



# Wine Restructuring Action Agenda

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## Industry identified need to change in 2007

*Directions to 2025* report stated that:

The factors that drove Australia's success between 1985 and 2005 are no longer dominant nor exclusive

- Consumer friendly, affordable, good quality, fruit forward wines are now over supplied
- More global competitors from New World and reinvigorated Old World
- Consolidation of retail channels has reduced supplier access and pricing power



## Since then we have faced the ‘perfect storm’

- Oversupply has worsened and damage to brands, margins, asset values and producers is mounting
- Our cost competitiveness has been substantially impaired by exchange rate movements
- The GFC suppressed wine demand and reversed the consumer trend from trading up to trading down
- Water and environmental sustainability risks require action
- Australian wine’s reputation and trade relationships are deteriorating



## We need to address four issues

- **Supply dimension** – too many grapes, too much wine
- **Demand dimension** – sales volumes falling (particularly at higher price points), margins eroding
- **Declining competitiveness** – costs high and increasing, not enough perceived uniqueness to offset
- **Viability problems** – Too many vineyards, and too many that are physically deficient or have sustainability issues



## The supply dimension

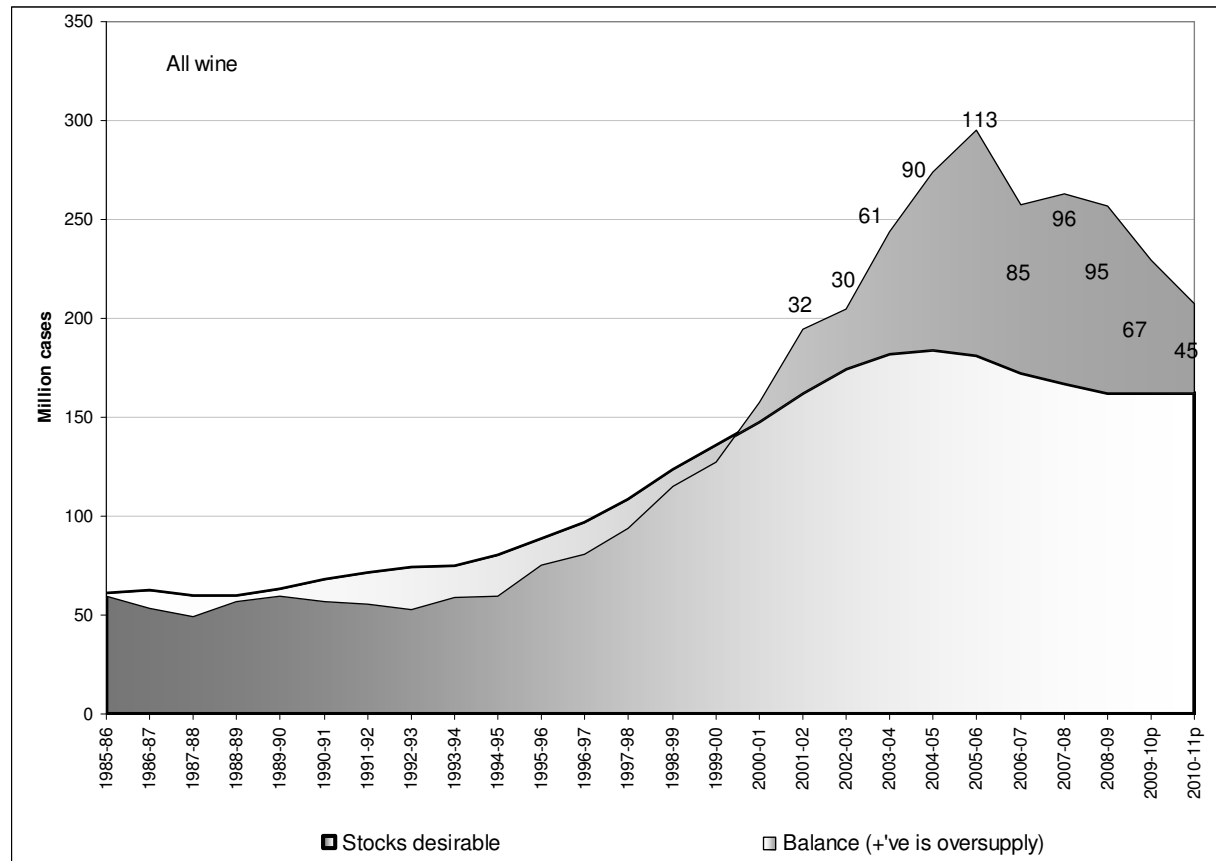


## Oversupply persists despite low 2010 vintage

- Annual grape surplus of 270k-500k tonnes (20k-40k hectares of vines)
- Surplus wine inventory equivalent to 95m cases
  - Annual additions 20 - 40m cases
- Oversupply affects all regions, most varieties and prices
- A global issue, but we have specific problems



# Oversupply persists despite low 2010 vintage





## The demand dimension

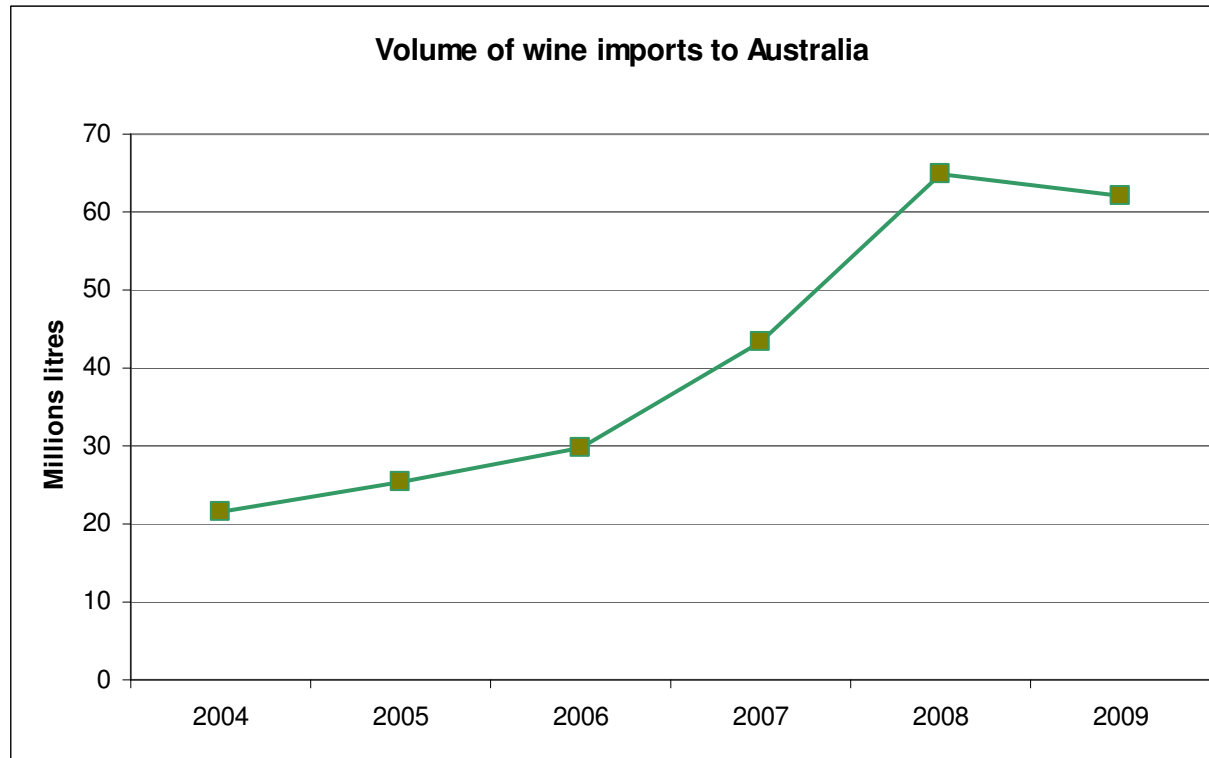


## Problems at home and abroad

- Imports have increased their share of the Australian market from under 5% historically to nearly 13% in 2009
- Some rebound in domestic sales, but how much is 'cleanskins'?
- Exports stalled in October 2007. Volumes have since risen by 6% but value is down by 20%
  - High value exports down 48%

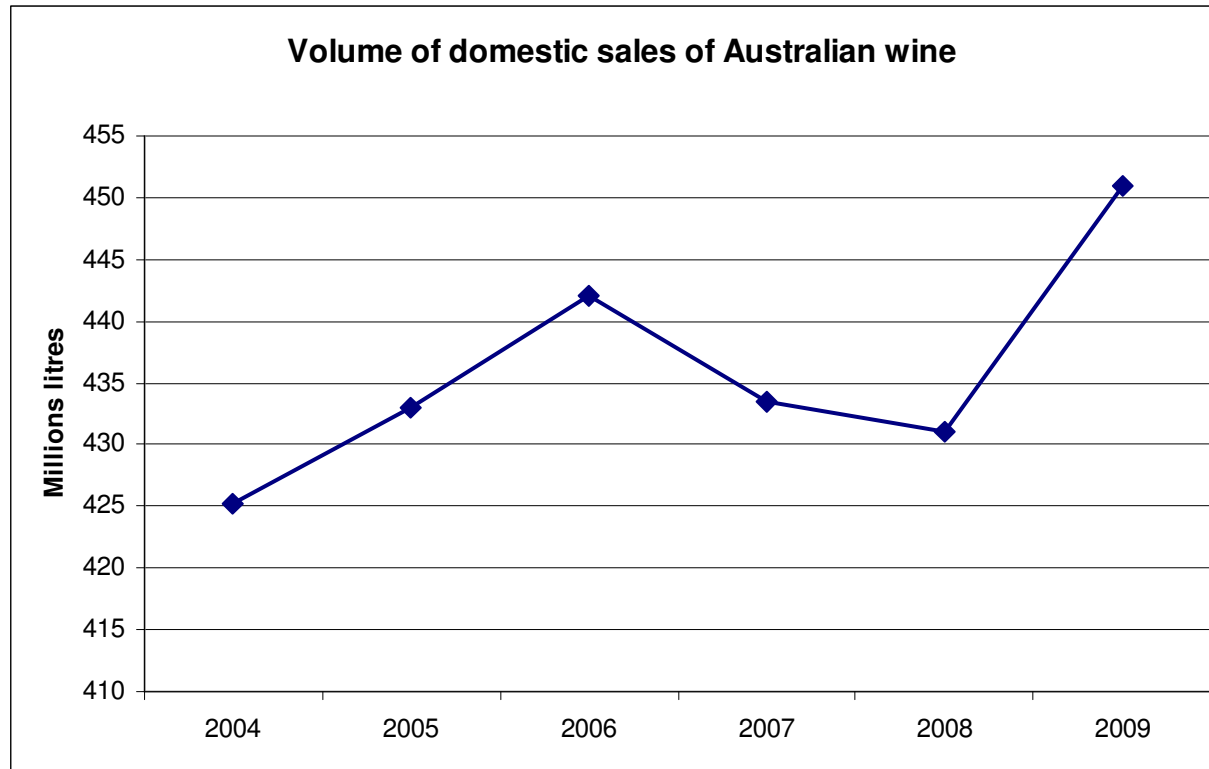


## A steady growth in imports ...



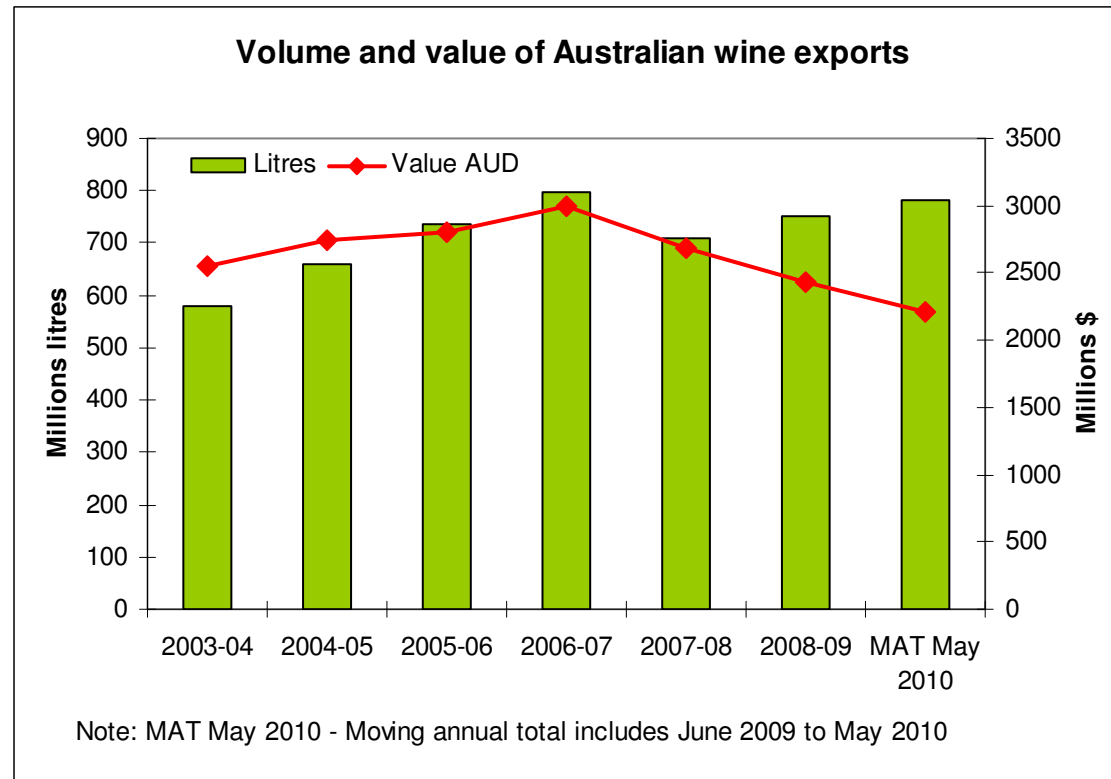


## ... at the expense of local wine



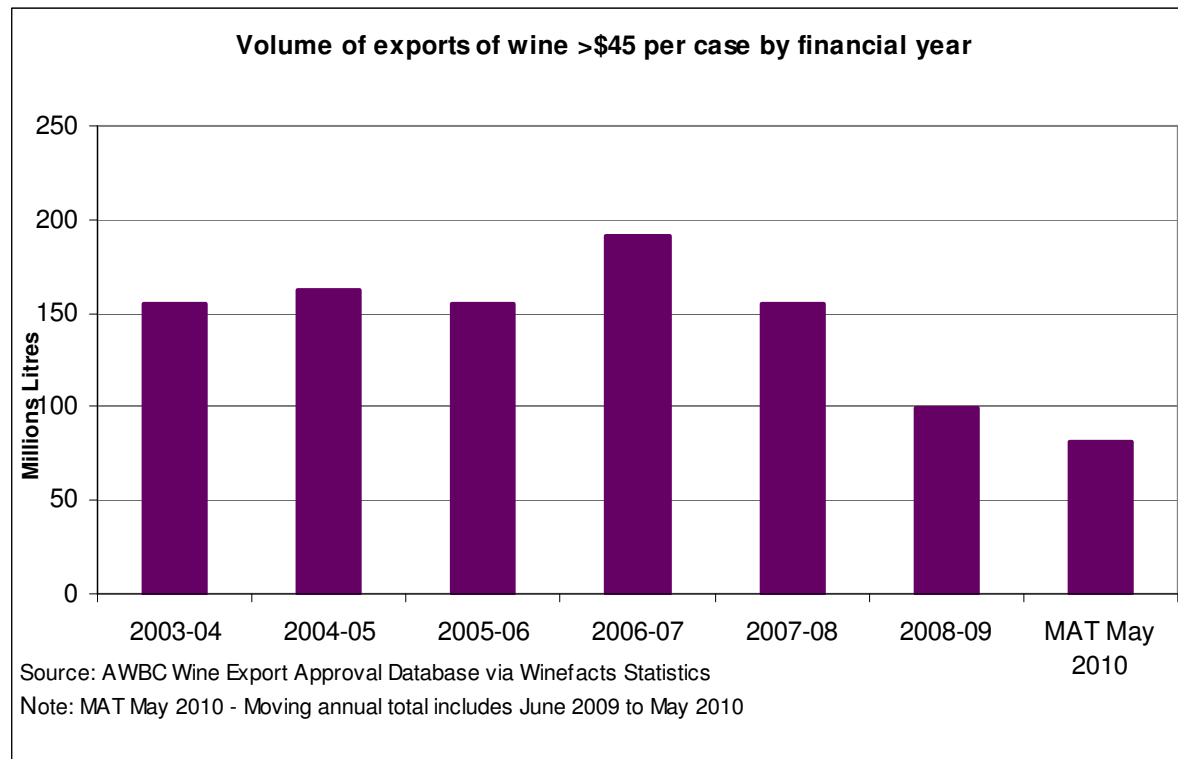


## Export sales value falling since peak in 2007





## Sales of high value exports falling most (48%)





# Declining competitiveness



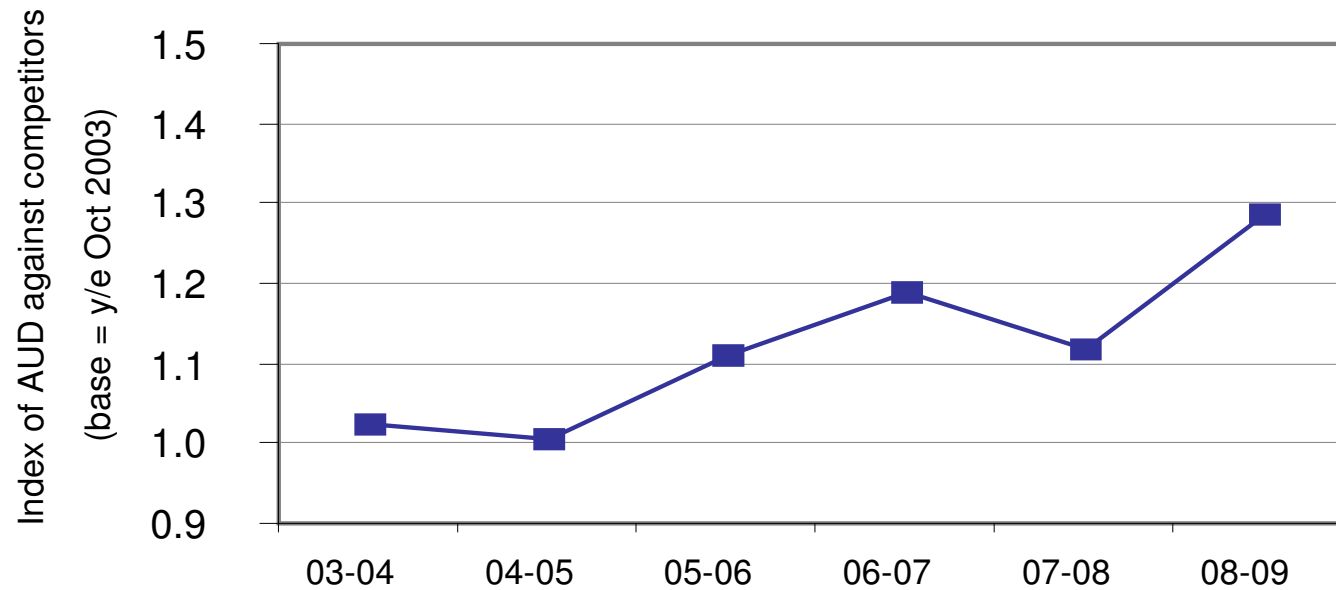
## Declining competitiveness

- Our costs are high and increasing
  - We are a higher cost producer of commodity wine than competitors
  - There is no perceived uniqueness to offset this disadvantage
- Exchange rate has greatest impact on competitiveness
  - \$A forecast to remain at historical highs, though volatile



## Declining competitiveness – exchange rates

- \$A has strengthened 30% against wine competitor countries





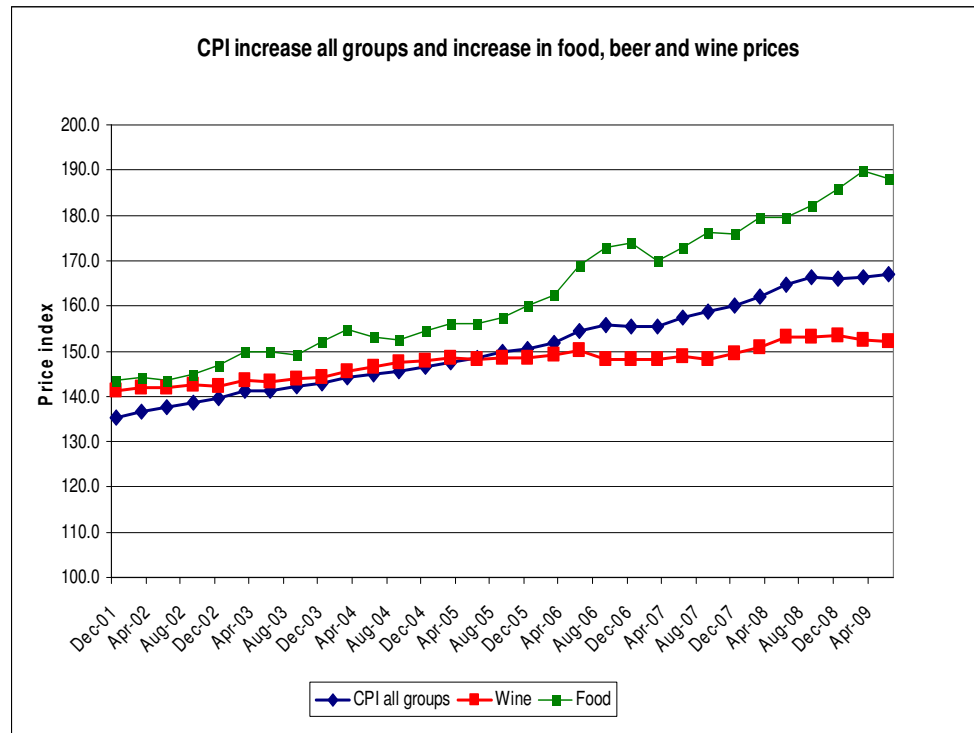
## Declining competitiveness – exchange rates 2

- Examples of export price reductions (margin losses) to hold retail prices (UK and US represent 67% of export sales)

Market and retail price point	FOB Case sale price, A \$	
	2004	2009
UK £6.99	48.76	24.16
UK £10.00	84.02	41.62
USA \$10	56.71	37.50
USA \$20	121.48	80.32



# Prices/margins in domestic markets declining





## Declining competitiveness – other factors

- Water prices increasing (resource management)
- Labour costs increasing (award modernisation)
- Carbon trading will increase input costs (e.g. energy)
- Reduction in winery throughput increases unit costs
- Increasing finance costs (interest rates)



# Viability problems



## Restructuring must address four areas

- **Cost of production** exceeding realistic prices commanded for grapes and/or wine of that quality
- **Deficient vineyards** due to physical limitations of site, layout, rootstock, clone, unsuitable variety for location etc.
- **Environmental sustainability** threats such as water, climate change and loss of biodiversity
- **Insufficient demand** at prices that provide sufficient profit for the whole supply chain to maintain long term viability



## Viability issues 1 – Cost of production

- As part of WRAA, Gaetjens Langley assessed average vineyard cost and quality performance for each region
- Key findings were
  - For 17% of vineyards, costs exceed value of quality produced, making them uneconomic
  - An estimated 307,000 tonnes of fruit is uneconomic – mostly C and D grade quality from cool regions
- Conclusions were supported by industry experts and corroborated by analysis undertaken by the AWBC



## Estimates of uneconomic tonnages and percentages

Quality Classification	Total Tonnage	Uneconomic Tonnage	% Uneconomic
A & B	180,850	Unable to calculate	Unable to calculate
C	409,552	147,241	36.0
D	553,211	134,517	24.3
E	652,116	25,592	3.9
Totals	1,795,729	307,350	17.1

### Assumptions

1. Uneconomic defined by uncompetitive cost of production only, no allowance for lack of demand.
2. All A & B assumed economic irrespective of production costs.



## Viability issues 2 – Deficient vineyards

- A significant % of vineyards do not meet best practice specifications – a legacy of rapid plantings in 1995–2003
- Contributing factors are:
  - Wrong regions and wrong varieties
  - Wrong sites and variability within sites
  - Young vineyards were overcropped to maximise returns
  - Inappropriate rootstock, clones
  - Management issues
  - Water shortages and climate change creating marginal vineyards
- “Days of have-a-go vineyards are over”



## Viability issues 3 – Sustainability threats

- Water security – availability and cost
- Salinity
- Environmental stewardship performance necessary to retain market access (carbon footprint, responsible resource use, biodiversity)
- Climate change impact on varietal mix in each wine region (vineyard replanting option)
- Sustainability solution may be investment in improved viticulture infrastructure and management practices
- If sustainability not feasible, vineyard removal required.

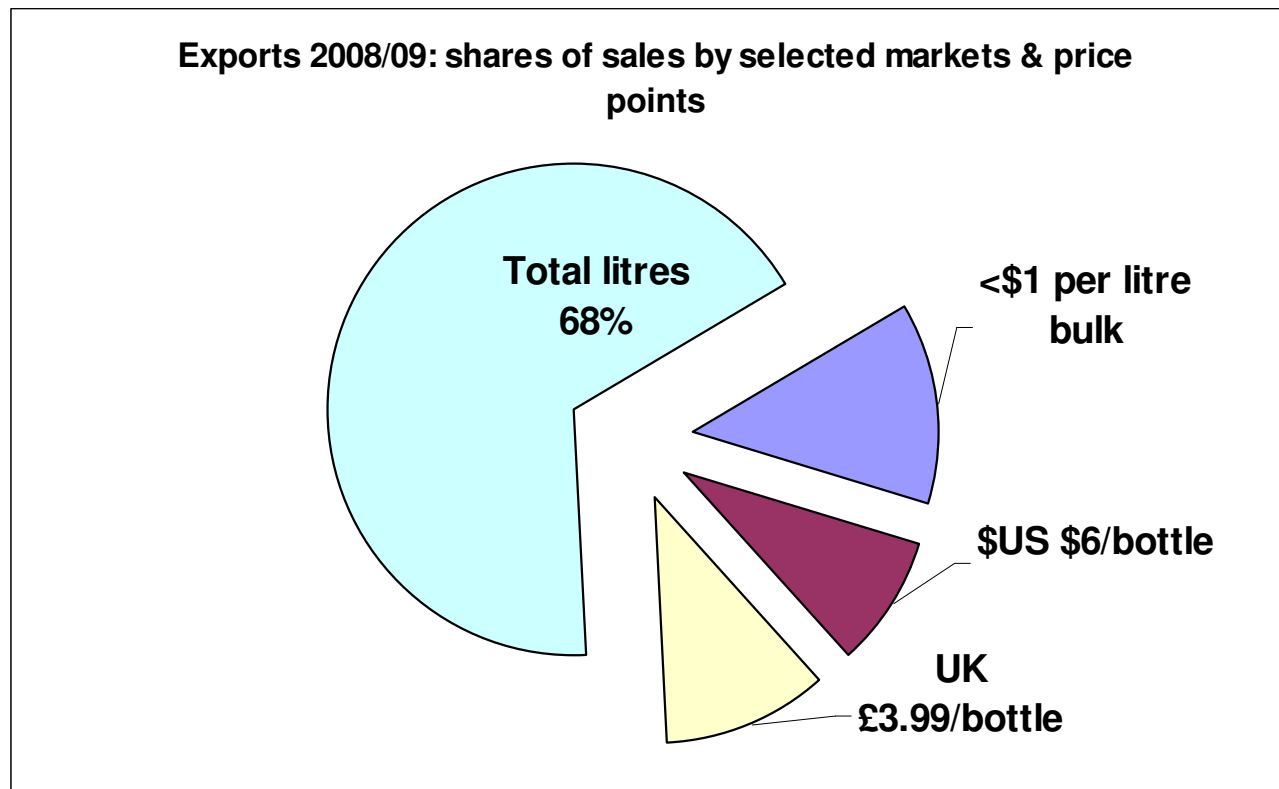


## Viability issues 4 – Insufficient demand

- Deficiency of demand at profitable prices a major contributor to the current oversupply situation
  
- Estimate at least 27 million cases were sold below cost
  - 11 million cases of current export sales made up of bulk wine sold at less than FOB \$1.00 per litre
  - 16 million cases of export sales below UK £3.99, USA \$6 price points unlikely to be viable at current exchange rates



## Indicators of exports at unsustainable prices





# The case for restructuring is compelling



## The case for industry restructuring 1

- Even ambitious demand growth predictions could reduce surplus by only 20%
- Water availability and climate change are unlikely to provide more than 10% of the supply adjustment required
- AUD exchange rate unlikely to revert to the lower average values of previous decade



## The case for industry restructuring 2

- Too much current production is not viable
- Unable to achieve sufficient cost reductions to restore competitiveness
- Trading out or Government bailouts are not an option
- Need to reduce capacity and align production to focus on those markets that can earn viable margins



## Taxation change will not help

- The Henry Review recommended:
  - Introducing a volumetric tax for wine as a matter of urgency at the beer rate and progressively increasing to the spirits rate (\$71/Lal)
  - Removal of the WET Rebate
- The Government's response was:
  - “In the interests of business and community certainty, the Government advises that it will not implement the following policy at any stage: Change alcohol tax in the middle of a wine glut and where there is an industry restructure underway”
- A volumetric tax will not generate increased demand for quality wine nor convert production assets to high quality



## There are positive signs

- Focus has shifted from quantitative to qualitative
  - Performance of vineyards not just volume of output
- Regions are broadening their thinking
  - Differentiation, sustainability and tourism potential being considered
- Individuals showing willingness to make tough decisions
  - Winemaking and grape growing is a business
- Adjustment is happening
  - But it can't be all in warm regions



## Signs of adjustment

- WFA estimate of 2010 vintage was 1.53m tonnes – below the long-term average
  - Seasonal conditions or permanent removals?
  
- Best estimate from industry sources is that 10-12,000 hectares of vines have been removed
  - This is a 6-7% reduction on total 2009 area of 162,550 hectares
  - WRAA statement said at least 20% of bearing vines are surplus to requirements



## There is still work to be done

- Restoring profitability requires:
  - More points of difference in the Australian offering
  - Realignment to new geographical markets and market segments
  - Vineyard improvement/sustainability
  - More marketing investments
- More ordered approach to growth and development
  - Regions need a vision
- Investment in the right way and for the right reasons
  - Wine requires 'patient capital'



# Regional and individual responses



## The regional response

- The national picture sets the challenge
- We are not asking regions to solve the national problem
- We are encouraging (and assisting) regions to determine how they might need to change to optimise their own future prospects
- In pursuing a more viable and sustainable future for themselves, they will create a better national future



## What is your Regional Action Agenda?

- What changes does your region need to embrace to succeed in the current environment for wine?
  - Viability of existing vineyards (cost, quality, sustainability, match to market preferences)?
  - Sustainability threats?
  - Differentiation?
  - Wine tourism offering?
- Commit to developing and implementing a change agenda for your region



## The individual response

- Does your business model and strategy take into account the changed competitive environment for wine?
- It is futile to wait until we get back to normal – the new normal will be nothing like 1995 to 2000
- Yes, grape and wine goes through supply cycles - but this is a more fundamental shift in our competitiveness
- Which means we must revise our businesses to:
  - enable us to operate profitably and sustain that performance
  - achieve our personal and business goals



# Restructuring initiatives by wine sector organisations



## Information gathering

- Vineyard exit/development survey
  - Collect robust, accurate data that gives a full national perspective on the pace of restructure
  - Co-ordinated by State Associations
- Review vineyard potential for redevelopment
  - Define scope and relative magnitude of existing vineyard shortcomings (rootstock, clonal and varietal mix and susceptibility to climate change)
  - Provide key insights into removal and redevelopment capacity
  - Checklist of redevelopment options for individual vineyards.



## Approaches to government

- Seek to review and amend Exit Packages
- Continued advocacy re concerns over agribusiness MIS
- Review alternative land use options
  - Assessment by region in conjunction with State Associations and governments
- Matching \$3m annually for market development



## Market development

- New AWBC Market Development Strategy
  - Opportunities by volume, value, channel and market
  - Key priority initiatives for Wine Australia
  
- China market competitor analysis
  - Understand our competitive advantages and disadvantages
  - Determine how to position Australian wine in the market
  - Optimise our product offering
  - Design the most effective marketing strategies



## WRAA Resources

- WFA Website [www.wfa.org.au](http://www.wfa.org.au)
- WRAA Toolkit
  - Gross margin ready reckoner for wineries
  - Vinebiz ready reckoner for grape growers
  - Vineyard decision checklist
  - Wine tourism profit builder



## The next steps



## ***Directions* strategic framework remains valid**

**1996**

**STRATEGY 2025**

**Vision of growth potential**

**Sector-driven strategy**

**Focus on production for export growth**

**2006-07**

**DIRECTIONS PERSPECTIVE**

**Vision of market opportunity**

**Market-driven strategy**

**Focus on returning value**