottles in 2006. Nevertheless, Georgian winemakers began developing other export markets, and growth in production and exports picked up again in 2010 onwards. In 2013, Russia lifted its trade embargo on Georgian wine and wine exports in 2013 doubled compared to 2012.

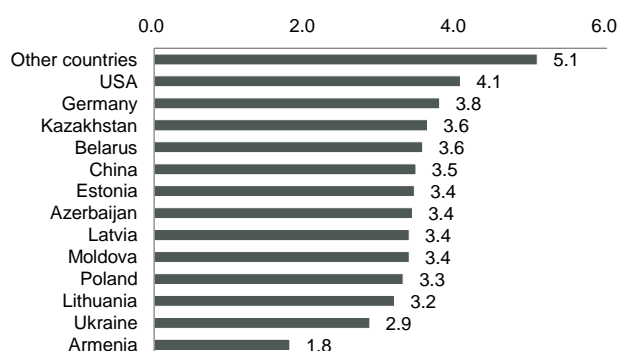
Figure 12: Georgian wine exports (2005-2013)



Source: NWA

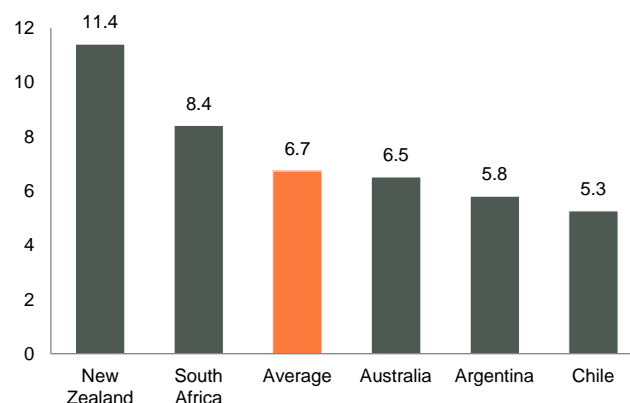
An encouraging outcome of the Russian embargo is that Georgia's wine exports, while declining in quantity, have risen in quality. The average export price rose from US\$ 1.4/bottle in 2005 to US\$ 3.0/bottle in 2013.

Figure 13: Average price of exported Georgian wines in 2010 (US\$/liter)



Source: VINEXPO, IWSR

Figure 14: Avg. retail price of imported wines in the USA (US\$/liter)



Source: USAID

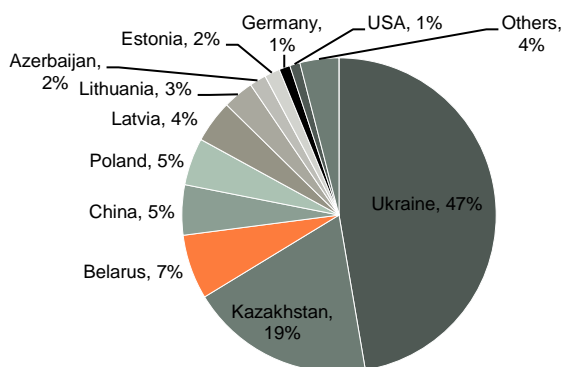
Prices for Georgian wines vary depending on the importing country. Generally, Georgian wines are cheaper in CIS/post-Soviet states due to lower transportation costs and as dry and semi-sweet table wines are more present. Levels of customer awareness and availability vary, but Georgian wines are considered mass market in the CIS and premium in the EU, North America, and Asia, where mostly PDO Saperavi and PDO dry white wines are sold.

Georgia's key target markets for wine exports fall into three main categories:

- The former Soviet Union states (Russia, Ukraine, Kazakhstan, Baltic states, Belarus and other)
- The English-speaking world and the EU (UK, USA, Canada and the EU)
- South-East Asia (China, Japan, and potentially India)

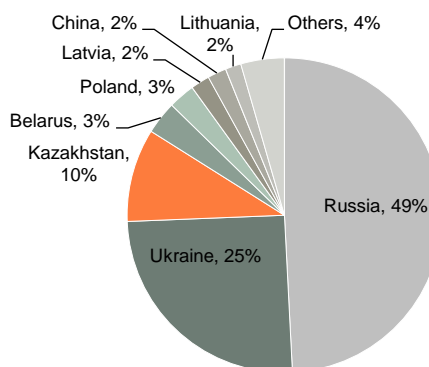
Around 93% of Georgia's wine exports went to former Soviet Union countries in 2013. Russia accounted for a large part of this, but even without Russia in 2012 these markets accounted for 85% of total exports. Poland is the largest non former Soviet Union export market (3% in 2013), followed by China (2%) and the US (>1%).

Figure 15: Georgia's wine export destinations in 2012 (by volume, 0.75l bottles)



Source: NWA

Figure 16: Georgia's wine export destinations in 2013 (by volume, 0.75l bottles)



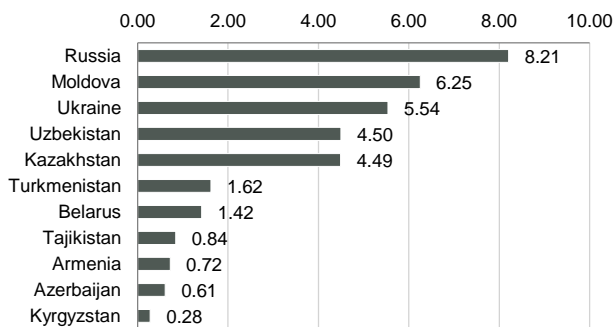
Source: NWA

Selected Ex-Soviet export destinations

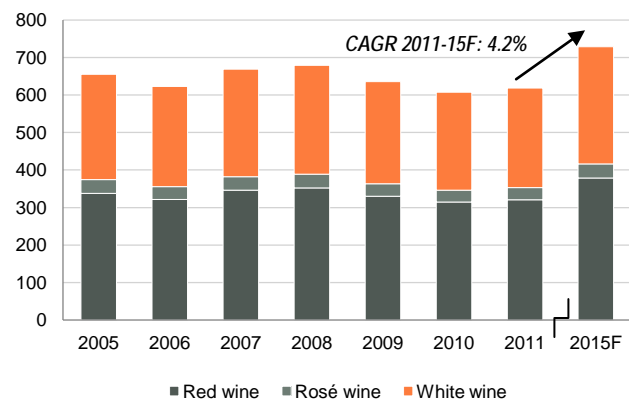
Russia

Russia is by far the largest market in Central and Eastern Europe. Russia is a sophisticated market, and there are opportunities for a wide range of value-added food and beverage products sold in both high-end retail establishments and food service outlets. In 2010, the average Russian drank 68 liters of beer, 12 liters of spirits and 8 liters of wine. In comparison, the average Canadian consumed 50 liters of beer, 4.3 liters of spirits, and 10 liters of wine.

Wine is the third-most popular alcoholic beverage among Russians after beer and spirits. Table wine continued to dominate the wine market, comprising 64% share of red wine segment by volume in 2010. This was likely prompted by the economic recession; with the premium still and high-quality red wines seeing their volume shares recede marginally. The white wine and rosé wine segments showed a similar trend, with table wine within these categories increasing its volume share to 66% and 77%, respectively.

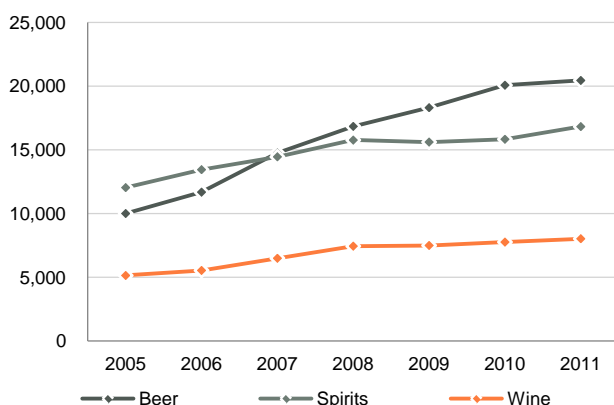
Figure 17: CIS wine consumption per capita, liters (2010)


Source: Anderson and Nelgen

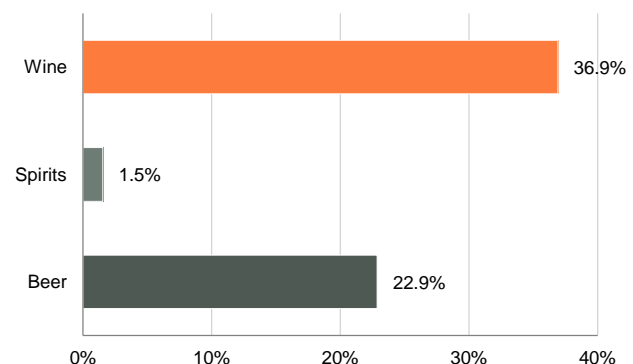
Figure 18: Russian wine market share by category (US\$ mn)


Source: Euromonitor

Wine sales in Russia grew 2.7% from 982mn liters in 2007 to 1,009mn liters in 2011. During the crisis of 2008-2009, wine sales fell to 910mn liters as lower disposable incomes prompted consumers to buy cheaper alcoholic beverages.

Figure 19: Alcoholic beverage markets in Russia (US\$ mn)


Source: Euromonitor

Figure 20: Projected Russian market growth 2011-15 (US\$ mn)


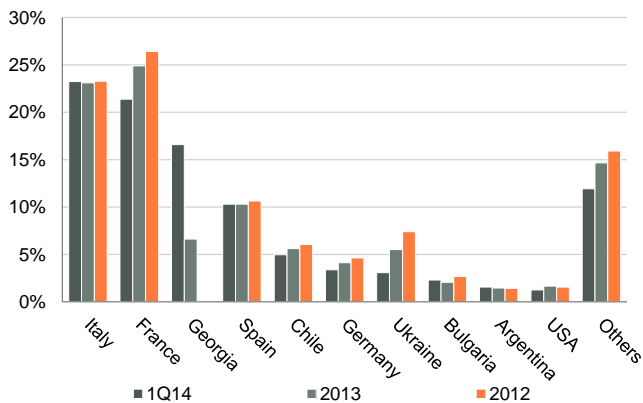
Source: Euromonitor

Spending on alcohol has increased significantly in Russia in recent years. Russia is the world's largest vodka market, but many Russian consumers are increasingly opting for beer or wine. Beer has become fashionable as a more casual drink, and brandy, whiskey, cognac, and mixed cocktails are gaining in popularity. The Russian alcohol market is highly regulated. In 2009, retail pricing standards were introduced, setting a minimum shelf price for half-liter bottles.

Russia banned Moldovan as well as Georgian alcohol imports in 2006, citing quality standards. Russia revoked the Moldovan ban in 2007, and 40 Moldovan wineries were allowed to ship to Russia. In 8M13, 29 wineries shipped 21mn liters to Russia. However, in August 2013, the Russian government once again announced a limit on imports due to safety concerns as a result of a lack of a national Moldovan wine regulator and the fact that only 43% of wine exports to Russia were inspected by Moldovan authorities.

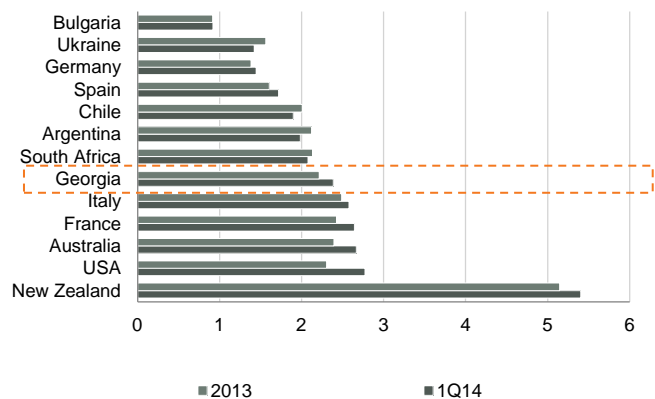
In 2013, Russia reopened its market to Georgian wine, allowing access to qualified wineries. As of December 2013, 17mn liters of wine had been shipped to Russia by 38 Georgian wineries. This represents 49% of total wine exports in 2013 and puts Russia first with double the volume of Ukraine. The re-opening of the Russian market slowed exports to other countries: total wine exports ex-Russia were up 2% y/y in 2013, compared to a 2007-2012 CAGR of 16%.

Figure 21: Share of Russian wine imports by country of origin, 2012-2014 (by value)



Source: Federal Customs Service of Russia

Figure 22: Average price per liter of imported bottled wine in Russia (2013-2014), US\$



Source: Federal Customs Service of Russia

Old World wines continue to hold leading market positions and are the main Russian wine imports. In 2013, France was Russia's leading wine supplier in value terms, followed by Italy and Spain. However, based on the 1Q14 statistics, Georgia is now the third largest bottled wine exporter to Russia with 17% market share, up from 7% in 2013. In terms of pricing, at an average price of US\$ 2.4/liter Georgian wines were significantly more expensive than Bulgarian or Ukrainian wines imported in Russia (US\$ 0.9/l and US\$ 1.4/l, respectively), but cheaper than those from two of the largest exporters, Italy and France (c. US\$ 2.6/l each).

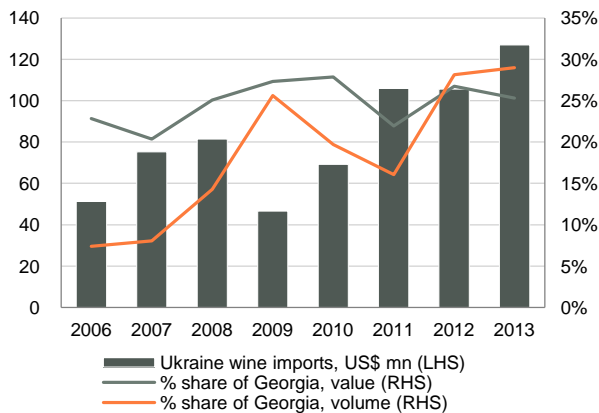
Most importers divide their wines between on-trade (e.g. restaurants and bars) and off-trade (e.g. supermarkets) consumption. Although 93% of wine sales in Russia are through the off-trade format, bars and restaurants are steadily increasing their share, especially in the premium and super-premium categories. Some importers try to reserve their best brands for the on-trade format, but very few can resist moving into the off-trade due to its significant volume sales. Russian consumers are increasingly associating high prices with high quality, and this is creating opportunities for foreign premium segment wine producers.

Ukraine

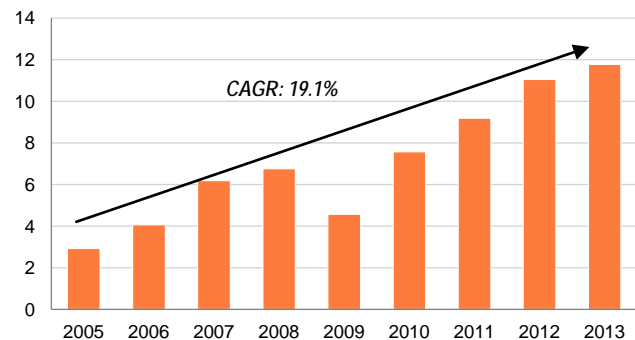
The Ukrainian wine market is growing strongly. Alcohol consumption in Ukraine has historically been dominated by spirits, and while this should continue, an opportunity exists in the wine and beer sectors. A study by Business Monitor forecasts per-capita wine consumption to reach 12.8 liters by 2016, double the 2009 level.

Wine sales in Ukraine have been boosted by a switch away from spirits. Ukraine has an active domestic wine industry with key wine-producing regions in Crimea, Odessa, Kherson, Mykolayiv, Transcarpathia, and Zaporizhia. By international standards, however, the sector is underdeveloped due to lack of investment and limited brand recognition in external markets. The top 10 Ukrainian brands boosted their aggregate market share 11pts y/y to 68% in 2012. Growth in bulk wine imports that are bottled domestically is a partial consequence of higher production by local companies.

Figure 23: Total wine imports in Ukraine and share of Georgia **Figure 24: Georgian wine exports to Ukraine (mn 0.75l bottles)**



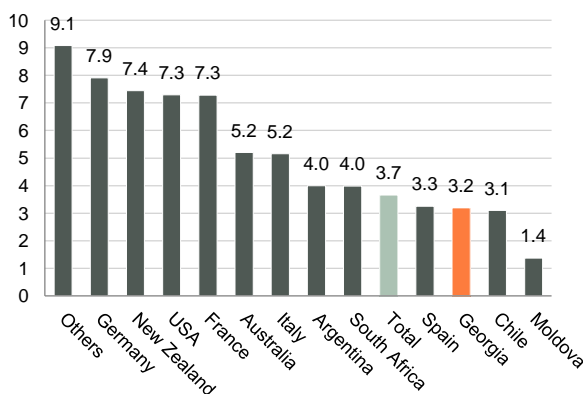
Source: State Statistics Office of Ukraine



Source: NWA

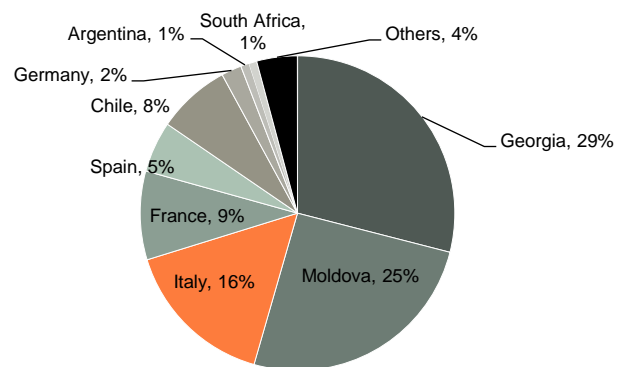
From 2005 to 2013, Georgian wine exports to Ukraine grew 4x to 11.8mn bottles (0.75l). We expect strong demand from Ukraine to continue, as 2013 exports to Ukraine still grew by 7% y/y in 2013.

Figure 25: Average price of wine imports in Ukraine in 2013 (US\$/liter)



Source: State Statistics Service of Ukraine

Figure 26: Ukraine wine imports by origin, 2013 (liters)



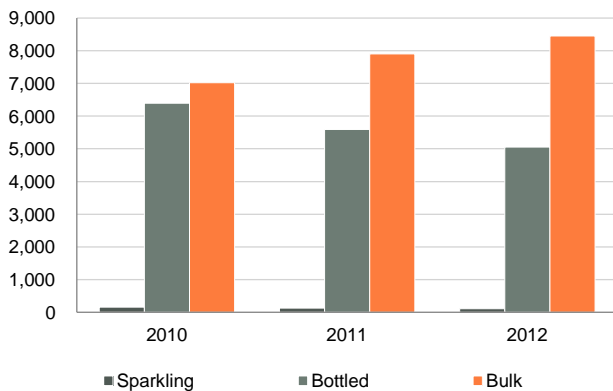
Source: State Statistics Service of Ukraine

Georgian wines had the largest share of Ukrainian wine imports at 29% in 2013, followed by Moldova and Italy with 25% and 16%, respectively. In terms of pricing, at US\$ 3.2/liter, Georgian wine imports in Ukraine are below their national average (US\$ 3.7/l), but more than double that of Moldova (US\$ 1.4/l).

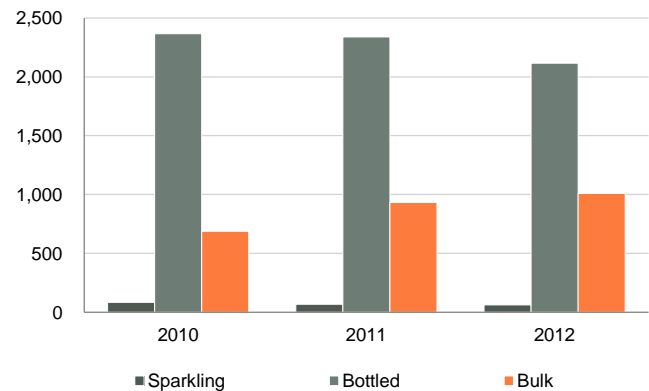
The EU and other countries as growth markets

The EU

The EU's share of Georgia's external trade is steadily rising. After Russia's embargo in 2006, Georgian producers responded by redirecting exports to other CIS countries, the EU, and the Middle East. The EU market has proven an attractive alternative for Georgian wine exports, which more than tripled from 2005 to 2012. The highest growth rates came from Poland and Bulgaria, where wine exports grew by 6.3x and 11.9x, respectively. Georgia exported 26mn liters (US\$ 9mn in value) of wine to the EU in 2012.

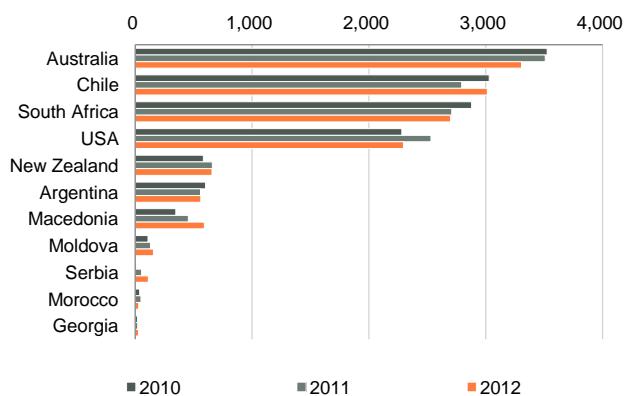
Figure 27: EU wine imports by volume ('000 hl)


Source: Global Trade Atlas

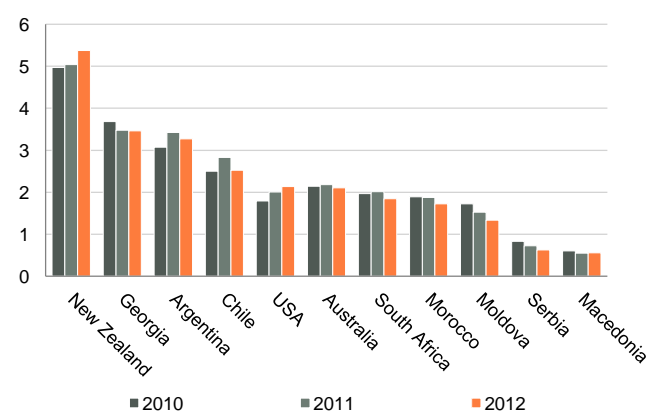
Figure 28: EU wine imports by value (US\$ mn)


Source: Global Trade Atlas

Bulk wine imports are steadily rising in the EU at the expense of bottled wines. Since 2004, this bulk trade remains competitive due to reduced tariffs and lower transportation and bottling costs. Retailers in Europe have been able to squeeze pricing from their suppliers by bottling bulk wine locally. Some have created competing private-label brands using foreign-sourced bulk wine. For example, one third of wine imported by British retailer, Asda, is currently bottled in the UK. However, this trend is less relevant to Georgian wines as the re-opening of Russian market created excess demand for bulk wine even domestically and also most of the global bulk wine trade is done for standardized varieties (e.g. Chardonnay, Sauvignon).

Figure 29: EU wine imports by country/volume ('000 hl)


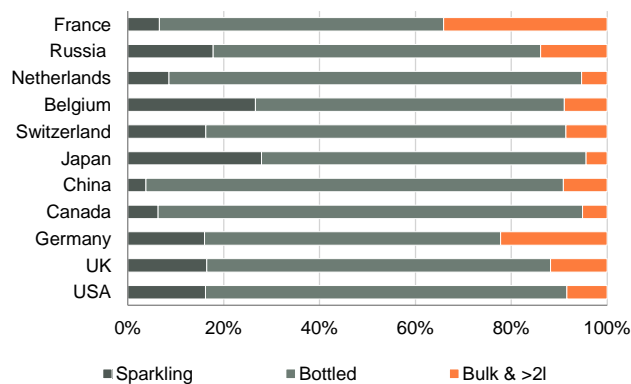
Source: Global Trade Atlas

Figure 30: EU wine imports by price per liter/country (US\$)


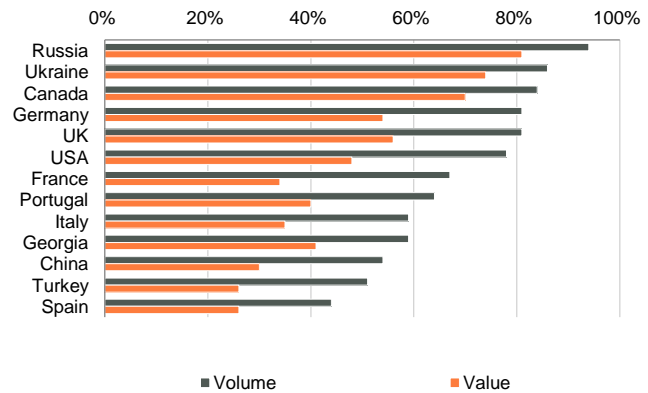
Source: Global Trade Atlas

In terms of pricing, Georgian wines in the EU are sold at the upper range along with wines from New Zealand and Argentina. Australia, Chile, South Africa, and the US are key wine exporters to Europe, and they are especially competitive in the mid- and low-range segments due to low production costs.

Given the high growth rates for Georgian wine exports to the EU over the past decade, we believe that Georgian wine makers will continue to capitalize on demand from the EU. The main challenge will be in creating and maintaining a global standard wine brand image that will match the high retail prices of Georgian wines.

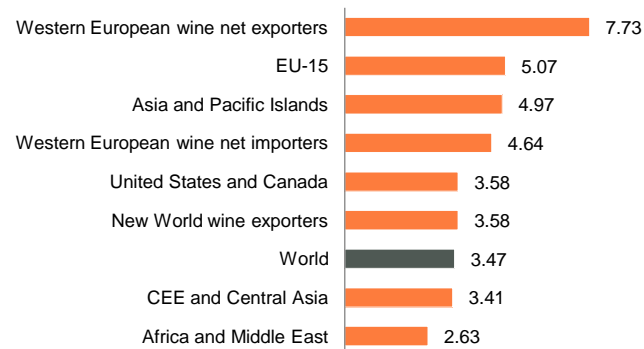
Figure 31: Top wine importing countries by type (2012)


Source: Global Trade Atlas, OIV, OeMv

Figure 32: Share of off-trade in wine consumption 2007-2009


Note: Off-trade refers to alcohol sales for consumption off-premises (e.g. at home)
Source: Anderson and Nelgen

The proportion of off-trade wine consumption is higher in Russia and Ukraine compared to the EU, implying that a greater proportion of wine is purchased at supermarkets rather than hotel, restaurant and catering establishments. Given that over 90% of wine in Russia in terms of volume is purchased to be consumed at home, this market obviously needs a different marketing and pricing approach than Turkey, where around 50% of wine is consumed within hotels, restaurants and catering sectors.

Figure 33: Unit value of Georgian wine exports by region in 2008 (US\$)


Source: Anderson and Nelgen

Table 4: Wine retail pricing by segment (US\$)

Price segment name		Price point
Non-premium wines	Jug wine	> \$3
	Extreme value wines	\$2 - \$3
	Popular premium	\$3 - \$7
Premium wines	Super-premium	\$7 - \$14
	Ultra-premium	\$14 - \$25
	Luxury	> \$25

Source: USAID, BoG Research

Other export destinations

Asia-Pacific, North America, and India also hold good export opportunities for Georgia. The Asia-Pacific region is expected to post the highest growth rate through 2015, while the US wine market has shown strong growth recently despite the recession. Demand is being driven by younger consumers, with many opting for lower-priced wines. The US wine industry accounts for almost 8% of global wine production and has overtaken Italy to become the world's leading consumer of wine.

China is becoming one of the biggest opportunities for Georgian wine producers. Although wine in China is mostly associated with France, sales values for Georgian wine are still high. Additional promotional investments are needed to increase awareness. According to the California-based Wine Institute, there are currently only 19mn people in China who can afford to purchase wine, 45% of which live in Shanghai. According to the Wine Institute, the Chinese wine market is now where Japan's was 25 years ago, but is developing at a faster rate. In 2011, the Ministry of Economy and Sustainable Development of Georgia founded a working group with the aim of increasing exports of Georgian wine to China. Georgian wines were officially introduced to China in March 2011, and there are currently around 20 brands sold on the Chinese market. In 2012, a group of Chinese journalists visited Georgia to report on the wine industry.

India's wine industry is expected to grow as Western habits and drinking patterns gain traction. RNCOS Industry Research is projecting wine consumption to grow by 25% in the three-year period ending 2014. Growth will be driven by rising disposable income, an expanding female consumer base, wine clubs and festivals, and wine tourism.

The marketing budget of Georgia's National Wine Agency (NWA) is set to triple in 2014 to GEL 4.5mn (US\$ 2.7mn) from GEL 1.5mn (US\$ 0.9mn) in previous years. The focus of its activities will be the US, UK, Poland, China, and former Soviet countries. This should help local companies enter the above markets in particular, where Georgian wine is relatively unknown.

Table 5: Potential export markets and key demand-side considerations

Export market	Target segments	Key considerations
US	<ul style="list-style-type: none"> Mid and premium segments Already present in the "ethnic" market – easier segment given the Georgian wine "story" 	<ul style="list-style-type: none"> Low quantities at the beginning, growth over time Financing needed to get established in premium segment Best suited products: mid and premium segment – local grape variety wines (e.g. Saperavi, Mtsvane, Rkatsiteli, etc.); "Ethnic" market – well-known wines
China	<ul style="list-style-type: none"> Mid and premium segment (incl. the gift segment) New wine consumers segment 	<ul style="list-style-type: none"> Currently low awareness of Georgian wine The aim is to be present in the premium segment in big cities such as Beijing, Shanghai and Hong Kong in low quantities and to be present in provincial cities
Germany	<ul style="list-style-type: none"> Mid and premium segments – experienced consumers "Ethnic" market: comparably low prices 	<ul style="list-style-type: none"> Best suited products: mostly red wines (Germany produces less of these); white – varietal wines, including Tsinandali; varietal wines for mid and premiums segment, including Saperavi, Mtsvane and Rkatsiteli Experienced wine consumers are looking for new, different and exclusive products More than one million emigrants from post-Soviet and socialist countries are familiar with Georgian wine
Poland	<ul style="list-style-type: none"> Mid and premium segments – experienced customer segment 	<ul style="list-style-type: none"> Professional wine consumers who love wine are looking for new, different and exclusive products. Best suited products: dry red wines, including Saperavi and Mukuzani Reason to buy: interest in Georgian wines
UK	<ul style="list-style-type: none"> Mid and premium segments with the highest-quality red wines, mainly Saperavi 	<ul style="list-style-type: none"> Reason to buy: willingness to try something different – new varietals, new taste from a new country

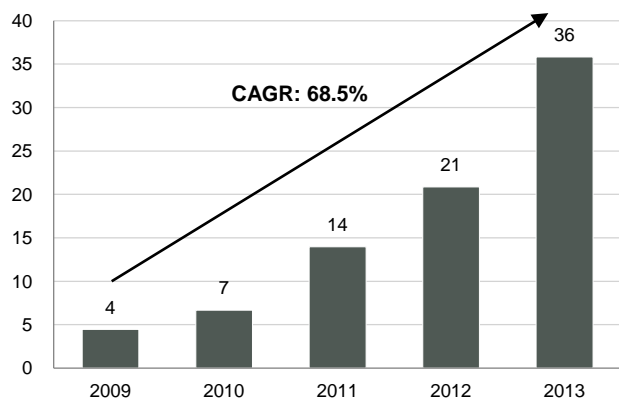
Source: USAID, Georgian Sommelier Association

Georgian brandy

Exports of brandy from Georgia are rising significantly on the back of strong demand from Ukraine and, as of 2013, Russia. In 2013, Georgian producers exported around 6mn liters of brandy at a value of US\$ 36mn, 70% higher than 2012. The per-liter value of the 6mn of exported brandy in 2013 was US\$ 6, comparing favorably to US\$ 4 for wine during the same period. Sarajishvili, which opened its first factory in 1884, is the most well-known Georgian brandy and cognac producer. Wine companies like Kakhetian Traditional Winemaking and Askaneli Brothers also have a strong presence in Georgia and export markets.

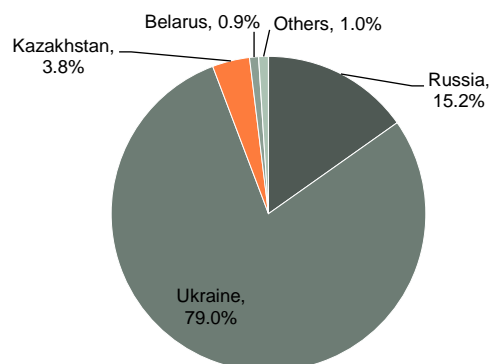


Figure 34: Georgian brandy exports (US\$ mn)



Source: NWA

Figure 35: Georgian brandy exports by destination in 2013 (by volume)



Source: NWA

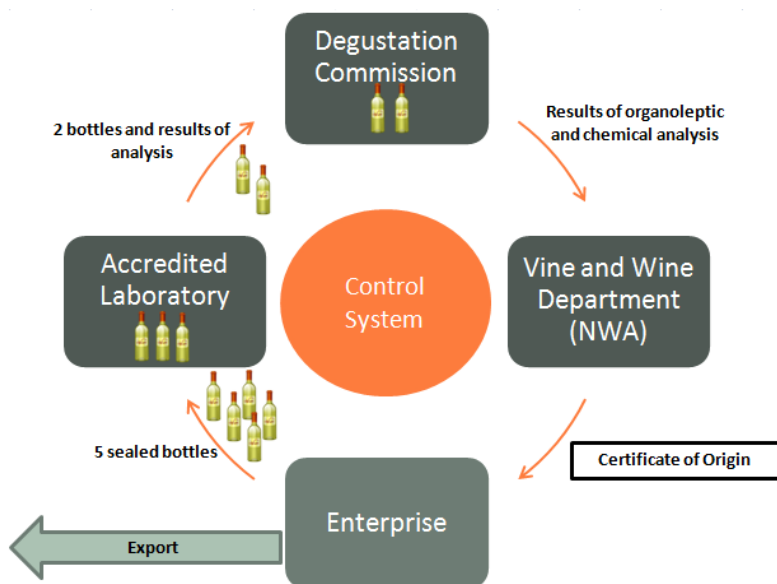
Legal Framework

Over the past 10 years progress has been made in terms of regulation, and consumer trust in the authenticity and quality of Georgian bottled wine has risen as a result. The National Wine Agency (NWA) is the government's main tool in establishing a well-regulated and trustworthy wine industry. Effective marketing abroad is also needed to commercialize the positive effects brought on by better domestic regulation.

Marketing efforts are driven by the NWA and Georgian Wine Association (GWA). Every year, the two approve a marketing strategy for target export markets. The appointment of the Georgian Wine Ambassador (currently the President of the Georgian Sommelier Association) was another positive step for marketing wines abroad. The ambassador's duties include hosting wine receptions and conducting educational classes as well as interaction with global wine media representatives to increase visibility.

The NWA operates under the Ministry of Agriculture – a move designed to ensure broad compliance with established standards – and it plays a key role in supporting the development of Georgia's wine sector and enhancing the quality of its wines. First established in the early 1920s to revitalize the country's ailing industry, it now regulates all aspects of wine production and ensures that producers comply with production standards. The agency monitors quality and supports the development of viticulture and winemaking, regulating everything from the breeding of vine grafts and vineyard planning to grape processing, wine production and sales. The agency is also responsible for overseeing the certification and labeling of quality wines and grants rights to use a registered Protected Designation of Origin (PDO).

Diagram 2: Wine industry certificate of origin system in Georgia



Source: Ministry of Agriculture of Georgia

The Law on Appellations of Origin (PDO) and Geographical Indications (GI) was adopted in June 1999. The law sets out the basic procedures for wine production, seeks to ensure the production of the highest quality wines and to protect the market against counterfeit and low-quality products. The law also defines the order of product registration according to geographical indication (GI), meaning it must have specific features related to particular climate conditions and/or human factors existing in the geographical area of its production. If a product meets these criteria, any individual or firm can file for registration as a PDO or GI.

The link with place of origin is stronger for PDOs than GIs. Under the World Intellectual Property Organization (WIPO)-administered Lisbon Agreement for the Protection of Appellations of Origin and their International Registration, a product qualifies for protection when its quality or characteristics “are due exclusively or essentially to the geographical environment, including natural and human factors,” whereas, under the Agreement on Trade Related Aspects of Intellectual Property (TRIPS) administered by the World Trade Organization, products qualify for protection as GIs when “a given quality, reputation or other characteristic” is “essentially attributable to its geographical origin.”

In Europe, for example, for GIs the production of the raw materials and the development of the qualifying product are not necessarily carried out entirely in the defined geographical area, whereas for PDOs they are. In 2004, Georgia signed up to the WIPO-administered Lisbon Agreement for the Protection of Appellations of Origin and its International Registration. This paved the way for wider international recognition of Georgia's stock of GIs, creating new opportunities for broader market access.

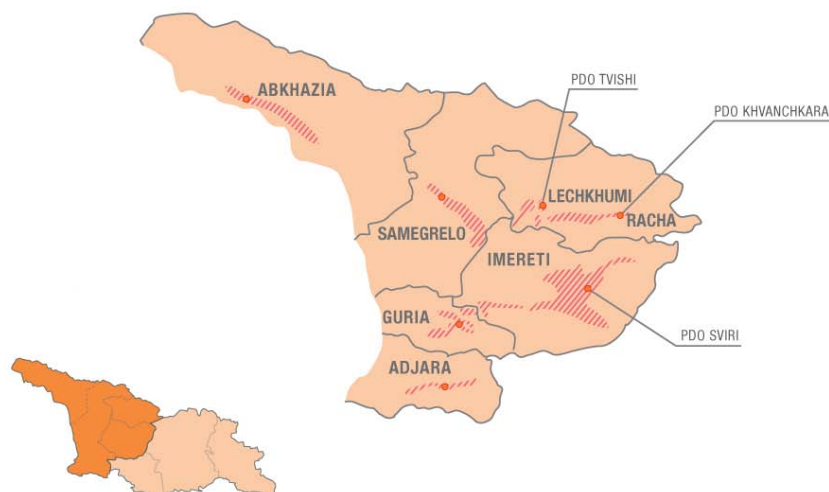
Georgia has 18 PDOs: 14 in Kakheti, 2 in Racha and Lechkhumi, and 1 each in Inner Kartli and Imereti. The names of the viticulture regions are not protected yet. PDO wines are subject to strict control procedures and are regulated from the start of grape production to the export stage.

Table 6: Georgia's Protected Designations of Origin wines

PDO	Grape varieties	Wine type	Region
Tibaani	Rkatsiteli	White Dry	Kakheti
Kardenakhi	Rkatsiteli, Khikhvi, Mtsvane Kakhuri	Fortified White	Kakheti
Kotekhi	Rkatsiteli, Saperavi	White Dry, Red Dry	Kakheti
Akhasheni	Saperavi	Red Semi-sweet	Kakheti
Mukuzani	Saperavi	Red Dry	Kakheti
Vazisubani	Rkatsiteli 85%, Mtsvane Kakhuri 15%	White Dry	Kakheti
Gurjaani	Rkatsiteli 85%, Mtsvane Kakhuri 15%	White Dry	Kakheti
Teliani	Cabernet Sauvignon	Red Dry	Kakheti
Tsinandali	Rkatsiteli 85%, Mtsvane Kakhuri 15%	White Dry	Kakheti
Napareuli	Rkatsiteli, Saperavi	White Dry, Red Dry	Kakheti
Kindzmarauli	Saperavi	Red Semi-sweet, Red Dry	Kakheti
Kvareli	Saperavi	Red Dry	Kakheti
Manavi	Mtsvane Kakhuri 85%, Rkatsiteli 15%	White Dry	Kakheti
Kakheti	Rkatsiteli, Mtsvane Kakhuri	White Dry	Kakheti
Ateni	Chinuri, Goruli Mtsvane, Aligote	Sparkling White	Inner Kartli
Sviri	Tsolikouri, Tsitska, Krakhuna	White Dry	Imereti
Tvishi	Tsolikouri	White Semi-sweet	Racha-Lechkhumi
Khvanchkara	Aleksandrouli, Mujuretuli	Red Semi-sweet	Racha-Lechkhumi

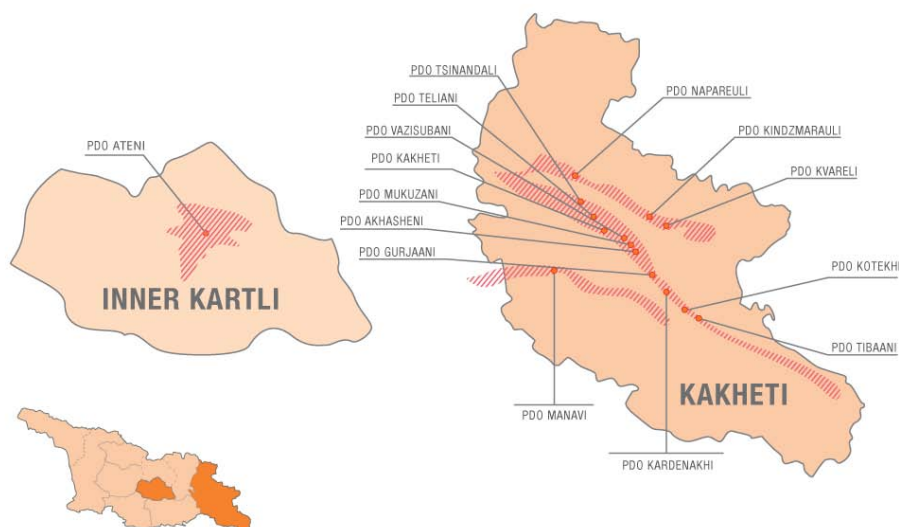
Source: GNTA, NWA

Map 2: PDO wine areas – West



Source: NWA

Map 3: PDO wine areas – South/East



Source: NWA

To help the wine industry after the Russian embargo, the Georgian government established the Wine Quality and System Formation Fund under the Ministry of Agriculture and adopted the Lisbon Agreement (an international treaty that obliges signatory countries to ensure that products are branded with the correct country of origin) to fight counterfeiting.

Georgia is taking significant steps to protect its wines with intellectual property. The National Intellectual Property Centre of Georgia signed a memorandum with the Wine Association promoting the competitive environment of the market and securing Georgian wine from counterfeiting both in the country and abroad. Initially, 18 Georgian wines were afforded GI protection in the EU, including Khvanchkara, Kindzmarauli, Saperavi, Mukuzani, and Tvishi. The PDOs of Georgian wine, as intellectual property of Georgia within the EU, have been issued and are being distributed to all Georgian embassies and the diaspora abroad. Since the Russian embargo in 2006, the Georgian wine sector has taken serious action to improve quality and control in order to enter more competitive markets like the EU. Currently, domestic production of counterfeit wine has been completely eliminated, and embassies along with NWA staff abroad are actively working to identify fake Georgian wines abroad.

Table 7: Entry tariffs for Georgian wine

Entry Tariff	Countries
0%	Albania, Armenia, Austria, Azerbaijan, Belarus, Belgium, Bulgaria, Canada, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hong Kong, Hungary, Iceland, Ireland, Italy, Kazakhstan, Kyrgyzstan, Latvia, Lichtenstein, Lithuania, Luxemburg, Macao, Macedonia, Malta, Moldova, Netherlands, Norway, Papua New Guinea, Poland, Portugal, Romania, Singapore, Slovakia, Slovenia, Spain, Sweden, Switzerland, Tajikistan, Tonga, Turkey, Ukraine, United Kingdom, Uzbekistan, USA
0 – 5%	New Zealand, Philippines, Australia
5 – 10%	Chile, Peru, Bolivia, Haiti, Mayotte, Nicaragua, Kosovo
10 -15%	Panama, Costa Rica, Croatia, Cuba, Bosnia and Herzegovina, French Polynesia, Honduras, Republic of Korea, Lebanon, Mauritius

Source: USAID

In October 2010, Georgia became a member of the World Wine Trade Group, joining Argentina, Australia, Canada, Chile, New Zealand, and the US. The group's purpose is to simplify trade between the member countries. In October 2011, the countries signed a Memorandum of Understanding (MoU) on Certification Requirements, which aims to reduce barriers to the international wine trade and support exporters of wine in each participating country by encouraging the elimination of burdensome requirements and routine certifications of wine products and ingredients.

In 2013, the Georgian government implemented several measures in support of the wine sector, including the subsidization of grape purchases and the provision of cheap credit. As part of the Preferential Agrocredit Project (PAP), wineries that purchase grapes for GEL 1/kg or more will be eligible for 15-month term loans at a 12-15% interest rate, of which 9% will be covered by the government. For example, Kakhetian Wine Cellar took out a US\$ 600,000 loan to purchase wine-making equipment and technology from Della Toffola. The government also provides a subsidy of GEL 0.40/kg for Rkatsiteli and Mtsvane and GEL 0.25/kg for Saperavi.



SWOT Analysis

Strengths

- Lower land prices compared to other wine-growing regions in Europe
- Favourable climate and soil conditions
- Availability of low-cost labour in agriculture
- Government and investment support and support from international donors
- Ease of starting business, investor-friendly legal and tax framework
- Relative ease of access to EU markets
- Strengthening international image of the "Cradle of Wine" with over 8,000 vintages
- Wide variety of indigenous grapes and wine styles

Weakness

- Small average sizes of vineyards and lack of consolidated land plots resulting in lower yields and no economies of scale
- Lack of experience and exposure in international markets
- Insufficient infrastructure and professionals in the fields of winemaking and wine tourism
- Production of varieties unknown outside of Georgia and the CIS
- High transportation costs and lack of bottle and cork production facilities domestically
- Still high local demand for homemade, jug wine limiting the domestic market and skewing the price of grapes upwards

Opportunities

- Increasing productivity for existing products
- Increasing trade to EU and new product opportunities in CIS, DFTA with EU
- Shift into production of higher value-added products
- Rising numbers of tourists and the related wine tourism
- Large number of small wineries poised for consolidation
- Re-opening of the Russian market in 2013
- Focus on qvevri-made and natural wines as a niche category strongly supported by the "Georgian wine story"
- Domestic demand increasing towards higher quality bottled wines

Threats

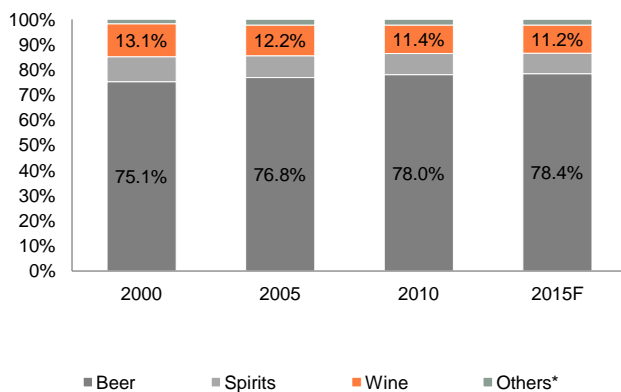
- Reputational damage (e.g. counterfeit wines)
- Protectionist/safeguard measures from wine-importing countries (e.g. Russia 2006)
- Increasing input costs
- Climate changes
- Fluctuation of market prices
- High barriers of entry in certain countries

Annex 1: Trends in the Global Wine Market

Supply Side

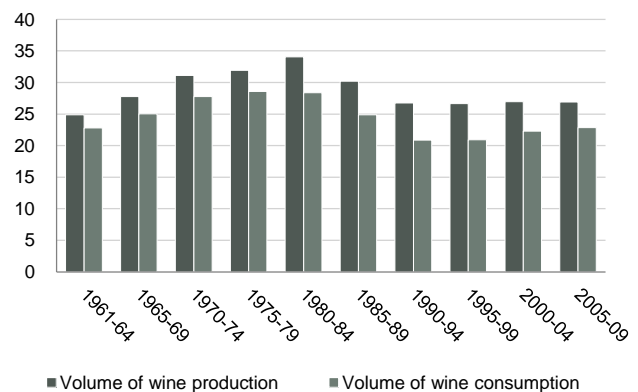
The global alcohol industry generates US\$ 2.5tn in revenue annually, 11% from wine. By 2016, the wine segment is expected to grow to US\$ 330bn from the current US\$ 285bn – annual growth of 4-5% on average. In recent years, spirits and wine have been losing market share to beer.

Figure 36: Global share of alcoholic drinks by category (vol.)



Source: Euromonitor

Figure 37: Historical wine production/consumption (bn liters)

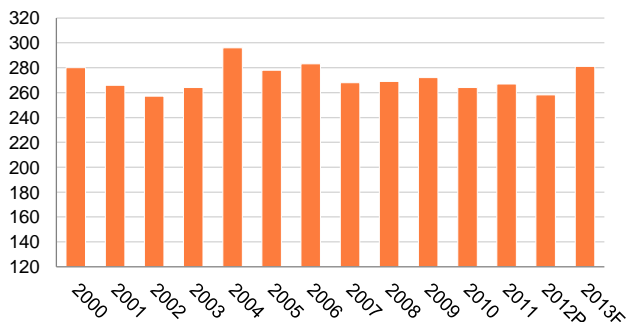


Source: Anderson and Nelgen

Wine production was down 25% since the early 1980s to 252mn hectolitres in 2012 as a result of lower output in Italy, France, Germany and Spain. This was not fully offset by an increase in production in the US, Australia, Chile and Argentina. The drop in output in the Old World countries was mainly due to a reduction in vineyard area as a result of government regulations. Wine consumption has also declined in Europe, and beer and spirits are making inroads in traditional wine-consuming countries.

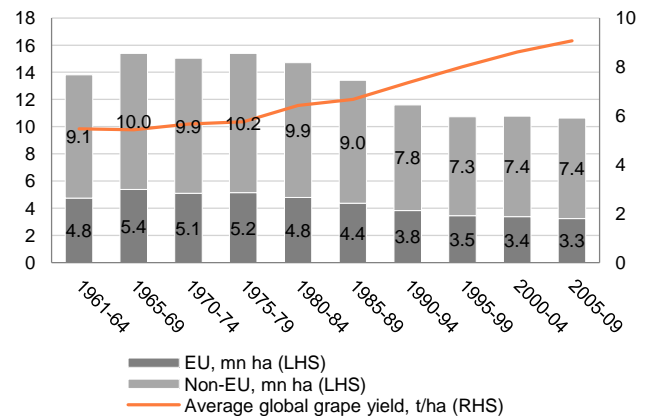
Cost-reduction efforts by governments have led to vineyards being replaced with more profitable crops, particularly in the EU. The impact of regulations in the EU has driven a decline in the total vine-growing area over the past few years due to shrinking margins. The EU also cut subsidies over 2009-2011 to reduce surpluses and eliminate the production of uncompetitive wines (in some cases this affected competitive winemaking regions too, such as parts of France's Bordeaux). Producers were compensated for shifting to alternate activities. As a result, EU wine production in 2012 declined 9% y/y to 141mn hl.

Figure 38: Global wine production (mn hectoliters)



Source: OIV

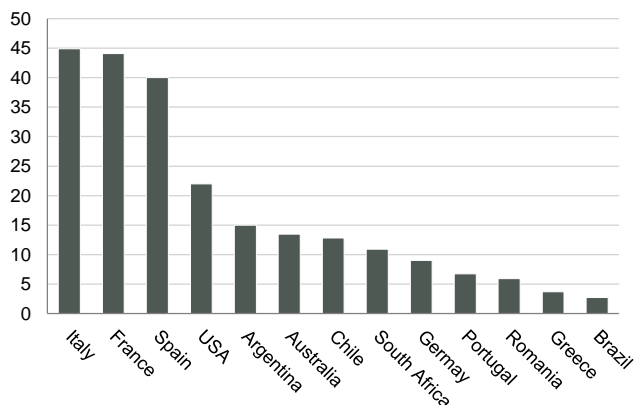
Figure 39: Global vineyard area and average yields



Source: Anderson and Nelgen

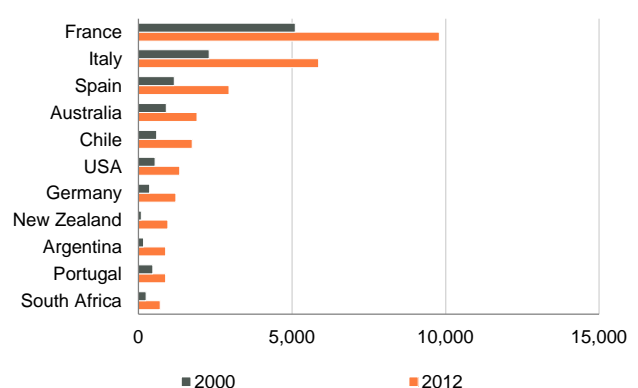
However, global wine production is expected to have risen by 9% y/y to 281mn hectoliters in 2013. Four EU countries (Spain, France, Italy, and Romania) along with the US and Argentina are the main contributors to this forecasted growth, increasing wine production by 18mn hectoliters in total.

Figure 40: Wine production by country in 2013 (mn hl)



Source: OIV

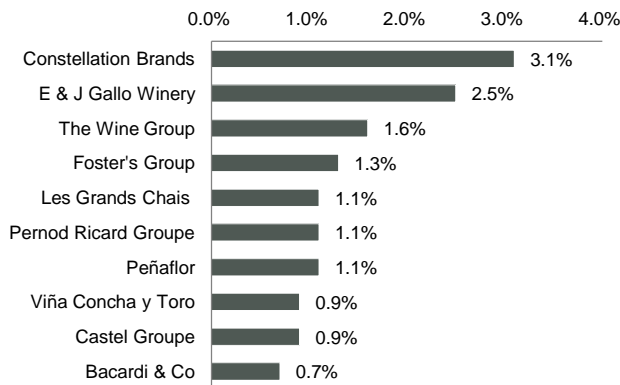
Figure 41: Top wine exporters (US\$ mn)



Source: Global Trade Atlas; OIV; OeMv

Five countries produced 59% of the world's wine in 2013. The EU is the world's leading wine producer, with almost half of the global vine-growing area and about 55% of production by volume. Italy, France, and Spain are the largest EU wine producers, representing 80% of total EU output. The US and China are the fourth- and fifth-largest producers.

Figure 42: Share of top 10 global wine producing companies (2009)



Source: Anderson and Nelgen

The world's top 10 companies hold only a 14% share of the market in volume terms. It is a highly fragmented market with many small local players, which creates an interesting diversity and makes a broad consolidation likely in the near-term. Cross-border M&A is expected to be a major theme for wine producers as they seek export revenues and geographical diversification of production facilities to limit exposure to country-specific risks like poor harvests or overproduction.

Demand Side

Changing consumer preferences have driven a decline in wine consumption since the 1980s. Drivers include the younger generation's shift towards beer and spirits, health concerns, and stricter laws for drunk driving. Notably, Italy, France, and Spain accounted for most of the global decline, with spirits and beers capturing an increasing share of total alcohol consumption.

Figure 43: Global consumption (mn hl)

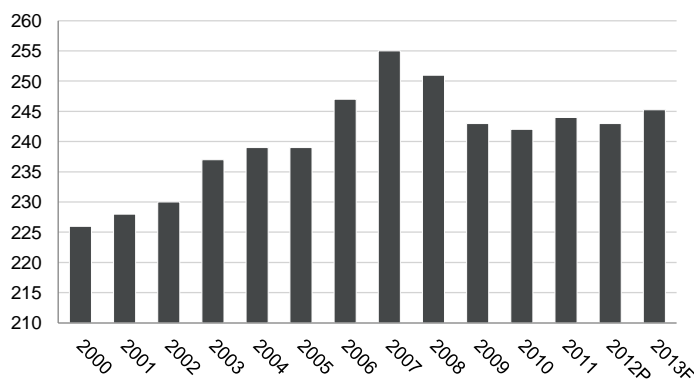
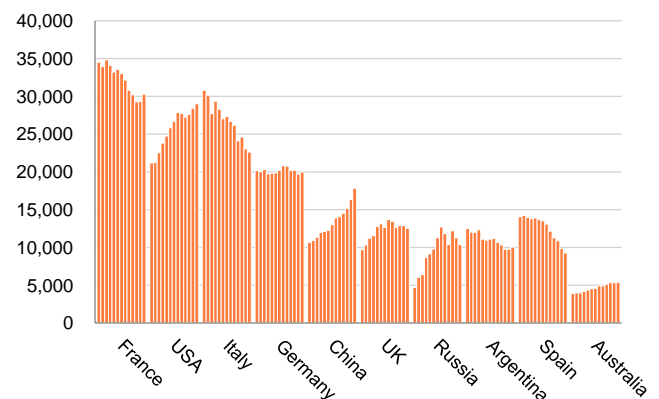


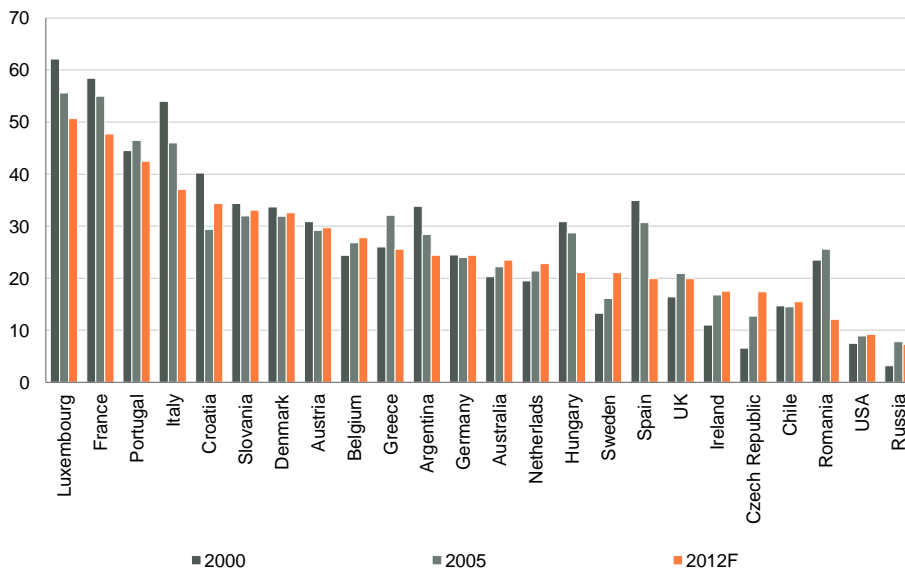
Figure 44: Consumption in top 10 countries 2000-12 ('000 hl)



Note: 2013F figure is an average of OIV's forecasted consumption range of 238.4mn hl and 252.1mn hl Source: OIV

European countries lead global per-capita wine consumption. Per-capita wine consumption differs greatly between countries for economic, geographic, and cultural reasons. With a few exceptions, average alcohol consumption has gradually fallen across Europe. There has been a degree of convergence in drinking habits across the EU, with wine consumption increasing in many traditional beer-drinking countries and vice versa. In the traditional wine-producing countries of Italy, France, and Spain, as well as in Greece, per-capita wine consumption has fallen considerably since 1980 but remains among the highest globally.

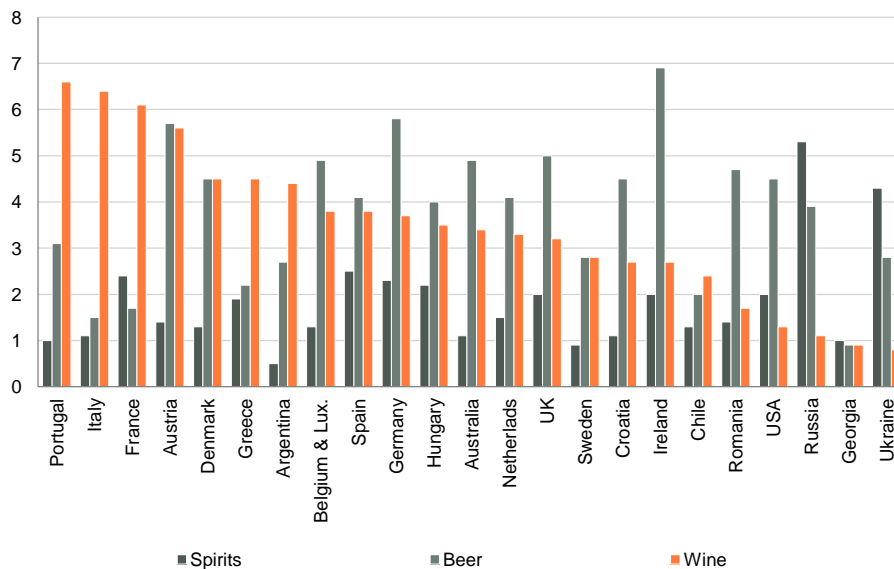
Figure 45: Per-capita wine consumption (liters per year)



Source: OIV

Per-capita wine consumption is on the decline in Southern Europe, where changing lifestyles and tastes, anti-alcohol campaigns, and health concerns have hit overall demand. Meanwhile, consumption is flat or slightly increasing in Northern Europe and is focused on branded wines or varietal wines (wines made primarily from single grape varieties).

Figure 46: Liters of alcohol, per-capita consumption (2005-2009 average)

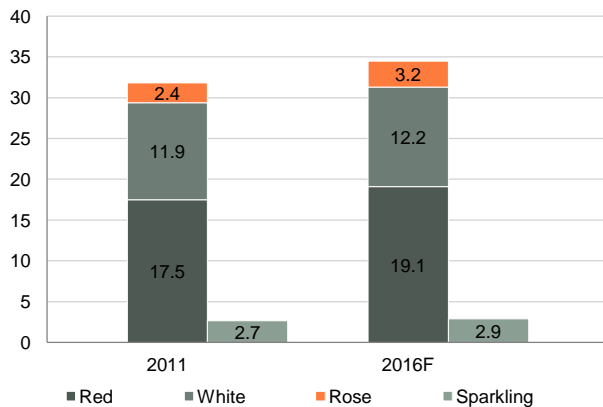


Note: Excludes the consumption of home-made alcoholic beverages
Source: Anderson and Nelgen

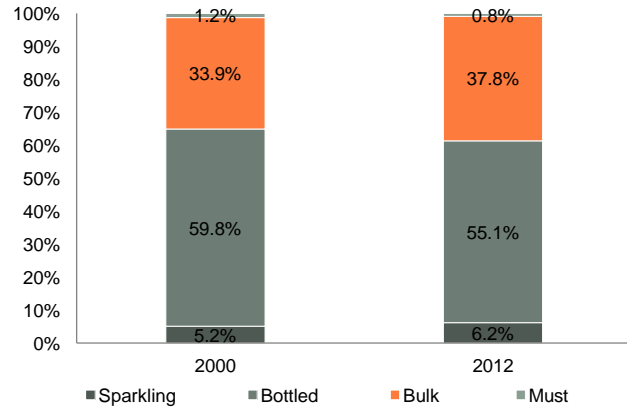
Global wine consumption is projected to grow 5.3% from 2012 to 2016. Vinexpo, which organizes international wine and spirits exhibitions, forecasts annual world consumption of 259mn hl in 2016, with growth led by China, the US, Russia, and Australia, while consumption in the EU is expected to remain flat. In 2010, China became the 5th-largest consumer in the world, while the US took the top spot in 2007, overtaking Italy. Australia also recently joined the top 10 consumers of wine.

Based on IWSR projections for 2011-2016 period, sparkling, red, and rosé wines are expected to post the highest growth rates (8.5%, 9.1% and 30.8% respectively). White wine is expected to grow modestly at 2.8% in total until 2016, losing its market share in the still wine category. The projected increase in the consumption of sparkling wine is primarily driven by rising demand in the category's top four markets: Germany, France, the US, and Russia. Growth in sales of red wine, on the other hand, is expected to be primarily driven by China.

Figure 47: Global consumption forecast, (bn 0.75 liter bottles) Figure 48: Share of world wine exports by volume



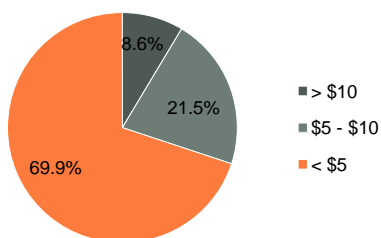
Source: VINEXPO, IWSR



Source: OIV

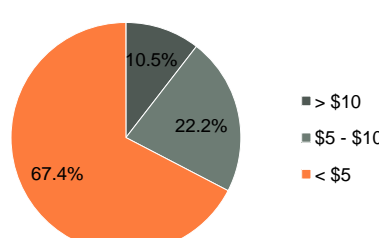
Bottled wines are expected to lose market share to bulk wines. Wine shipments are shifting towards 24,000-liter polypropylene "flexi-tanks", a trend that has spread through New World wine-producing countries such as Chile, Argentina, Australia, and New Zealand. Shipping distance is a serious consideration in these countries, as are strong currencies in Australia and New Zealand, all of which are forcing producers to cut costs to stay competitive. On the downside, when wine is bottled outside the country, winemakers lose control of a key part of the production process. Bottlers and wine industry players that are trying to counter growth in bulk exports are diversifying to China, Japan, and Africa, where demand for wine is growing.

Figure 49: Global wine consumption by price category in 2011 (0.75l bottles)



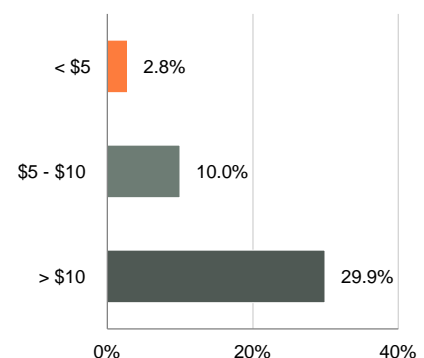
Source: VINEXPO, IWSR

Figure 50: Global wine consumption by price category in 2016 (0.75l bottles)



Source: VINEXPO, IWSR

Figure 51: Global wine consumption growth rates by price category 2011-2016



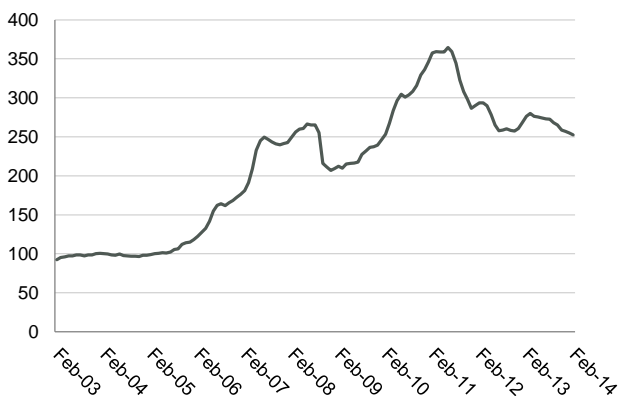
Source: VINEXPO, IWSR

Premium wines, priced at above US\$ 10/bottle, are expected to post the highest growth in the next five years. These wines accounted for 8.6% of global still wine consumption in 2011, and consumption has grown by 12.6% since 2007, mainly due to sales in China, the US and Canada. The premium wine segment is expected to grow by an impressive 29.9% over the 2011-2016 period.

Globalization has affected wine consumption by, for example, creating "brands" from popular international grape varieties. Consumers often choose wines not only on the basis of

the country of origin and manufacturer, but also on the grape variety. Because consumers have a wide variety of choice in terms of countries, regions, appellations, varieties, and manufacturers, it is often simpler to opt for a variety, regardless of the country of origin. This standardization of taste creates some barriers for entry-level wines in the commercial category. Wines from valuable terroirs (natural environment in which a particular wine is produced, including factors such as the soil, topography, and climate) and highly-acclaimed history do not face this issue.

Figure 52: Liv-ex Fine Wine 100: price index development of the most popular wines



Source: Bloomberg

Since its peak in June 2011, the benchmark fine wine prices index Liv-ex Fine Wine 100 fell by 30% from 365 to 252 in February 2014. Calculated monthly, the Liv-ex Fine Wine 100 Index tracks the price movement of 100 of the most sought-after fine wines for which there is a strong secondary market. The constituent wines of the index are mostly from France (Bordeaux, Burgundy, the Rhone and Champagne regions) and Italy. After a peak in July 2011, the subsequent soft recovery has come mainly on lower production on the back of drought and hail damage in Italy, France, and Argentina in 2012. The production slump depleted stocks, which eventually propped up prices in 1H13 before marginally declining in 2H13 and 1Q14.

Annex 2: Old and New World Wines

New World and Old World are two broad categories for the classification of wine-producing countries. The Old World category comprises EU-based countries with a long tradition of wine-making, principally France, Italy, Spain and Germany. The New World category comprises countries where winemaking has a shorter history, including Australia, Chile, and the US. For a long time, Old World wines were considered superior in terms of quality and taste. This has been challenged in 1976 in Paris, when a blind taste test conducted by French judges placed Californian wines ahead of French ones in both the red and white wine categories.

New World producers have benefitted from ample land resources and lower labor costs. They have also taken advantage of off-cycle growing seasons in the southern hemisphere to focus on export-dominated strategies.

	New World	Old World
Constituent countries	<ul style="list-style-type: none"> USA, Canada, Australia, New Zealand, Chile, Argentina, Uruguay, and South Africa 	<ul style="list-style-type: none"> France, Italy, Spain, Portugal, and Germany
Production methodology	<ul style="list-style-type: none"> More modern methods of production; consistently able to create high-quality wine Some producers opt to use computer-monitored steel tanks 	<ul style="list-style-type: none"> Tend to use older methods of production that have become a part of their culture instead of constantly innovating, particularly France. It is common to use oak casks Other, more unorthodox methods are relatively less widespread Latest technologies are also widely used
Market segment	<ul style="list-style-type: none"> New World wines usually target the lower and middle price ranges and have a hard time competing in the premium market, although there are many regions (e.g. Opus One) capable of producing premium wines 	<ul style="list-style-type: none"> French wines typically are capable of competing in the higher price classes, and it is not uncommon to find French wines that retail for over US\$ 100 Italian wines tend to be known as good for pairing with meals and therefore do not tend to fetch as high a price as French wines, but they do compete very well in the mid to lower price categories
Packaging	<ul style="list-style-type: none"> In recent years, countries like the US, Australia and South Africa are much more likely to use metal screw caps instead of corks. <ul style="list-style-type: none"> Although untraditional, this minimizes the chance that the wine inside the bottle will become oxidized, leading to spoilage, but at the same time hinders its development Australia also developed the innovative wine-in-a-box, a rectangular shaped container with a plastic spigot near the top for pouring. <ul style="list-style-type: none"> This device, seen as gaudy by many wine traditionalists, does offer benefits in terms of reducing shipping costs and being easier to store in freight or a consumer's refrigerator. 	<ul style="list-style-type: none"> Traditional packaging with glass bottles and corks is preferred, emphasizing the consistency and value of the wine Latest technologies are also used
Vineyard sizes	<ul style="list-style-type: none"> In the US, the average vineyard is 213 acres (86 ha), while in Australia it is 167 acres (68 ha) 	<ul style="list-style-type: none"> Land/vineyard of just 7.4 acres (3 ha) in France and 1.3 acres (0.5 ha) in Italy These differences are a remnant of the old inheritance systems of Europe between the 16th and 19th centuries, when estates were broken up into smaller holdings to be divided between children This has led to a supply market in the Old World that is extremely fragmented
Vertical integration	<ul style="list-style-type: none"> The large land holdings of US and Australian wine companies allow them to own the entire supply chain from grape to bottle This advantage allows New World wineries to cater to changes in consumer preferences downstream and thereby respond to shifts more effectively 	<ul style="list-style-type: none"> Wineries and vineyards are both small, offering only specialized regional products. Wineries, vineyards and distributors are rarely under the ownership of the same entity Typically, small vineyard owners sell their grapes to a nearby vintner, who also receives grapes from other farmers. The vintner then ferments the wine and sells it in bulk to a wine merchant, who receives wine from many different vintners within the same region Finally, the wine merchants blend and bottle the products before distributing them for sale
Regulatory framework	<ul style="list-style-type: none"> Regulatory entities are more receptive to innovative methods 	<ul style="list-style-type: none"> Because wines are so important from a cultural standpoint, there is greater legal oversight over production and



	<ul style="list-style-type: none">• For example, drip irrigation, a method employed in Australia to make marginal soils more arable, has created opportunities to expand land holdings, but it is forbidden in France• Another example is the use of reverse osmosis– a technology used to give wine a fuller flavor by concentrating the must during fermentation, a practice mostly restricted in Old World countries	<p>processing methods</p> <ul style="list-style-type: none">• Germany, for instance, has a wine law dating from 1971 mandating that a government panel sample each vineyard's annual harvest and assign it a quality level• French wines are regulated by the Appellation d'Origine Contrôlée (AOC), a set of laws that define regional boundaries and enforce a set of winemaking standards for vineyards and wine makers• Italy has a similar set of laws called the Denominazione di Origine Controllata (DOC)
Production costs	<ul style="list-style-type: none">• Economies of scale, cheaper labor, cheaper land, fewer regulations, openness to innovation and milder climates have all played a role in reducing production costs• For example, to produce one ton of wine in Australia costs around EUR 137	<ul style="list-style-type: none">• Fundamental differences in laws, customs, and underlying production factors make Old World production costs much higher than in the New World• In France, the cost to produce one ton of wine is approximately EUR 238 (US\$ 310)



Annex 3: Wine Classification

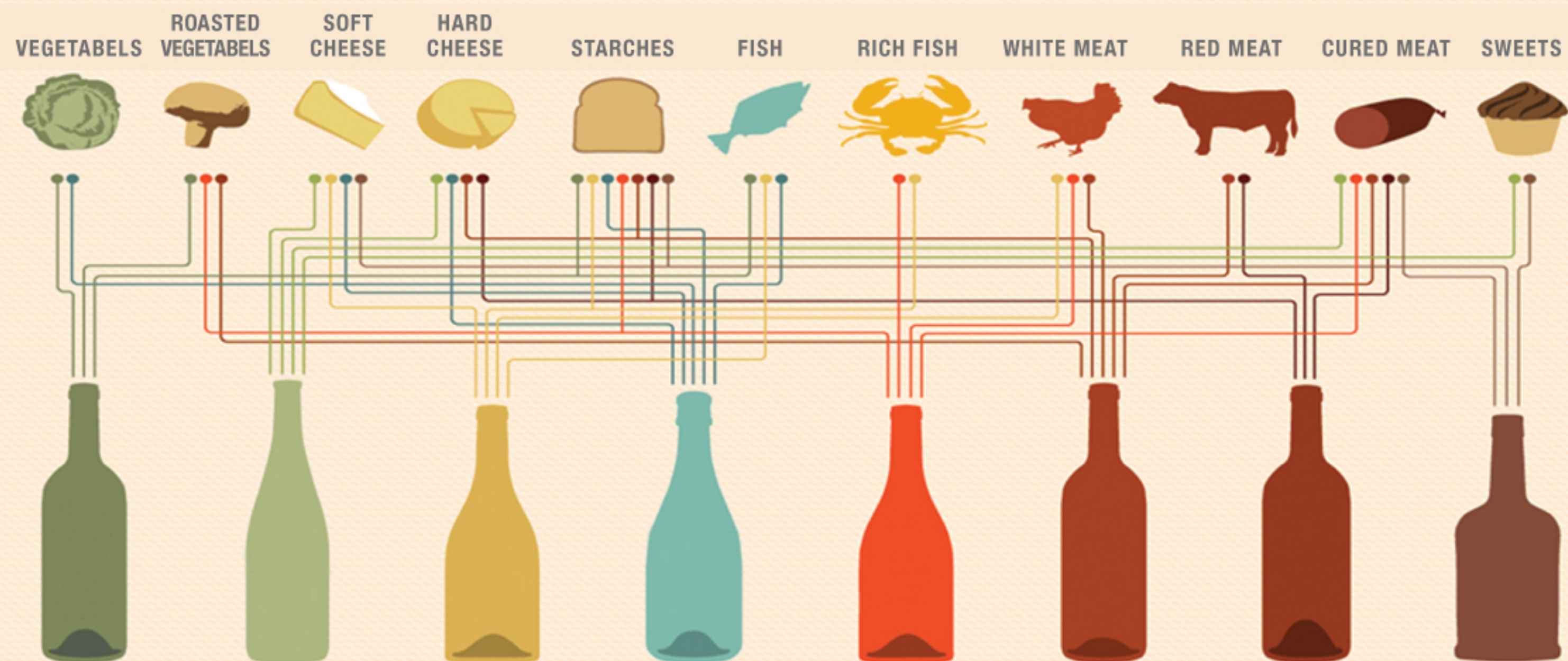
Wine types

Still wines	The majority of wines fall into this category. Still wines are not sparkling or fizzy and have an alcohol content level of between 8% and 15%, with most containing 11.5-14.0% alcohol. Many still wines are named after the region in which they are produced. Wine from New World countries such as Australia is often labelled with the name of the grape used.
Sparkling wine	Wines containing bubbles of carbon dioxide. For example, Champagne, Cava from Spain and Asti from Italy.
Fortified wine	Wines with higher alcohol levels of 15-22%. Examples of fortified wines include Sherry from Spain and Port from Portugal.

Wine styles

Color	
Red	The color of the wine comes from using black grapes. The juice ferments in contact with the grape skin, coloring the juice.
White	White wine is usually made from white grapes. It is possible to make white wine from black grapes if the skins are removed before fermentation. White wines are often seen as a lighter, refreshing alternative to red wines.
Rosé	These wines are made from black grapes, with the wine having less contact with the skins. Rosé wines are usually not as full-bodied as red wines, but offer more body than white. Rosé tends to be a very seasonal drink, selling mostly in summer.
Sweetness	
Grape juice is naturally sweet, but as yeast feeds on the grape sugars during fermentation, the juice becomes less sweet. Yeast will die once the alcohol reaches 15% or when all the sugars have been used. Any sugar remaining in the wine once the yeast is dead will determine the sweetness of the wine.	
Dry	Residual sugar is below 0.5% in bone dry wines and is between 0.5% to 1.0% in dry wines. The majority of wine is dry because the yeast turns all the sugar into alcohol and carbon dioxide gas. Most red wines and the majority of white wines are dry, although some are drier than others.
Semisweet / Medium	Medium wines are usually white or rosé. To make a medium wine, the winemaker either removes the yeast from the juice before all the sugar has been consumed or adds unfermented, sweet grape juice to dry wine. A medium wine should be sweet but not sickly. Normally, the residual sugar level is 1% to 2% for medium dry wines and 2% to 3% for medium sweet wines.
Sweet	The residual sugar level is normally above 3% for sweet wines. Sweetness is immediately noticeable. Often, the sugar makes the wine feel thicker and richer. The best sweet wines are made from grapes so rich in sugar that the yeast dies before all the sugar is consumed. The sweetness should be balanced with a refreshing acidity to prevent these wines from being cloying.
Body	
<p><i>Body is the general feel of the wine in the mouth.</i></p> <p><i>Red wines derive their color from a wide array of grape varieties, giving rise to such color classifications as light red, ruby red, opaque purple, deep violet, and maroon. Grape skins are responsible for the distinct color spectrum of red wines.</i></p> <p><i>White wines have a spectrum of color ranging from light straw, usually with green tints, to a deep golden yellow. The colors are derived from the distinct grape varieties and blends – from grape juice and the skin of green, gold or yellowish colored grapes.</i></p>	
Red	
Light-Bodied	These have plenty of acid and often taste like cherries or other bright red fruits. Light-bodied red wines have less tannins and less presence on the palate. An example of a light-bodied red wine is one that is derived from the Gamay grape. This type of wine color tends to be less demanding and partners with flavor-filled foods.
Medium-Bodied	These contain more tannins than light-bodied red wines. They don't have a strong presence on the palate. Examples of this type of wine are Merlot, Chianti or Sangiovese.
Full-Bodied	These boast the highest level of tannin and alcohol content. They feel heavier in the mouth. They are highly opaque. Examples are Bordeaux wines, California's Cabernet Sauvignon, and Super Tuscans.
Old	This type of wine has a dull brown color, likely indicating that it is past its prime. Others stain orange (Merlot and Nebbiolo) earlier than new wines.
Rosé	These have a pink coloring which can range from a soft subtle hue (pale salmon) to vibrant pink (magenta) depending on the type of grape used and how long the grape skins were in contact with the juice. Examples are Pinot Noir and Garnacha.
White	
Light-Bodied	This type of wine is usually described as feeling thinner and more like water in the mouth. Its coloring ranges from clear to pale straw yellow to light gold. It has tropical fruit notes. Examples are Pinot Grigio, Albarino, Riesling, and Muscadet.
Medium-Bodied	This type of wine falls in between light-bodied and full-bodied wines. Most white wines are in this category and are in pale-yellow-gold in hue. Examples are Chenin Blanc and Sauvignon Blanc.
Full-Bodied	This type of wine is described as feeling thicker and heavier, more like milk in the mouth. They have less acidity and are oak-aged to add creaminess and vanilla aromas. Examples are Oaked Chardonnay and Marssanne.
Old	Most white wines are made to last for just a couple of years, as after that they lose their sheen and become very dull-looking. Sensitivity to light makes white wine turn orange as it ages.

Source: BoG Research, Georgian Sommelier Association, G Brand International, Liquid Partyworks



	DRY WHITE	SWEET WHITE	RICH WHITE	SPARKLING	LIGHT RED	MEDIUM RED	BOLD RED	DESSERT
FOREIGN VARIETIES	Sauvignon Blanc, Grüner Veltliner, Pinot Grigio, Albariño	Gewürztraminer, Müller-Thurgau, Malvasia, Moscato, Riesling	Chardonnay, Roussanne, Marsanne, Viognier	Sparkling wine, Prosecco, Champagne, Cava	St. Laurent, Pinot Noir, Zweigelt, Gamay	Red table wine, Tempranillo, Sangiovese, Zinfandel, Grenacha, Merlot	Cabernet Sauvignon, Monastrell, Aglianico, Malbec, Syrah	Late harvest, Ice wine, Sherry, Port
GEORGIAN VARIETIES	Tsitska, Tsolikouri, Kisi	Tvishi (Tsolikouri), Tetra (Rachuli Tetra), Kardanakhi (Rkatsiteli)	EUROPEAN STYLE Krakhuna, Rkatsiteli, Kakhuri Mtsvane, Khikhvi IMERETIAN STYLE Wines from qevri Tsitska, Tsolikouri, Krakhuna KAKHETIAN STYLE Wines from qevri: Rkatsiteli, Kakhuri Mtsvane, Kisi, Khikhvi	Sparkling wines from Chinuri, Tsitska, Goruli Mtsvane	Aladasturi, Tavkveri, Chkhaveri (Rose)	Aleksandrouli, Usakhelouri, Shavkapito	Saperavi, Otskhanuri Sapere	Khvanchkara (Aleksandrouli, Mujuretuli), Usakhelouri , Ojaleshi (Ojaleshi and Orbeluri Ojaleshi), Kindzmarauli (Saperavi), Akhasheni (Saperavi)

Annex 4: Wine Production Process

All wines

1. Grape receiving

Grapes are received in special reception areas at wine-making facilities. The reception area is where the vineyard meets the winery. The grapes are unloaded and weighed here. The grapes are mainly delivered by trucks. Distance from the vineyard and the winery determines the delivery method. For short distances, grapes are placed directly on trucks. For long distances, grapes are placed in 20-22kg plastic boxes, which are stacked to prevent crushing.

2. De-stemming/crushing

After being weighed, the grapes are loaded onto a selection carpet where below-grade bunches are removed. Grape bunches are then loaded into a crusher de-stemmer. During the crushing process, moisture content and sugars are removed. Many wineries use special machines to crush and press grapes.

White/Rosé

3. Juice extraction

Juice is extracted from grapes through the process of pressing. This can be done with the aid of a wine press, by hand, or even by the weight of the grapes themselves.

4. Grape-must clarification

This is a method for the clarification and concentration of grape musts. Harvested, picked, and crushed grapes are placed in a vinification vat, from which must (juice) is extracted. The must then passes into an apparatus in which the must's solids and liquids are separated, and the liquids are then introduced into a flotation apparatus for clarification. The clarified must is then conveyed to a vat connected to a reverse osmosis concentration loop.

5. Juice fermentation

The fermentation process turns grape juice into alcohol. During fermentation, yeasts interact with sugars in the juice to create ethanol, commonly known as ethyl alcohol, and carbon dioxide, which is a by-product. The temperature and speed of fermentation are important considerations as is the level of oxygen present in the must at the start of fermentation.

6. Lees recovery

There are often substantial quantities of grape juice and unfinished wine left behind in the solids and sediments at the bottom of the tanks used in many different stages of making and processing wine. Recovering these can make a noticeable difference to costs.

Red

7. Fermentation

Red wines are fermented in contact with solid materials from the grape in order to extract the compounds that give the wine its color, body, and depth of flavor and aroma.

8. Wine extraction

A key process in red wine production is the extraction of flavor and color from grape skins. The pulp of almost all grapes is colorless, the exception being rare teinturier grapes such as Alicante Bouschet and Sousão. The skins, however, are richly pigmented, containing a range of compounds such as anthocyanins and tannins that are important contributors to the color and structure of red wines.

All wines

9. Wine clarification

Clarifying wine is the process of enhancing its clarity, color, and taste. There are insoluble materials that cause the wine to become cloudy, and clarification removes any unwanted sediment deposit. It also removes temperature-unstable proteins that cause the wine to appear hazy if exposed to high temperatures after bottling. The goal of clarification is to improve the taste, color, bouquet, and clarity of the wine. Clarifying the wine should not have an effect on its aroma and flavor.

10. Wine stabilization

Wine must be stabilized before bottling, otherwise there is a high risk of re-fermentation, malo-lactic problems and "spritziness" in bottles. These problems make for an unpleasant drinking experience, leave behind dead yeast and unwanted flavors, and cause corks to eject themselves.

11. Bag-in-box filling

Aseptic processing and packaging involves the filling of commercially sterilized products into pre-sterilized containers. The sterile, cooled product is processed separately from the packaging. Incoming packaging is sterilized independently of the product. Packaging is filled and hermetically sealed with a pre-sterilized closure in an atmosphere free of microorganisms. Hot-fill processing sees the heated, commercially sterile product placed in non-sterile packaging. The product is held for a predetermined time and temperature in order to sterilize the packaging prior to the filling process. Only high-acid products can be hot-filled and held at ambient temperatures without refrigeration.



12. Bottling

A standard wine bottle has a neck opening of 18.5 mm in diameter that accommodates a standard cork. Bottles are sanitized before use. This prevents the growth of organisms in the bottle. A sanitized siphon hose and rod are necessary, and a siphon filler is an excellent tool for getting the fill levels right. Consisting of a rigid tube and a one-way valve, it allows carefully controlled filling. Bottles are filled so that the wine is about one inch from the bottom of the cork.

13. Aging

There are no general standards about how long any given wine will age. For example, while it is certain that many Cabernet Sauvignons will age well for 5-7 years, there are plenty that will not age at all (fruitier, less expensive wines) and some that will age for decades (richer, more expensive wines). The factors that allow a wine to age are quite complex, but there are a few rules of thumb: The wine must have a fairly high tannin level; acidity is necessary to maintain a fresh taste; and a high fruit content is required to prevent the wine losing flavor as it ages. The more that these three elements are present in a wine, the longer it will age.

Sources: Wine country tours, Moreflavor, Wineanorak.com, Alfalaval, Scholle, Mainbrew

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Head of Research

Ekaterina Gazadze | egazadze@bog.ge

Address: 29a Gagarin Str. Tbilisi 0160, Georgia**Tel:** + (995) 32 2444 444**Email:** Research@bog.ge**Economist**

Eva Bochorishvili | evabochorishvili@bog.ge

Economist

Alim Hasanov | ahasanov@bog.ge

Senior Associate

Giorgi Nakashidze | gnakashidze@bog.ge

Associate

Giorgi Iremashvili | giremashvili@bog.ge