

Elliot Turner, Managing Partner and Chief Investment Officer of RGA Investment Advisors, and Nick Devlin, Chief Executive Officer of Naked Wines (UK: WINE), joined members for a fireside chat at Latticework on December 16, 2021.

Elliot and Nick discussed the evolution and business model of Naked Wines and explored the topic, “Driving Customer Value via Scale Economies Shared”.

This conversation is available as an episode of “Gain Industry Insights” and “Discover Great Ideas”, member podcasts of MOI Global. (Learn [how to access](#).)

The following transcript has been edited for space and clarity.

John Mihaljevic: Today’s session is with Elliot Turner of RGA Investment Advisors and Nick Devlin of Naked Wines.

I’m sure many of you — if not most — know Elliot quite well. He has been so generous sharing his insights and wisdom with the MOI Global community over the years, and he is co-host with me on our podcast, *This Week in Intelligent Investing*.

What stands out to me about Elliot is the work he does on all of the companies he invests in. He is a long-term shareholder and tries to get to know those businesses like an operator would. That’s what sets him apart. That’s the reason that he has delivered so many great ideas to the MOI Global community in his past presentations. Elliot has a CFA as well as a law degree. He is one of the smartest guys I know in the business.

Briefly on RGA, the firm runs a long-term, low-turnover, growth-at-a-reasonable-price investment strategy, seeking out global opportunities.

I’ll now turn it over to Elliot to say a few words about Nick and get us started with this conversation.

Elliot Turner: Thank you so much, John, for that incredibly kind introduction. I am fortunate to learn from your wisdom week in, week out as my partner in crime, along with Phil, on *This Week in Intelligent Investing*. I’ve learned so much from the community you’ve put together, and I look forward to another opportunity for an in-person event with you. I was eager to get back to Switzerland this year — who knows what might happen. I’ve missed the personal presence as well, but I know that’ll happen again.

I’m delighted that you invited me to host this session today, and I’m grateful that Nick Devlin was willing to give us some of his time. I’ve gotten to know Nick over the past year and a half, and I’ve been enjoying our conversations. I’ve appreciated Nick’s perspective on business and have enjoyed getting to know how he thinks. He’s one of those long-term, sharp thinkers who breaks down a problem in a focused, neat way.

I’ve looked at many companies and have invested in many companies where lifetime value analysis is important. One of the things that excites me about Naked Wines is that their disclosures and the level of detail and the candor and quality of presentation is second to none. It’s a breath of fresh air. In an industry where there’s a lot of opacity, you have an

honest, forward-thinking company that will tell you exactly how they see it. That's due to Nick and the culture at Naked Wines itself.

I was lucky to have had the opportunity to meet Nick in person this past year, to get to know him and talk beyond business. He's a great guy. He's got a little competitive side to him which doesn't come through as much on the conference calls, but it's there, and it's interesting to see. He's a good athlete in his own right. I'm looking forward to cycling with him some time in the not-too-distant future.

With that, I want to share a couple of my favorite wines from Naked Wines because this is an incredibly fun company to diligence, and I'd encourage all of you to at least try. I always make sure to have the DRG reserve cab at home. I like the Matt Parish Trevino. The Jesse Katz Exposed is interesting and is one of the hidden gems in the wine industry — something that gives you incredible value and great bang for your buck for a special occasion. I'll throw those out there. Nick, could you share a couple of your favorites and then tell us how you first got to Naked Wines?

Nick Devlin: You don't have to twist my arm too much, Elliot, to talk about wine. It's a pleasure to come on. In turn, thank you for your kind words. I've enjoyed our conversations a ton as well. It's been a lot of fun getting to know each other — I learned something new about you today: I knew about your investing background, but I didn't know you had a law degree. That explains some of the sharp, perceptive questioning that comes along.

Let's talk about wine! I'm going to pick out a couple of favorites in the range for a couple of different reasons. One of the first wines that I fell in love with at Naked, and that brought home to me some of the things that we can do that are different, was another Matt Parish wine, but it's a wine from El Dorado County which is in the foothills of California, so it's a bit inland. It's a reserve cab he makes there with a crew he calls the Pilot Hill Gang. They're the set of growers out there. What he set out to do with that wine was answer the question, "What happens if you take Napa farming practices and you put them on to a good established cabernet vineyard in a lesser-known region?" The answer: you get a beautiful wine. He makes it exactly the same way he makes his reserve here at Napa Wines for us — the same kind of oak profile, same treatment, and same kind of vineyard. We get a beautiful product that tastes like a \$50 wine that we can sell to our members at \$20. I come back to that one time and time again.

Something from a little further afield is the wine I've been obsessed with this year — we've got this fantastic charismatic grower, a guy called Gerd Stepp in the fields in Germany. He's got this professor kind of hairstyle. He spends a lot of his time out on the vineyards, and crafts these beautiful, fresh, vibrant wines. He's brought a pinot noir rosé through to the market this year which I was drinking all summer long.

I could go on all day, and I know we've got a lot of topics to get through, so I'll move on from wine and I'll give you the short version of how I ended up in the wine industry, especially in this role at Naked.

It's not an obvious career path when you're growing up in the UK. I haven't done anything

as impressive as you, Elliot. I've got a history degree, so I needed to go and find a job. What do you do when you haven't got any real training? You become a business consultant, so that's what I did.

I worked for a strategy house called OC&C in London for seven and a half to eight years, mainly in their consumer and leisure practice. Towards the end of that time, I was working as an associate partner there and had a bit of good fortune. A partner I worked with closely sold a project to Phil Wrigley, who at the time was the chairman of a business called Majestic Wine. Anyone who knows the Naked story will probably recognize that name, but for those of you who don't know, it was and still is the UK's largest retail wine seller, a business with about 250 stores as well as an online presence.

The project was a strategic review which I led. This was 2014. The business was struggling because it had started to see systematic volume decline. It was a fascinating project for me because I'd always been passionate about the wine industry as a consumer. I won't go too much into it because it's not so relevant here, but for me, it solidified a desire I had. It was fascinating to work in the business. We ended up with a seven-week review and after handing over the pile of recommendations. I thought, "I'd love a chance to actually do some of this stuff."

Long story short, our recommendations included a need for some new management at Majestic, but there was also a need for more digital capability in the business. Phil put those two things together and it corresponded at the time with the founder of Naked Wines, Rowan Gormley, looking for additional funding for the business. That was effectively the genesis of the tie-up between those two companies. That's how I got to meet Rowan.

During the course of him closing out his due diligence, I had a chance to meet with him and James Crawford who is still in the business today. I thought they had a real vision for doing something different in the wine industry — not just disrupting the way wine is sold, although that's part of it, but also they've got a passion and a vision for how to solve some of the challenges and issues faced by producers in the industry. That was what really resonated — that this was a business that was thinking about how it could solve problems for both consumers and producers, and doing something different. I was hooked pretty quickly. As a follow-up after the deal closed, I met Rowan for coffee. We had a half-hour chat and shook hands on a deal, and that's how I started working at Naked Wines.

Turner: Rowan is an interesting character. He built an interesting culture, a mission-driven culture with a passion for testing and learning — very data-oriented. Could you talk a bit about that culture, and the fact that you've inherited this culture and you've had the opportunity to steer it a bit to leave your own imprint while maintaining the essence of it, now that Naked Wines has been given its own wings from Majestic. It's kind of the reversal of that merger from the past.

Devlin: The great culture that we have in the business all stems from the fact that we have this authentic, clear, guiding mission. That's why of the 11-strong team who moved with Rowan to found the business 13 and a half years ago, a decent number of those people are still working in the business today. They're still as passionate about what we do as they

were back then when it was a small group of people trying to prove to the world that this crazy idea could work. What most of us get out of bed in the morning for is thinking about how we can change the way the industry works, and how we can solve real problems on behalf of our producers — our winemakers.

When you do that and you think, “My job is to work out how to create the conditions for a talented independent producer to be able to build a viable, thriving, growing business of their own and produce world-class wine, and connect them directly to people who love drinking it, and ultimately get out of the way and break down all of these barriers that have been set up —most notably in the US, through the infrastructure of the three-tier system,” that’s something that energizes people.

That’s the root of why the culture is so strong, because everyone is here for the same reason and the same purpose. Even when times are tough or things are hard, that’s something you can latch back on to, and it’s incredibly easy to reconnect to. Any time you’re having a tough day, a conversation with one of our winemakers about the impact the business has had, or even simply opening a bottle of wine, can put things into perspective.

That’s the root of the great culture. I heard Rowan talk about this once. He said, “I never really thought about culture at all. I just thought about building a group of people who are passionate about a shared goal, and a lot of what followed, followed really naturally.” That’s the first thing.

There are some hallmarks and some elements that Rowan bequeathed to the business — whether it was by design or by force of personality and nature — that I found attractive when I joined, and am keen to preserve. One of these is that it’s a pretty flat culture, and we strongly believe in having a marketplace of ideas. There’s no monopoly of great ideas. It doesn’t follow the org chart or follow seniority, but what you do need to be rigorous about is having a culture where everyone recognizes that there’s a right way to choose between a ton of ideas. You need to work out how to put ideas to the test — how to create an agile test-and-learn culture. You need to build an organization where there’s depth of literacy in data, where people are able to have an engaged debate and discussion about results and findings, where the best ideas win and are protected.

That’s been a hallmark in lots of different elements of Naked. It’s how we’ve been able to punch a bit above our weight, and why we’ve been able to continuously grow the business. It’s something that I loved when I joined. It was so different from the environment I’d found during a lot of my consulting career, in FTSE 100 environments. It was something that stood out for me at Naked. I felt at home here. It’s something that a lot of us in the business are particularly passionate about.

Ultimately, it’s a group of people that are fun to come to work with every day because we’ve got the same goal in mind.

Turner: Naked started as a UK business, and one of the big changes since you’ve taken over is that the US has emerged as one of the largest growth opportunities. There are some distinct differences in the markets, and there are opportunities for the culture to capture

and create even more value. What are the differences between the two countries, and what does that mean for your business strategy and your opportunities?

Devlin: Although I'm a Brit, I've spent most of my Naked career working in the US. These days I live in Napa, California. Fast forwarding my personal story, I moved down in 2017 and ran our US division from 2017 to the end of 2020 when Rowan retired and I took over as group chief executive.

It is natural to reflect on what's different, but let me start with what's similar. The core challenge in our business units in Australia, the UK, and the US, is pretty similar. It's hard in the wine industry for a talented independent producer who's making great-quality wine to turn that skill into a viable business that they can invest in and grow, and to share that product to consumers. The reasons, though, are slightly different depending on the country. In the UK and Australia, it's around the extreme consolidation of buying power at the retailer end — whether it's Coles and Woolies in Australia, or the big four supermarkets in the UK. They have extreme power and tend towards a commoditization of the wine category.

In Australia, there's a focus on private-label strategy — big-production wineries, big vats of wine, create it and slap a label on it. In the UK, it's extreme aggressive negotiation. In the US, that reaches its zenith. You have that same challenge — 70 percent of wine sold to American consumers comes from the top five producers — but you add a second challenge, which is this gatekeeper role that the big distributors play, with wine being sold through a regulated three-tier system. Those big distributors have no commercial incentive and no interest in nourishing and supporting new producers, or giving them access to market. Ultimately, they don't want to distribute new products to help you grow a brand, so you have this situation where it's incredibly hard for anyone to scale anything new.

That's a common challenge, and that's why our businesses are a lot alike, but one of the things that is different when you look at the US opportunity, is the consequence for consumers of that heavily regulated market environment. Americans pay more on average for a bottle of wine than people in pretty much any other country on Earth. I'd love to be able to say that it's because all of the wine is better than anything that's being drunk anywhere else, but sadly, that's not true. Instead, it's a function of this three-tier system. When you buy that bottle of wine at a liquor store, you're effectively the third buyer. A winery has made it. They've often spent a lot of money marketing it. A distributor has extracted a markup along the way, and then the retailer sells it to you again.

When we moved to America, we found this market which was extraordinarily ripe for what we offer: a combination of using our capital together with finance drawn from our pool of nearly a million members to support independent producers and help them produce great wine at lower costs, but then using our direct-to-consumer model to strip out that intermediary role and reduce the number of margins being taken out, so that we can offer superior value for the consumer. That is ultimately why the proposition is probably the most differentiated in the US market, and why the amount of excess value we have to share — and we can talk about how we share it with the consumer — is at its greatest there.

The second thing that's interesting is when you enter a new market, you do have a chance

to almost make a bit of a fresh start, or to reconsider and reappraise how you think about yourselves. That's one of the areas in which we have evolved the culture a little. In the UK, when we first started out, it was a team of 11 people who left another wine business — a company called Virgin Wines — and were out to prove that they could do this better. It was a real backs-against-the-wall situation. The business was founded in 2008 during a massive downturn. Everyone said it's a terrible time to start a business, so it came with this underdog mentality of "we're going to prove you wrong; we're going to show you, we can do this."

One of the things that I've looked to build over time is moving away from this underdog mentality. We're the largest direct-to-consumer wine business on Earth. As you start to be a leader in a category, it's important to think about how you can act and behave to grow the category, to grow consumer understanding, and focus more on that positive differentiation versus having that scrappy underdog spirit where you're up for a fight with everyone. That's probably one of the things that's evolved a bit over the years.

Turner: Naked combines some of the best traits of marketplace and subscription businesses, and one of the misperceptions or challenges I encounter with some investors — and I think you alluded to it a little — is that people are not sure whether to think of you as a marketplace or as a wine club or as a subscription. How does the consumer relationship work and what is it like? One of the things I found most interesting is, if you go on a Zoom where Matt Parish is talking to some customers who view him as their favorite winemaker, you can see that it's a community. It's something more than just a wine club or more than just a subscription, and the way the customer pays you is different from the way someone would in a club, for example. The amount of reviews and engagement you get is different. Maybe talk about that element — what the consumer relationship is like and building a community as well.

Devlin: I'll start with some of the marketplace-type elements of the model. They stem from the origin of Naked and the fact that we were focused on solving problems for both consumer and winemaker. We had this epiphany where we realized that if you can bring consumer and winemaker together, they can help each other solve those problems. Practically, the way Naked membership works is that our members (we have nearly a million members) are paying a monthly deposit into their account. We call it an angel account — we call our members angels. That gives us a pool of capital — it's somewhere in the region of 300 million dollars a year being paid in — and that gives us an ability to go and invest in and support different winemakers to produce wine.

The consumers are therefore solving the winemakers' problem of access to capital. We're giving a guaranteed commitment on that wine to winemakers, and that's solving a few problems for them. The guarantee in the volume is improving their production efficiencies, reducing their cost per bottle of production, so it's stopping them being subscale producers making wine for too much money per bottle.

The guarantee of having an audience of members to sell back to means they don't have to spend a lot of money on marketing, sales teams, and distribution teams, which again, reduces their costs, and it means they've got access to distribution — that challenge I talked

about earlier where distributors normally don't want to help support a new brand or help it gain traction in the market. You solve two problems for winemakers by pairing them up with consumers.

On the consumer side, there are a couple of common problems in the wine industry. Everyone's been in that situation where you go into a bottle shop or a supermarket, and you're faced with a wall of liquor. How do you choose what to buy? All you know is a label or something like that. We believe that a product is much more enjoyable when you've got a connection to the person who made it. We talk about the emotional differentiation in the business. We want to give you that opportunity to connect directly — whether that's messaging Matt Parish on his wall and giving him feedback and having a live conversation with him about the product you drank, or joining him for a tasting call, or joining one of our in-person events that we run in more normal times. All of that deepens the relationship. It gives you access to a bit of that thing you've probably all experienced when you've visited a winery, or you've gone somewhere and you've tried something and you bring it home. Every time you taste it, it reminds you of that experience. We've found a model that, at scale, can give consumers that feeling. That helps build a sense of loyalty.

Obviously for us, all of this is not philanthropic. It's intentional, because when consumers become intensely loyal to these winemakers, and their products are available exclusively at Naked, you've got an ecosystem which is engineered and designed to create these strong bonds between consumer and winemaker, but that also creates a business which is going to have high retention — a sticky, loyal consumer base. That's one of the ways in which we think about that.

What are the differences from a pure marketplace? If you look at a business like Vivino which is the archetype of taking that to an extreme — a pure marketplace in the wine space — it still ends up being confusing for consumers. It doesn't solve the problem of extreme choice for consumers.

If you think about a fashion business, the most successful fashion businesses don't offer you, say, 10,000 pairs of jeans. They've got a distinctive edit, and they're going to bring you a style and an identity. In the same way, our role at Naked is to scour the world and to bring you two or three producers who epitomize the best of, for example, the Russian River, as opposed to giving you 150 to choose from and expecting you to do the hard work.

There's also a difference when it comes to the economics. Vivino is acting as a marketplace selling on behalf of retailers in the US. It's trying to take a fourth margin out of what's already an incredibly intense set of margins before the customer gets the product. We don't do that. We take on the production role, we take on that funding risk, we support winemakers to produce, and we guarantee an outlet, so we get to this environment where you get a great result for the consumer — an attractive price and better wine for your money — but we've also got an attractive margin business. You can look at the disclosure. Groupwide, we're running the business at just under 30-percent contribution margin on sales to our members. Actually, it's higher than that — contribution margins are in the mid-to-high 30s in our US division, which is our fastest-growing division. You get some of the economics which look much more like traditional retail, but at good retention rates. That's

how you can think about some of the different trade-offs. We feel that we've arrived at a nice combination, certainly for the wine category, of some of the best elements of both.

Turner: You reference no longer being this underdog. With COVID, you've taken a level up in scale. Early on, you recognized this was potentially transformational for your business, and you created a \$5 million COVID relief fund for winemakers. From my seat, it looks like winemakers have a different perspective of Naked Wines. In the beginning, maybe you had to recruit winemakers, and now people recognize you and want to come to you. How has that changed the business, having this new scale? Also, why do winemakers now find your offer appealing — why do they now want to be there?

Devlin: The truth is that 13 years ago, Rowan had this amazing idea about how we could solve problems for winemakers and consumers. Convincing consumers was relatively easy from day one, but winemakers were a little harder to convince. I joke that the wine industry is not the classic "oldest profession", but it's right up there. It's not always a profession that adapts or moves that quickly.

What we found in our early days was that we had to court producers for a long period of time, and build relationships to convince the producer to come on board. People were concerned about doing something that was a little different. People were wondering how other producers they respected would think about them selling their wine in a different way, and what it would be like creating a brand purely online.

Over time, we've broken down a lot of that the best way you can, which is with a track record of consistently doing what you say you're going to do, and building relationships one at a time. A lot of the winemakers who've joined us have been recommended by someone else who says, "This is amazing! They funded and supported my project. I got to make what I wanted. I'm building my own brand, and I'm actually making more money than I ever have before." Suddenly, you start to get more people coming to you.

You're absolutely right to identify a step change over the course of the last two years, and it comes down to two things: one that's purely numbers, and one that's more sentiment.

The thing that's pure numbers is that the business is double the scale it was 24 months ago. In terms of working with new winemakers, there's a certain amount of commitment we're willing to make to a new producer, and we think about that in terms of purchasing risk. For the same level of risk with a new producer, I can now buy twice as much wine as I could two years ago, and about four times as much wine as I could five years ago, because the risk to us, mathematically, is the percentage of our total buy that we're giving to a new, unknown producer. That means from the get-go, we're able to put together a compelling commercial offer for new winemakers, and that's really stepped up.

On the emotional side, there's been a re-evaluation for producers around what the future is going to look like. The last 18 months have shown producers that they've got to have a direct-to-consumer strategy, but they can't be reliant on physical premises to be all of their D2C strategy. They know they need to now have an online component. It's also taught people who've tried to do some of this themselves that it's not easy. It's tough, which means

people are much more receptive to the idea of doing something differently, especially when it's with a business like Naked.

You talked about our COVID relief fund. We worked with 45 different winemakers from outside of our stable of producers and gave them help when they really needed it. That's how we first met Jesse Katz, and that led to us co-creating the Exposed brand with Jesse. That's a testament to the type of producer who's now interested in working with Naked. I don't know if you saw, but he recently set the world record for a bottle of wine - the Calling. It's a project he created exclusively for auction, and it went for \$1 million. He's made the most expensive bottle of wine on Earth. He's also making wine exclusively for angels, so we're proud of that.

Turner: That's an interesting point, because the typical perception had been that you should come to Naked to get cheap quality, but now it's a platform where you have affordable luxury. You've made a product with a lot of pretension accessible to a much larger customer base. How has the perception evolved — both from the customer and the winemaker side — and what does that mean in terms of your strategy as a business?

Devlin: The first thing is that there's something real that underpins that. In all parts of our business, we're committed to a real continuous improvement culture. We talk a lot externally about our marketing approach, but it also applies when we think about the quality of wine we're producing and the range and how we've evolved that.

One of the things that gives me the most pride is if I think back to the range we had when I first got involved with the business five and a half years ago, and the range we've got today, we've made massive steps forward. That's because we've been working with good people, we've given them the funding and the support they need, we've extended the length of contracts we've entered into so that producers can keep dialing up the quality. That's the first thing that's there: the real underpinning of the quality of wine we've made has never been stronger.

We're passionate about data. We spend a lot of time validating that. We look at things like our wines' Vivino ratings against the market. You can see that quality premium, but as you say, that hasn't always been well understood. One of the things we focused on a lot last year and something we're still working on — I'm not in any way pretending that this is the finished article— is better communicating that quality to customers. You describe it beautifully: helping people understand that Naked Wines isn't a business that gives you access to cheap wine. There's already a world-class business that does cheap wine in the US. It's called Ernest Gallo. It's a fantastic, well-run business that produces cheap wine effectively. We don't want to be in that game.

What we are able to do is give you access to the type of quality wine that you get from small wineries in regions like the Barossa in Australia or Napa or anywhere else you'd care to name. We can do that. We can give you access to that quality at a much lower price, and we do that because the way we work with producers lets them produce the same wine at lower cost, and the way we bring that to market strips out frictional cost. Those two things mean that we can sustainably — and with good economics for ourselves — give you access to

better prices.

Shaking off the underdog spirit is also helping us communicate that. It lets us be a little more comfortable doing things like entering traditional wine awards. We enter our wines into things like the Decanter World Wine Awards, and they win tons of medals. It's not hard but, culturally for us, there was a bit of a feeling of "that's for the traditional wine industry, we won't do that." We've got to a point where we're comfortable saying, "We want to showcase our producers and provide them a platform to show the great work they're doing, and help consumers understand that what you're getting here is a better way to buy great-quality wine, not just a solution for something that's cheap."

The other thing that's interesting there is a question I often get asked, or maybe a misperception that the investment community sometimes has around "what do we need to do in terms of price point?" and "why are we talking about premiumization or this kind of idea of quality perception?"

It's all about the opportunity we have to drive awareness and consideration. If we can get more people to understand that we've got a unique model that lets you produce quality for less, that's much more valuable than just a discount. Dollar Shave Club became popular because they convinced people that it didn't cost a lot to make a great-quality razor, which is a much more compelling argument than giving someone a cheap razor. No one wants to hack their face off with a cheap blade.

The flip side of that is the beauty of our business, and how we designed it from day one. Our margins selling wine for \$10, \$12, or \$13 are brilliant. We don't have any requirement to increase our average price per bottle for economic sake, but we think there's a great opportunity if we can convince people of the quality of wine that we're able to produce.

Turner: You often share in your investor communications this great slide that shows the customer value prop, using Vivino as the arbiter of quality, of the \$10 to \$15 range and upwards, where you have much more consumer surplus created at the higher levels of price.

One of the things that I've been reflecting on that I find interesting is you have two distinct opportunities insofar as price is concerned: one is taking your customers on a journey — introducing them to your wines and walking them up price points as they get more interested in the wine and more engaged in the community; and the other is onboarding new customers from the start at higher price points. There are two vectors that you could explore there. Your costs to ship a case of wine are fixed, so when you do sell at higher price points, you have more contribution, so you get to think about how to allocate that surplus between customers. There's a lot in there, but it comes together as something cohesive. Could you discuss that a bit?

Devlin: One thing we already know, and we've proven to ourselves, is there's plenty of demand within our existing customer base to explore and try more premium products. Just taking the US as an example, over half our members have spent more than \$20 a bottle on something in the course of the last year which is a big increase from where it would have been a few years ago. We sold something like a quarter of a million dollars of Jesse Katz's

debut wine on launch day, and around \$600,000 of the launch project this year of Daniel Baron, called Francophone. Baron is an amazing character and a great guy. He was the head winemaker for over a decade at Silver Oak in the Napa Valley. He also made wine at Dominus, one of the few places in Napa that's had multiple 100-point Parker scores, so he has an extreme pedigree. You can see that there's appetite to stretch up into more premium products. When we produce a world-class winemaker from an iconic region selling wines for \$30, \$40, \$50 a bottle, there's demand. The first opportunity is proven and we're taking advantage of it.

The second opportunity is absolutely there. It probably means that, of our \$20-billion TAM in the US, we know about \$3 billion of that is people buying wine at over \$30 a bottle. I think we can grow that section faster now that we're building out this repertoire and range of more premium product, and as we become more effective at conveying that understanding.

The most interesting part of the question is how do we think, philosophically, about this question of a potentially greater surplus. It's true that the more and more expensive wine gets, the more and more of what you're paying is going on stuff that isn't grapes and oak and winemaker talent. It's going on either the marketing budget for a big producer in Napa or just the mathematical effect of a moderately high-cost price being ratcheted up through three sets of margin due to the three-tier system. We're not interested in maximizing the contribution margin of Naked Wines for the sake of having a high margin. Ultimately, we want that margin to be the lowest it can be to enable us to produce high lifetime value, sufficiently valuable customers that we can invest aggressively in to grow the business, and continue delivering great returns on the cohorts we acquire.

As the business gets stronger and things improve, whether we scale the business and reduce our variable costs or we scale the business and reduce our producers' costs, our default instinct is to share that with members. The same is true of pricing. We have pretty moderate accretion of contribution margin as we go into more luxury product. We see, instead, the greatest opportunity in getting customers drinking wines of a quality they wouldn't be able to try elsewhere, and using that to drive loyalty. That's always our default bias.

If you think about a subscription business, there are ultimately two paths to a long-term, high-EBIT margin. One path is where you make your contribution margin higher and higher, and that is what drives bottom-line margin at maturity. The other approach is to hold steady the contribution margin and to reinvest and give more value back to consumers, which drives higher and higher retention rates, which reduces your cost to replenish. You have fewer customers leaving. It costs less at maturity to replace them. That way, you also get to a business that sees higher and higher long-term profitability. Philosophically, the second type of business is much harder to compete with than the first one.

Turner: You mentioned TAM. Last year at this time, I presented Naked Wines at Manual of Ideas' Best Ideas Conference. I've heard a lot of feedback from investors, and one of the things that some people tell me is, "I really like the business. I get the value prop. I think everything makes sense, but I'm just not sure this could get really big." Meanwhile, I think

you have a pretty conservative assessment of what your TAM is. How do you see your market opportunity? How big do you think your TAM is, and how big do you think you could get within that addressable market?

Devlin: I've seen other people in the category claim that their TAM is three or four times the size that we claim on ours. I agree with you. We don't like to overpromise things.

The way we think about our TAM is like this: within the zone of wine that's consumed at home in our addressable markets, we extract everything below the minimum price we're interested in selling at, because we're not in the cheap wine business, and we also extract anything that's sold to people who aren't regular multiple-times-a-month wine consumers, because we don't think they're good subscription buyers.

Taking the US example, we cut out half of the \$40-billion wine market that's sold for our home consumption to get to our \$20-billion TAM. We sell spirits in the UK and Australia, but we don't put any of the spirits market into our addressable market. Midterm, that could definitely be addressable. I'm with you — I think it's quite conservative.

There are maybe a couple of things that people might misperceive when they think about this business as somehow niche, and when they question that even though there's a \$25-billion TAM, whether you can build a multibillion-dollar-revenue business here. Some people have characterized the online wine D2C market as a bit of this digital-niche, early-adopter market, and wonder therefore, whether it's going to scale or generalize to the mainstream of wine consumption.

That's why, ultimately, we designed a business to find a way to enable the best wine producers to make the best wines at the price points that most people want to pay, which is around \$10 to \$30 a bottle. We've gotten a real advantage there that's rooted in better wine for your money. That's very different from a business like Wink which is a classic D2C marketing story. "How can I produce a beautiful website, a little bit of digital marketing, an app, and get a bunch of people to engage with it and play around with it?"

Our focus is different: how we can create a business model that enables us to produce a differentiated product? It means that our sweet spot of consumer that we tend to do best with looks like the core or the heart of the American wine-drinking market. They're people who've got kids at home or are post kids at home, they're regular wine drinkers, they love wine but don't feel super confident about it. It's a real "every man" or "every woman" portrait of the American wine drinker. The types of customer we do best with are segments of the market that have moved online a little later. A lot of these consumers who will be perfect for Naked are still buying wine in a very traditional way. There's absolutely potential for this to be a 10-percent-share business within that TAM. What does that get you to? A couple of billion? That's the kind of target or ambition we have internally for this business because we don't see it as a niche opportunity.

You can already point to some early signs. You can look at the fact that we've got a higher level of market penetration in the UK where we've been trading longer, or you look at some states in the US where regulation has opened them up more recently. It's been a bit of a

Ground Zero start somewhere like Pennsylvania where we see market share in double digits, which shows that we've got an ability to do that. I certainly see it as an opportunity to build something at real scale.

The one thing though that we're always careful about is not promising exactly when. Promising that you can deliver a certain revenue number in a certain time horizon goes against something else that we've always believed in, which is you've got to have the discipline and willingness to say, "We're going to grow the business at the right rate." That means we're confident that every time we invest money and we acquire customers, we're generating real value for shareholders. Maybe that's why we have growth at a reasonable price. That's why we've always got on well, Elliot.

Turner: Exactly right! Shall we move on to the audience Q&A?

Mihaljevic: A question that stood out was about competition, if you could talk about that a bit more, including from Virgin Wines and other players? How do you see the market longer-term in terms of how many companies can be successful at scale at the same time?

Devlin: I'm happy to talk about that current competitive piece. I'll start with the US market because it's obviously our biggest growth opportunity and it's our largest division these days. It's still a pretty nascent market in terms of the movement of demand online. Our best estimate is that, as of today, and post a big COVID increase, still only around 7 percent of the spend in the wine category in the US is online. Given that it's a category where it's easy for you to gain information online — you can read product reviews, and understand what to buy — and that it's a big, bulky, heavy category that's suitable for delivery, and that lots of people live in areas that aren't well served by a specialist wine retailer, I think it is massively underpenetrated. If you take an end-of-the-decade view, whether that number is 20 percent or 30 percent, I think we'd all be confident that it's going to head in only one direction.

With that in mind, there are going to be multiple different types of winners and winning models emerging online. You can maybe align some of the different participants against that. You see innovation and money going to certain businesses — Uber looking at Drizly, and things like that. There's definitely one strand here which is the convenience mission. "I want to buy a bottle of wine for tonight online." That's not our market, so we don't see those businesses as competitors. That is moving your local 7-Eleven spend and giving an alternative to that.

At the other end of the market, you've got some businesses that are looking to serve a sophisticated wine consumer who's got a fixed idea about what they want to buy. Wine.com and Vivino are interesting companies that are competing for a customer who feels like they've got a high level of confidence and wine knowledge, and those companies are ultimately looking to play the long assortment game where they have a 20,000 SKU range: "Any wine you've ever wanted, we can give that wine to you."

What's interesting about those businesses is that their economics mean they work on a pretty small portion of the TAM you've got in the US. If you think about wine.com, it's a 30-

percent-gross-margin retail model with all the same distribution and fulfillment costs we've got. If you think about Vivino, it's operating as a fourth margin at the end of the three-tier system. It works well on a trophy bottle of wine that there's excess stock of that you can discount by 50 percent, but it's still \$50. There's enough absolute contribution for everyone to get paid, but it struggles when it comes to monetizing demand from the everyday American wine consumer. I'm most interested in how the wines are stacking up against Costco and Trader Joe's, and how we're doing against the chain liquor stores and the wine ranges at a grocery, because the reality is, for over half the customers that move online to Naked and become great members, we're the first time they've been buying their wine online.

That gives you a little bit of an overview of the US scene in particular.

I want to talk about Virgin Wines because everyone always asks about Virgin Wines. Compared to some of the people who've been in the business longer, I can be a little more dispassionate. It's a solid, tidily run business in one of our divisions. It's under a fifth of the total size in terms of customer base and revenue that Naked is. It's been nicely run by its management team, and they've had a successful crystallization of some value and gone into the public market. It's not been run for growth. If you look at that business over a course of a 10-year run pre-COVID, I think it netted about 2-percent compound growth, so roughly offsetting inflation — probably below inflation in terms of wine bottle prices, so probably an ex-volume growth business.

Ultimately, that reflects the fact that it hasn't got as compelling a customer proposition. You don't see it as a business that's got the same level of ambition to change things for consumers. It's also different in that it doesn't have the same desire or willingness to build long-term relationships with producers.

You can go and have a look at the Virgin Wines IPO deck. There's a slide in there — with apologies to our good friends across the other side in Norwich — that essentially says that the magic recipe for a great bottle of wine is one quarter great wine and three quarters cheap wine, which makes great high-margin wine. That encapsulates everything philosophically that's different about the businesses. We believe in building long-term partnership with world-class winemakers. We think that's how you build brands that have got real consumer appeal and authenticity behind them, which is a little different.

Turner: I see a question that you'll recognize as something you and I have had a lot of the conversations about, but I'll preface the question by saying that two of the foremost challenges and opportunities that I've seen for the business, through doing some surveys and seeing what's happened over the last couple years, is that not many people know that you can buy wine online, and not many people know that Naked Wines exists. The unaided awareness isn't strong. The question is: "Nick has spoken recently about launching more brand advertising for Naked Wines. How do you aim to be eye-catching and different in this marketing approach?"

Devlin: That's a great question. We absolutely see the opportunity to tell our story as a big part of the plan over the course of the coming years. Like most D2C companies, we come

from this heritage and this place of comfort where you could grow to a certain scale with an almost exclusive performance marketing mix — whole sets of channels where you know and can attribute the value all the way through, you understand the metrics, you set a target rate of return and, if you're good operators, you hit that consistently and you scale the business. That's what we've done. We've got a great heritage there, but we've got an opportunity — a breakout opportunity — to start to tell more of the story and help build the category and change consumer perception. To do that, we need, one, to tell the world our story and help people understand how and why we're different — that we're not just another online wine club or online wine business, but we have a model which changes the rules of the game. It changes the core economics for winemakers and therefore does create this consumer surplus that we can share back.

Then, two, we need to find a way to bring it to life and make it memorable. That's both the biggest excitement and the thing that, frankly, is the most scary about moving into a brand advertising world. The difference in terms of impact between doing it well and doing it mediocrity is enormous. There are some things we know from our early creative testing in Australia, though, that give us some good guardrails and, in working with our creative partners, we've been clear on. One of them is in order to be successful, we've got to make sure we never forget that ultimately, we're not really the hero of our business. The producers we work with are the talent here. They're the stars.

Certainly in Australia, we had some good early success in terms of changing perceptions of the business and building greater awareness — both aided and unaided — and better comprehension, which we achieved through content that's not been excessively high production but has had an unrelenting focus on our winemakers. It's put them front and center. That's one of the things that we know and one of the things that you can look out for.

The second thing is, even as you move into a brand challenge, it's important you don't forget about the things that you're good at as a business. One of the things we do pride ourselves on is our test-and-learn culture. The way in which we're trying to build our brand advertising strategy reflects that. Sure, it's not the same as being able to run 20 Facebook ad sets and see the results the next day, but you can still break a problem down. For us, we broke it down into saying, "Step one, can we spend money through brand advertising and a set of different channels and change people's minds on a cost-effective basis?"

That's where we've got to so far in Australia. We have quarterly measurements through an extensive brand tracker. We've been able to see that in regions where we spent money above the line — in particular, on TV — we have changed perceptions. We understand what it cost us to do that. We can see that the perceptions have moved more than they have in regions where we haven't advertised, so we understand that it's due to the action we've taken.

We can move on to a step two which talks about "how do we work out the right amount of impact and impression, and how does that overall spend feed through into the performance effectiveness of other channels we have?" We can still break down a problem and we can still apply our strengths to it. That's what we look forward to doing over the course of the

next 12 months or so.

I just had a quick look at the Q&A, and there are quite a lot of people asking questions about inflation and the inflationary environment. I wonder if we should touch on that?

Turner: Absolutely. That was the one I had queued up next: “Is inflation impacting Naked Wines’ operations, and do you expect inflation to impact operations next year?”

Devlin: This is an important one. It sits in combination with what we talked earlier about, the fact that philosophically, we’re not a company that looks to create the highest-margin business for the sake of it. Our default is to share value back with our consumers, but the flip side of that is we do have an enormous amount of surplus available. A different way of expressing that is I’m confident the business has a degree of pricing power. That means we’re set up pretty well for an inflationary environment.

It’s also, to an extent, worth thinking about the different ways in which different types of inflation will affect us and affect some of our competitors.

A lot of the stuff that we’re seeing at the moment is inflation in terms of labor rates, distribution, and transport costs. Our direct-to-consumer model, being deeply involved in production and then selling direct to consumer, physically touches our product less than a traditional three-tier model. That’s one way in which the business is quite well positioned in that kind of inflation.

The second one is if you think about the impact on shelf price of a given level of inflation that everyone will have to bear on things like glass bottles which are becoming much more expensive, or international transport for imported wines. Because our model is direct — one margin — if everyone chooses to hold percentage margin, you’re going to see much less movement on the price of a wine at Naked than you are on a wine that’s been brought into the US, that’s been sold through into distribution, into retail, and then sold on to the consumer.

Wine Spectator has been looking into this recently. I think they’ve talked about expecting to see \$1 to \$3 per bottle on wine under \$20, and \$5-plus above that. For our model, we’d be able to comfortably maintain margin with the inflationary pressure we’re seeing with much lower price rises than that. From a game theory perspective, Naked is well set up for an inflationary environment. It’s not anything anyone looks forward to, but I fully anticipate we’ll come out the other side and I don’t expect to see any midterm margin erosion. Probably what you’ll see when we next go and cut that Vivino chart, we’ll actually be seeing a broadening of the differentiation and the value we’re able to offer to consumers.

Turner: This is an interesting question: “Are partnerships a possible growth engine in the future? What sort of partner would be ideal?”

Devlin: It’s worth saying that partnerships exist at lots of different levels. One of the differentiating factors for Naked is that we actually built this business off a lot of B2B2C partnership activity. We partner with over 600 different — mainly retailing — organizations

in the UK, the US, and Australia and we use that to put offers into third-party packages. You might have received a Nordstrom Rack or something like that box with a Naked Wines voucher in, but I think the question here is getting to whether there are opportunities to deepen some of those partnerships, and how we might extend them.

There absolutely is that opportunity. I can mention one that we're just putting into market at the moment. I don't know how old anyone on the call is, so I don't know if anyone will be likely to get the AARP (American Association of Retired Persons) magazine delivered to them — and I won't judge if you admit to it in the comments — but we're on page two of the December edition this year. That's a new partnership we've created where we've given an exclusive offer to members of that organization. There are over 40 million American households with at least one person subscribed to AARP. A ton of them are wine lovers, and they're looking for that affordable luxury.

They're typically spending \$10 to \$25 a bottle, looking for a high-quality product, and they have a high interest in and affinity for supporting American producers. That's exactly the kind of partnership opportunity that makes a lot of sense where you've got affinity and overlap in terms of audience, and you've got an organization that helps boost and build the credibility of your brand. Whenever you're trying to grow awareness and strengthen perception of a brand that's new and innovative, partnering with someone that can help you with that dimension is helpful.

There are definitely opportunities for us to continue to build through that type of partnership. Equally, there are opportunities to find other types of partners that share our values or want collectively to help work on some of the things we're passionate about — whether that'll also be looking at giving back to producers, or people who are interested in working with us to help make the wine industry more sustainable, or anything like that. You can expect to see more of that type of activity.

Turner: The next question from our audience: "Why doesn't Naked Wines have more natural organic lines?" From my side, I have noticed a few more, but I'm curious to hear about that — and maybe this says something about different tastes in different age groups, and different preferences. Maybe you could also touch on your Wine Genie offering, which was something I wanted to ask about that hadn't come up.

Devlin: Let's start with natural and organic. We do produce a lot of wine from organically farmed fruit. I don't know if the question is from someone in the US, but if it is, the US is an interesting market for organic wine, and there's an extremely strict threshold applied in the US as to what you can label as an organic wine.

To get a bit geeky, it's not enough to just grow it from organically farmed fruit which is what most people would associate with organics. You also need to bottle it at a location that's certified organic, and very few bottling lines are. The criteria require you to use no sulfur at all in the production of the wine. Compare this to, say, the organic criteria in France, where a small amount of sulfur will be allowed and is normal. Sulfur is essentially just a preservative to give stability to the wine to make sure you've got a product that's going to behave as a consumer would expect over its normal lifetime. That's why we don't

tend to bottle much under a pure organic label in the US.

Ultimately, we don't think it's in the consumer's best interests. You tend to get far too much bottle-to-bottle variation, and you end up with a product where you can't guarantee with confidence that it's going to stay stable if people want to enjoy it over the course of one or two years. We have lots of organic fruit, but it doesn't all turn up in organically labeled wine.

The natural wine question is another interesting one. The natural wine movement is stylistically similar. There's probably an opportunity for us to have a couple more producers on the platform that really embrace that movement, but again, it's a movement sometimes that's more about making wines to stand out or make an impression for their own sake. They're popular with the east- and west-coast sommelier community.

When you look at the consumer data, and you have people sample the wines, it's not a style of wine that as many wine drinkers genuinely love. We're ultimately a company that always believes in creating a great product that is going to be enjoyed. That's always going to be a filter that we apply to the range, so it's unlikely to become our heartland anytime soon.

You were going to ask me about Wine Genie? What specifically did you want to ask?

Turner: It's two parts. You have this accelerating growth of your data asset. You have interesting data, with a lot of reviews from your community, and you're able to put together something with that. That's part one. Part two is, there's a wheelhouse customer that you've historically been associated with, but I think that customer is different from what the Wine Genie customer base would be. Talk about how you're taking advantage of this data asset and how it gives you opportunities to target a different kind of customer from the customer that is historically associated with Naked Wines.

Devlin: You're right about the data. We've collected somewhere in the region of 28 to 29 million explicit customer ratings, and outside of that, we have a far wider dataset of implicit behavior, where we can look at a set of purchase behaviors and history and interactions to help us understand which other wines a certain customer would probably like. That's the foundation — the IP, the assets — that we've used to help create the Wine Genie product, which effectively uses algorithms to recommend your next wines, given a broad set of parameters that you're in control of. Think of it like this: you slide the dials and we work out exactly what wine you get in the time horizon you've asked for.

In terms of where that fits into our overall business and Naked's opportunity — and excuse the big generalization, but the data bears this out in general — there's a big split in terms of wine consumption preference along the dimension of age. By and large, a lot of consumers who are a bit older than me really love to have control. A lot of people will tell us in focus groups, "I know the kind of things I like. I don't want to be surprised. I like to make my own choices." We consciously built a wine club that was different, where you could be in charge of when you bought and what you bought, and you could pick every bottle. That's traditionally been the heartland of Naked. About 70 percent of our sales to members come with customers picking every single bottle.

By contrast, there's a younger generation who have an expectation, in lots of elements of their consumption, that businesses are going to help them understand what they should be consuming. Whether that's someone who's grown up discovering new artists by listening to Spotify or is used to the idea of someone selecting new fashion brands and things to try and sending those to them. We created Wine Genie with that type of customer in mind — someone who says, "I don't know that much about wine, but I love what you're doing. I like the idea of discovering more. You've got a bunch of the world's best winemakers. Let's go. Tell me what I should be trying."

That means we've got an exciting opportunity. Those two types of customers can coexist well. They're not in any way in competition with each other. As long as we can work out which customer to put which proposition in front of, we can use that to improve our overall cohort economics. You were very kind at the beginning of this chat about our disclosure, and a key performance metric that we disclose is what we call payback. It's the ratio of five-year lifetime value to the cost of acquisition for any given cohort. If you subsegment that, you see that we're making higher returns from customers aged 40 and up than the overall average. For customers in their late 20s and early 30s, we're making lower returns. If we can find a proposition that better meets those differentiated needs and raises that up, that will drive overall cohort returns, and it's going to give us the ability to reinvest and drive faster growth in the business.

That's an exciting opportunity. The first year of live testing of that product went well, which was great to see. It gives me a lot of confidence that we can scale that up and use it to drive improved returns over the next couple of years.

Turner: That's a good note to end on. You've been incredibly generous with your time. Thank you, Nick.

About the session host:

Elliot Turner is a co-founder and Managing Partner, CIO at RGA Investment Advisors, LLC. RGA Investment Advisors runs a long-term, low turnover, growth at a reasonable price investment strategy seeking out global opportunities. Elliot focuses on discovering and analyzing long-term, high quality investment opportunities and strategic portfolio management. Prior to joining RGA, Elliot managed portfolios at at AustinWeston Asset Management LLC, Chimera Securities and T3 Capital. Elliot holds the Chartered Financial Analyst (CFA) designation as well as a Juris Doctor from Brooklyn Law School. He also holds a Bachelor of Arts degree from Emory University where he double majored in Political Science and Philosophy.

About the featured guest:

Nick Devlin serves as Chief Executive Officer of Naked Wines plc (UK: WINE). Nick was appointed Director of the Board in June 2019 and was promoted to the CEO role in January 2020. Since then, Nick has led Naked through a rapidly evolving operational and customer

environment to deliver a step change in growth in 2020. Previously and as President of Nakedwines.com, Nick had grown and professionalised our US business and established it as the number one direct-to-consumer wine business in America. Nick has a background in corporate strategy, having previously worked in OC&C's consumer practice in London. He is a passionate wine lover and advocate for the role of Naked in transforming the shape of the wine industry.