

# Towards a Sustainable Wine Grape Sector

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# Presentation outline

- The objective of this presentation is to provide an update on the sustainability of the Australian wine grape sector, including;
- Current issues impeding sector returns;
- Recent adjustments to the supply base;
- Key sustainability indicators; and
- Trends in wine grape prices for the Murray Darling and Swan Hill regions

## ■ Introduction

- Issues impeding sector returns
- Adjustments to the supply base
- Key sustainability indicators
- Wine grape prices in Murray Darling and Swan Hill

# “Sustainable” = Sustainable returns

- “Sustainable” is a broad term covering profitability, the environment and social responsibility
- This presentation will focus only on sustainable returns to growers and wine producers
- *Directions to 2025* and *Taking Stock and Setting Directions* set out strategies to address sector sustainability in 2007
- *Wine Restructuring Action Agenda (WRAA)* addressed some of the structural issues hampering progress in late 2009
- Apart from structural issues, there are numerous other factors that are inhibiting the achievement of sustainable returns to both growers and wine producers

■ Introduction

■ **Issues impeding sector returns**

■ Adjustments to the supply base

■ Key sustainability indicators

■ Wine grape prices in Murray Darling and Swan Hill

# The toughest period in decades

- It is widely acknowledged that the Australian wine sector is enduring its toughest period in decades
- There are numerous factors inhibiting returns to the sector, many outside our control, such as
  - foreign exchange rates impacting on the competitiveness of the Australian category both abroad and domestically – a direct hit on margins;
  - subdued economic conditions in key markets - dampening consumer demand and resulting in some trading down;
  - competitor countries' enhanced performance – the competition is fierce in both the export and domestic markets;
  - global oversupply – placing downward pressure on grape and wine prices;
  - impact of retail consolidation – further downward pressure on prices;
  - growing prevalence of private labels – the GFC and global oversupply have aided the growth in private labels, placing more pressure on prices – the prime beneficiary is the retailer and the growth in private labels is therefore likely to continue;
  - increased duties and taxes in key markets – placing more pressure on margins
  - energy and water costs – will continue to rise ahead of inflation
  - relatively high cost of Australian labour – we will never be the lowest cost producer

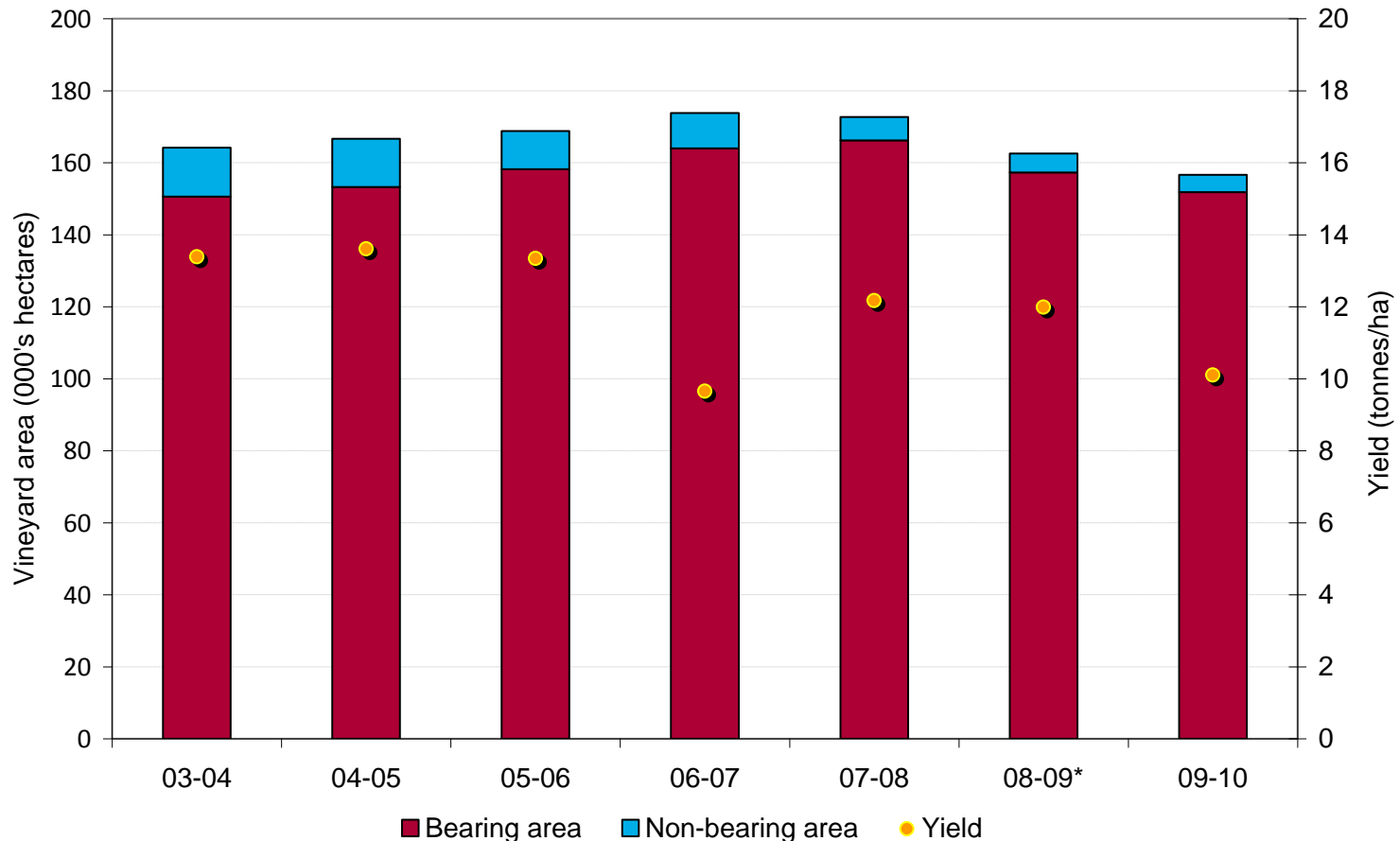
# Structural excess supply = low grape prices

- Key factors we can influence
  - Excess Australian wine capacity – leading to low grape prices and growth in private and opportunistic labels, particularly at lower price points;
  - Low grape prices - impacting on vineyard profitability and valuations;
  - Image of Australian wine – the category needs to recapture an image as exciting and aspirational, generating growth at higher price points;
  - Image of value, but mainly at lower price points - Australian sales concentrated at entry level price points in many markets
- All these factors are linked and are driving down the value of the Australian wine sector
- Restoring excitement in the Australian wine category requires a significant marketing effort and investment as does developing new markets
- Excess wine is a structural issue – next section will examine progress in addressing this

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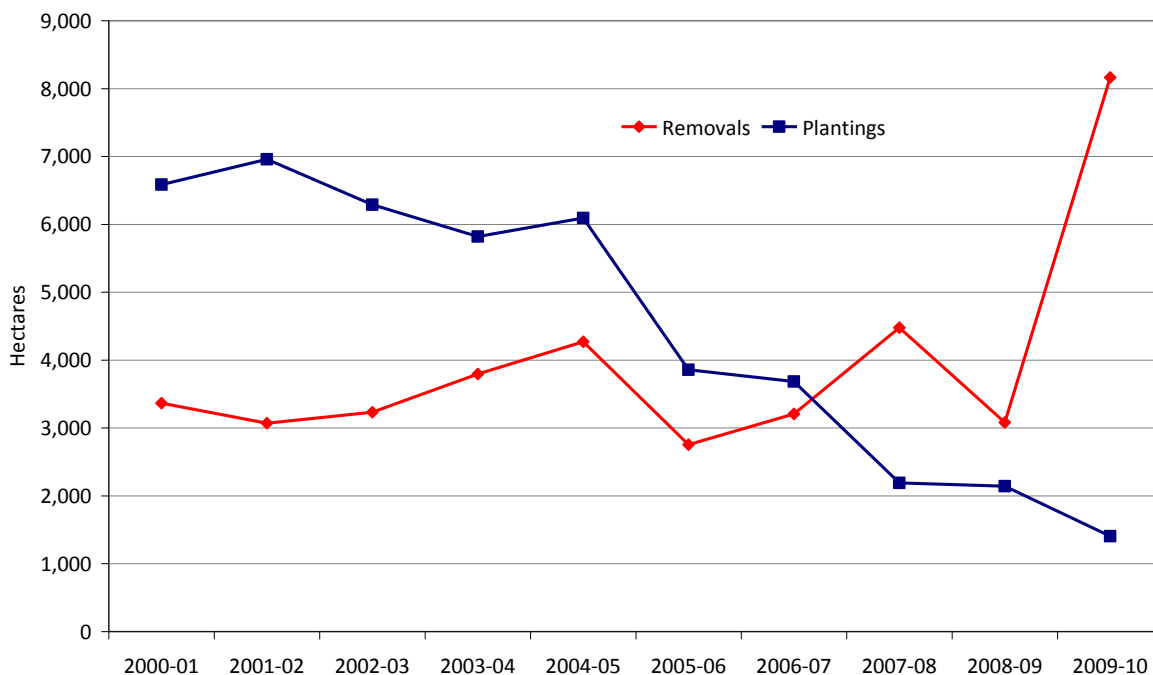
# Australian vineyard area in decline

- Australian winegrape area in 2010 – 157,000ha (17,000ha removed since 2007)
- Current bearing area - 152,000ha
- Not yet bearing 5,000ha – therefore, still potentially another 50-60,000 tonnes to come into production over the next few years



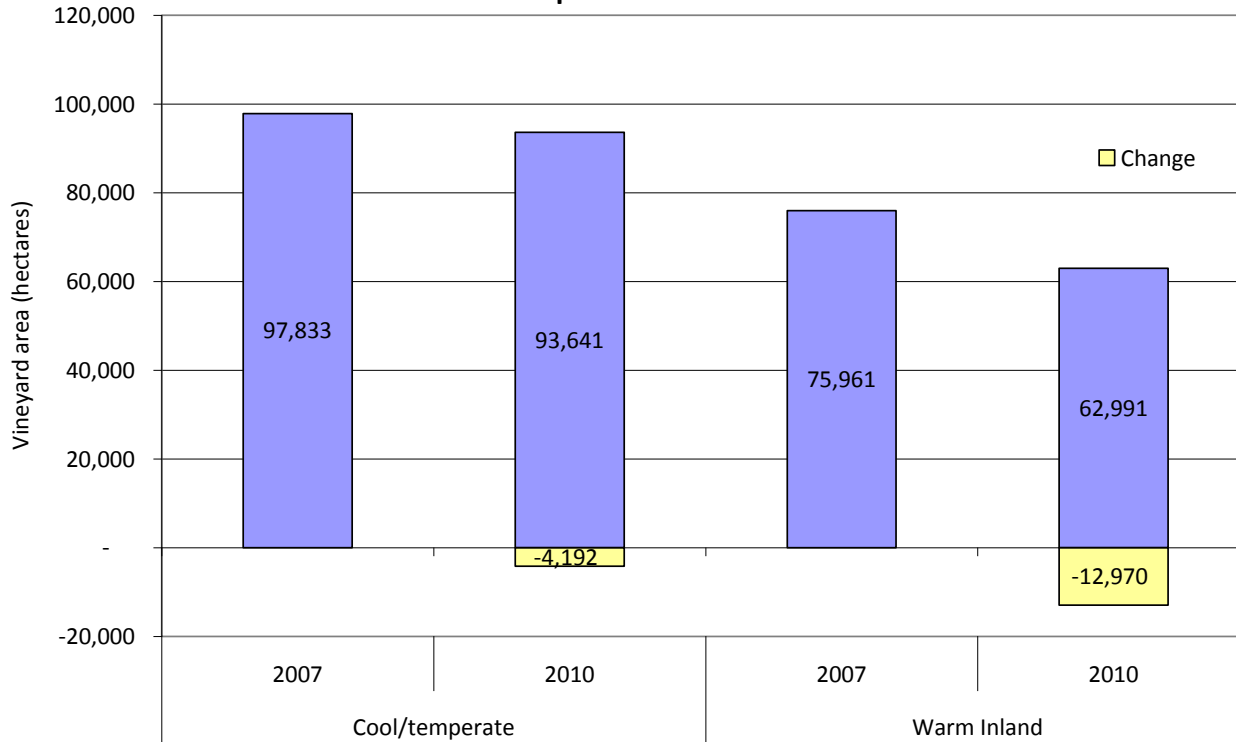
# Net removals for 3 successive seasons

- Prior to the start of the 2010 harvest, 8,164ha were removed from the Australian wine grape production base while 1,405ha were planted resulting in a net removal of 6,758ha (data does not include any removals that may have occurred after the 2010 harvest)
- While this was the third successive season where removals exceeded plantings, removals were significantly higher than in previous years.
- Plantings continued a long-term downward trend.
- There were 13,000ha left unpicked in 2010



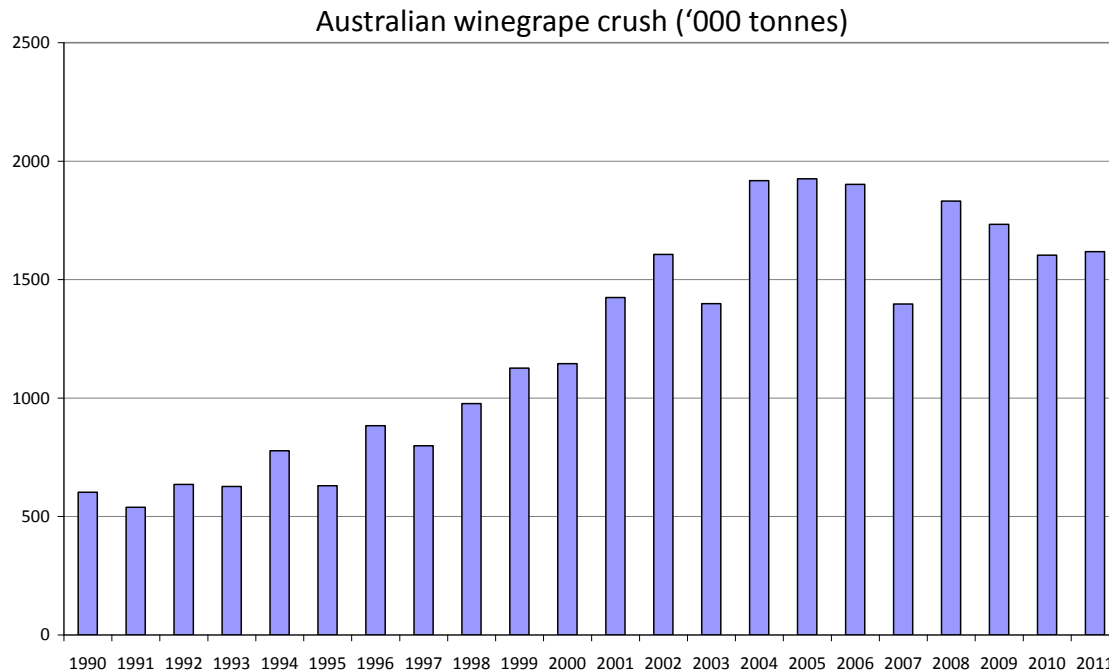
# MD-SH the major contributor to removals

- The adjustments in vineyard area since 2007 are weighted towards the warm inland regions (Murray Darling-Swan Hill, Riverland, Riverina)
- The warm inland area declined by almost 13,000ha compared to just over 4,000ha in the cool and temperate climate regions. Murray Darling-Swan Hill was by far the biggest contributor with a decline of 12,000ha (32k ha to 20k ha).
- The area removed represented 17% of the total warm inland area (38% of MD-SH area) and 4% of the total cool and temperate climate area.



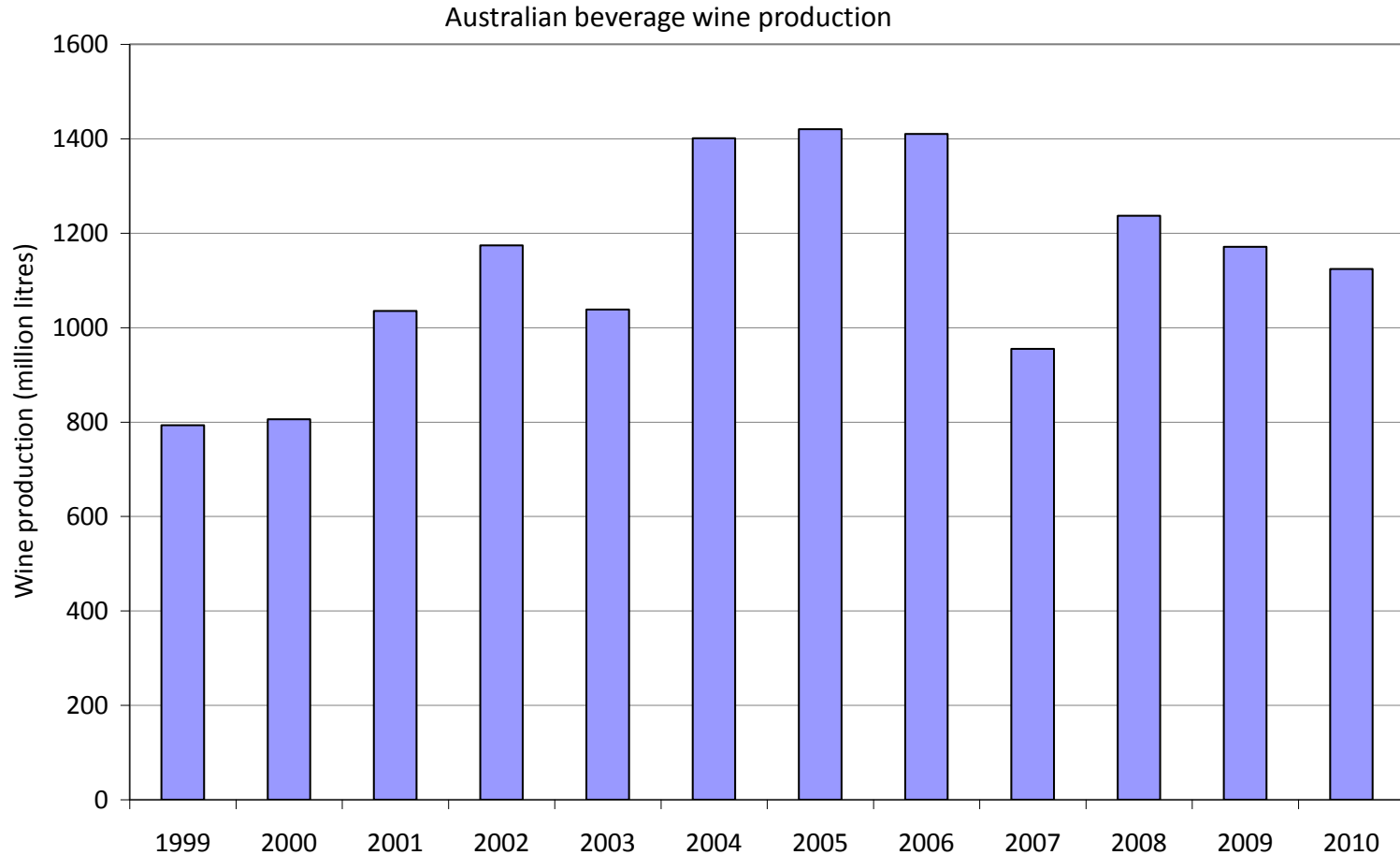
# Australian winegrape crush up in 2011

- 2011 Australian winegrape crush of 1.63Mt slightly up on 2010 but down from the peak in 2005 of 1.93Mt – however, there is still scope to produce a harvest of 1.9Mt
- Disease and rainfall were significant issues in 2011 but the harvest was still up – the 13,000ha not picked in 2010 may have come into play
- Higher crush may not translate into higher volumes of wine as extraction rates are expected to be lower. Two reasons – a) higher levels of concentrate used to boost Baume levels from grapes picked earlier due to heavy rains and b) higher incidence of disease-affected fruit in the crush



# Australian wine production down

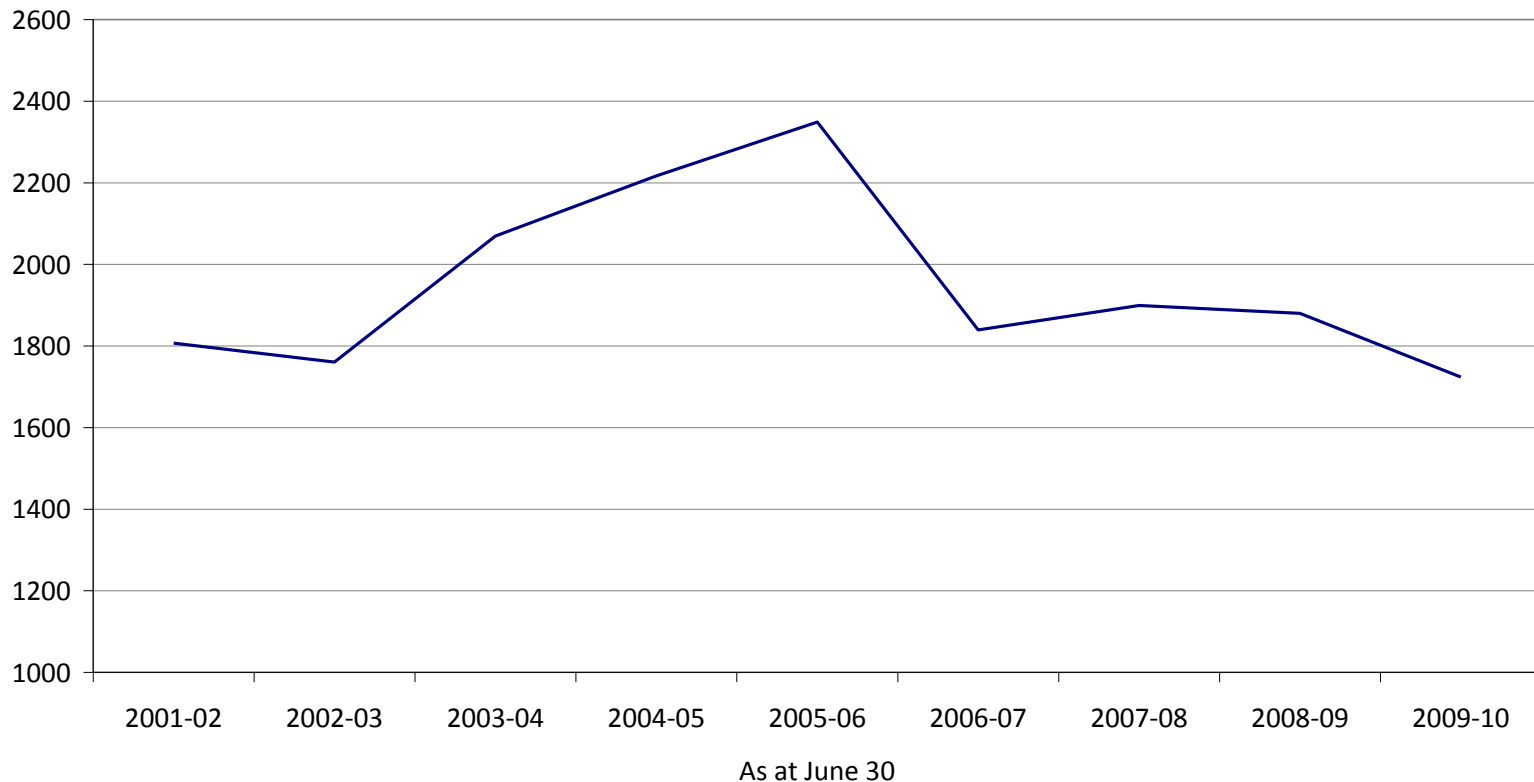
- Australian wine production of 1.12 billion litres in 2010, down from 2005 peak of 1.42 billion litres
- Has declined over the past two years – expect it to be lower in 2011



# Australian wine stock levels have fallen

- With shipments up and production down in the previous year, Australian wine stock levels fell in 2009-10, down to 1.7 billion litres at June 2010
- With wine production likely to be slightly down and sales also down in 2010-11, there is likely to be little change in the stock levels at June 2011

AUSTRALIAN WINE STOCK LEVEL (million litres)



# Further adjustments required

- The 2009-10 forward stock-to-sales ratio (SSR) was 1.51 compared to an assumed ideal SSR of 1.36. This equates to an over-supply of around 200 ML (22 million cases), which is relatively close to balance. **HOWEVER**
- Firstly, in 2009-10, there was a conservative estimate of 300 ML of sales that may be considered to be unprofitable and therefore unsustainable. Netting these sales out of total sales would increase the surplus to 600 ML (66 million cases)
- Secondly, there were seasonal factors that contributed to lower yielding harvests in 2010 and 2011 which was a factor in the reduction in wine production. If 2010 was an average yielding season, then the harvest was potentially around 1.8 Mt. Wine production and stocks at the end of 2009-10 would have therefore potentially been 200 ML higher.

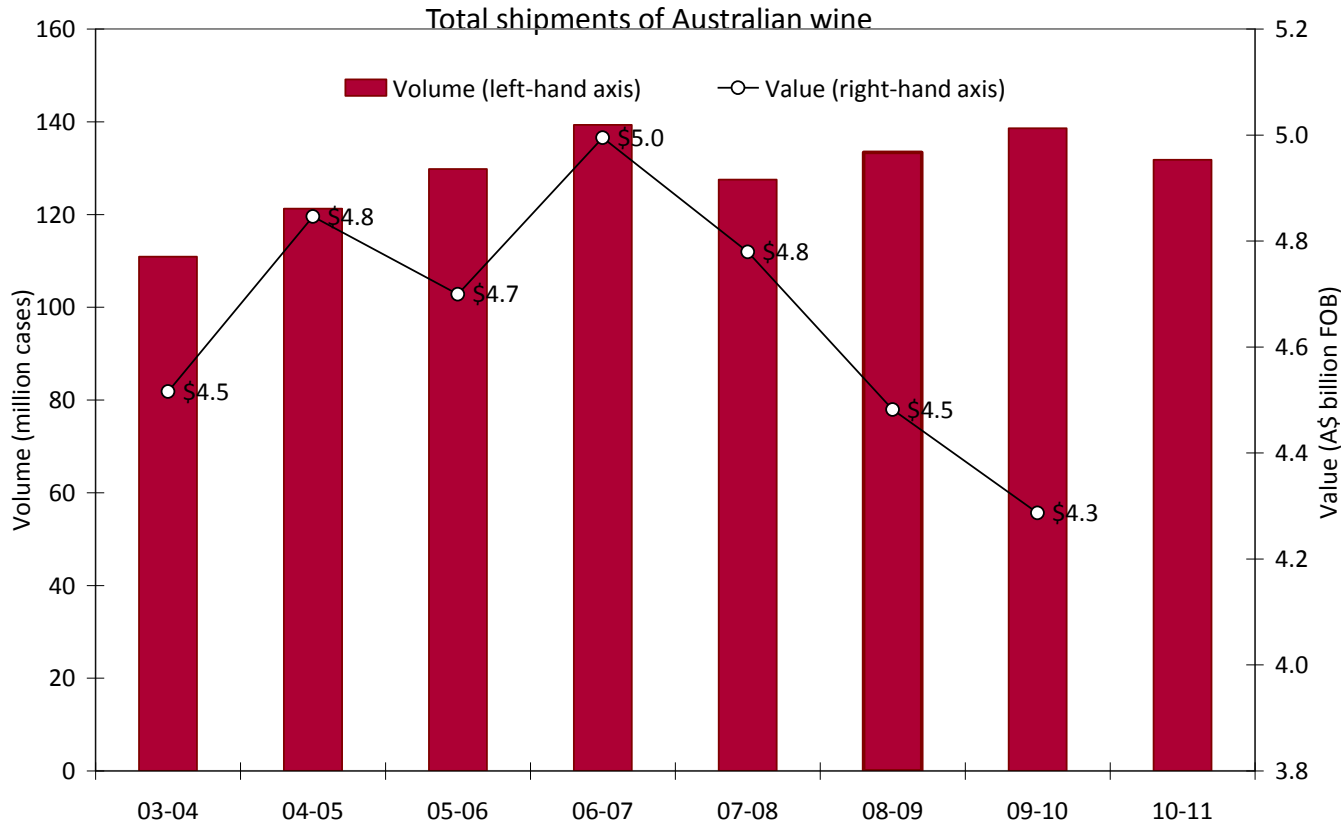


- What this suggests is that there is still the potential for a harvest bigger than was recorded in last 2 years which could add to the existing over-supply.
- Further adjustments are required to move towards a sustainable base

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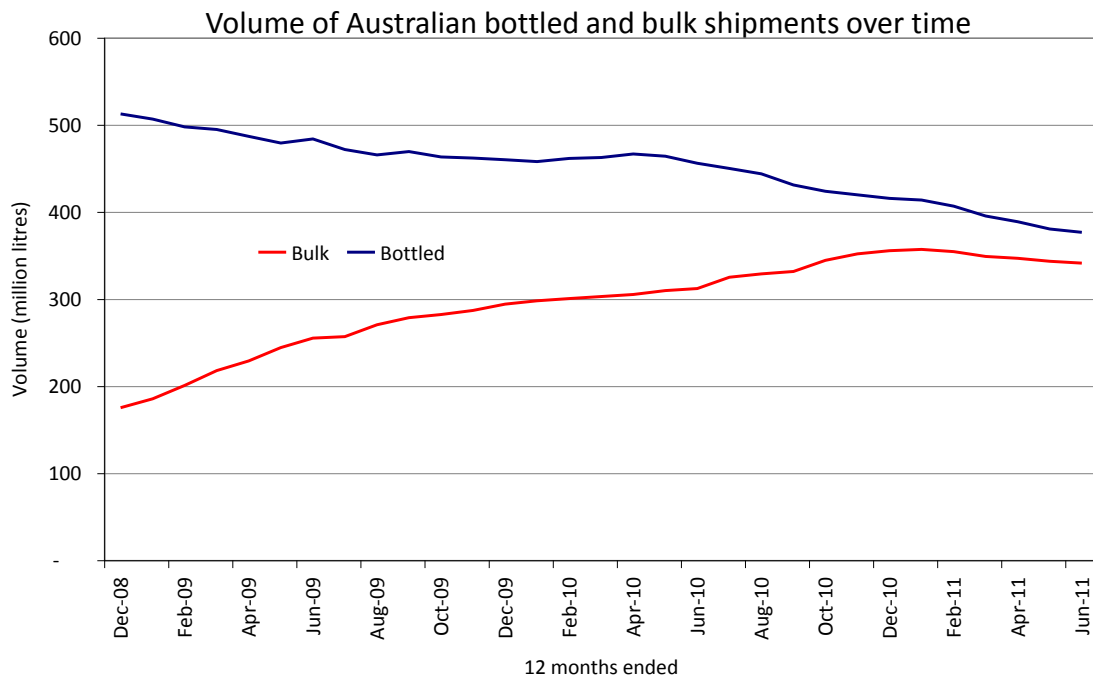
# Total Australian shipments – vol & value ↓

- Total Australian wine shipments (exports + domestic) decline 5% in volume in 2010-11. Value declined by 6% in 2009-10
- Total value has declined over the last three years, driven by increased bulk exports and a decline in bottled exports – from \$5 billion to \$4.3 billion – indications that value dropped again in 2010-11



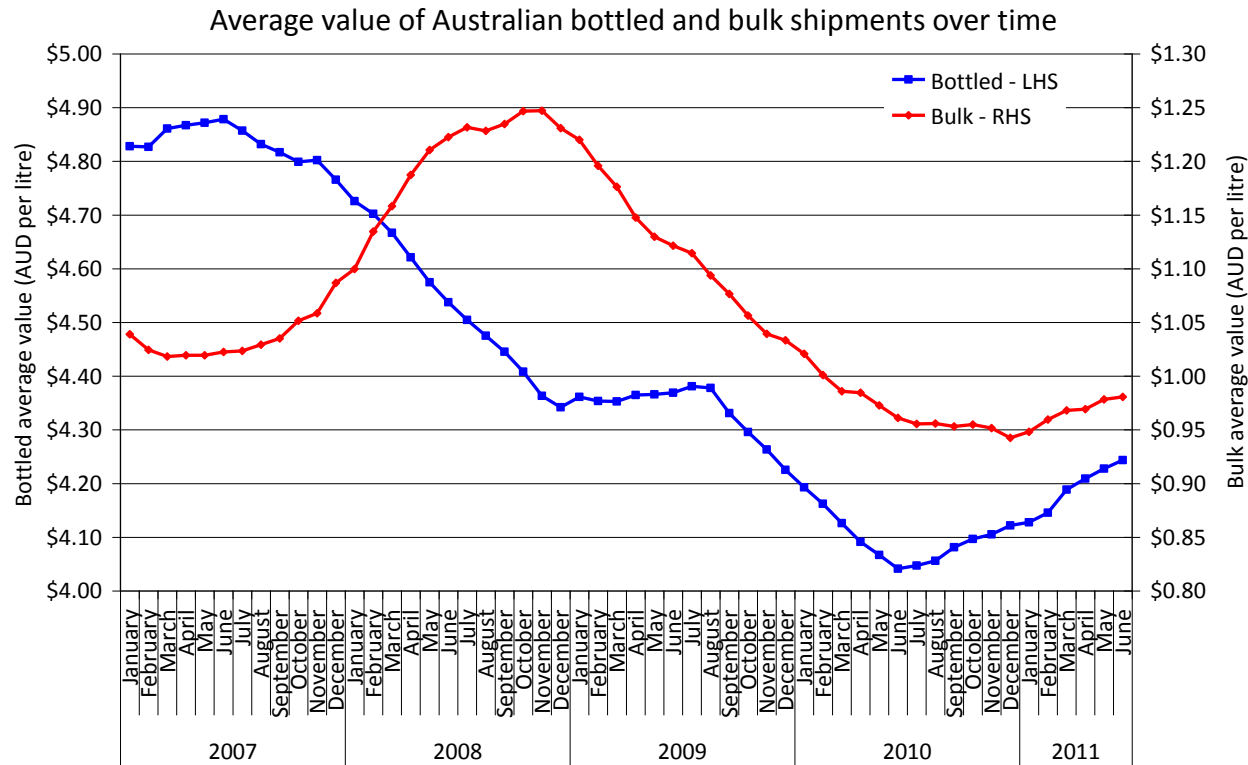
# Exports – bulk growing at the expense of bottled

- In 2010-11, Australian wine exports declined by 6% to 728 million litres valued at A\$1.96 billion
- The decline in the volume of exports was driven by a decline in bottled exports offsetting a smaller increase in bulk exports
- Factors that contributed to this include the on-going strong Australian dollar and a larger proportion of the adjustments to the excess supply position occurring in the previous year. Shipping branded wine in bulk for packaging offshore and the growing presence of private labels/buyers-own brands, particularly in the UK, continues.



# Gradual improvement in average values

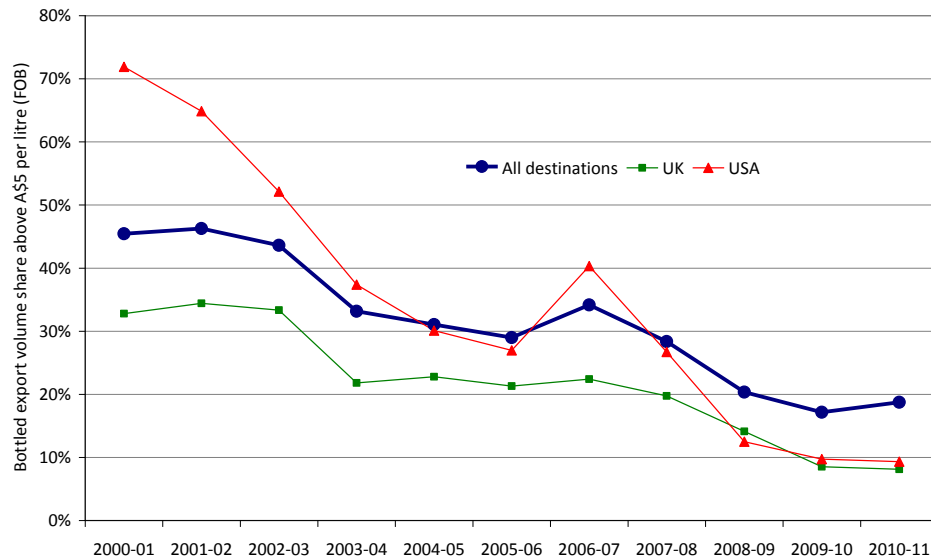
- An improvement in the average value of bottled exports has been recorded for 12 consecutive MAT periods, and the average value is now higher than what it was 12 months ago – driven mainly by a decline of bottled shipments at the low price end
- After falling below A\$1 per litre for the first time since 1995, the average value of bulk exports has improved over the last 6 MAT periods – but is still <A\$1 per litre



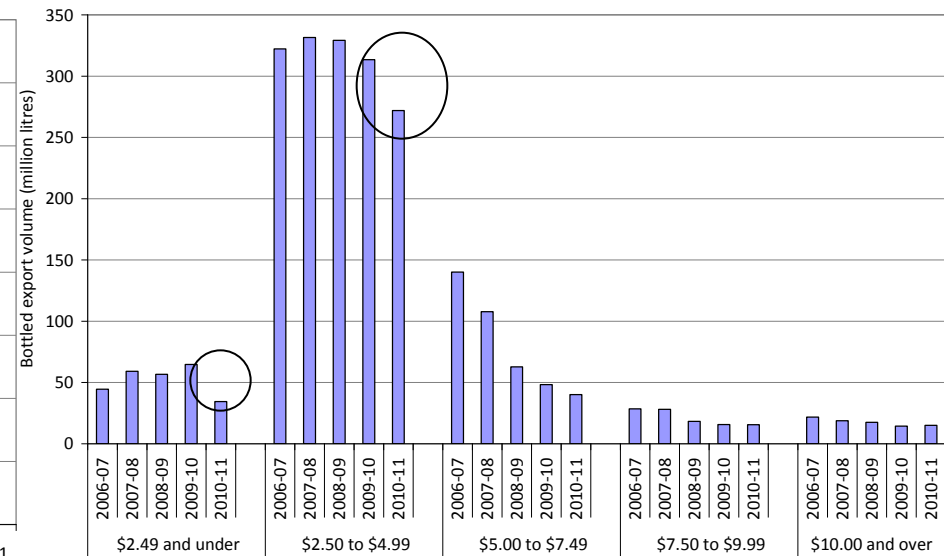
# Bottled exports – share above A\$5/L falling

- Average bottled value of Australian wine exports has fallen from A\$5.36/L in 2000-01 to A\$4.24/L in 2010-11
- Over the same period, the share of bottled exports above A\$5/L has more than halved - from 45% in 2000-01 to 19% in 2010-11
- UK and US performances are major factors
- UK share >A\$5 fallen from 33% to 8%; USA down from 72% to 9%
- A decline in 2010-11 at lower end as more sent in bulk and bottled overseas

Share of Australian bottled exports >A\$5/L (FOB)



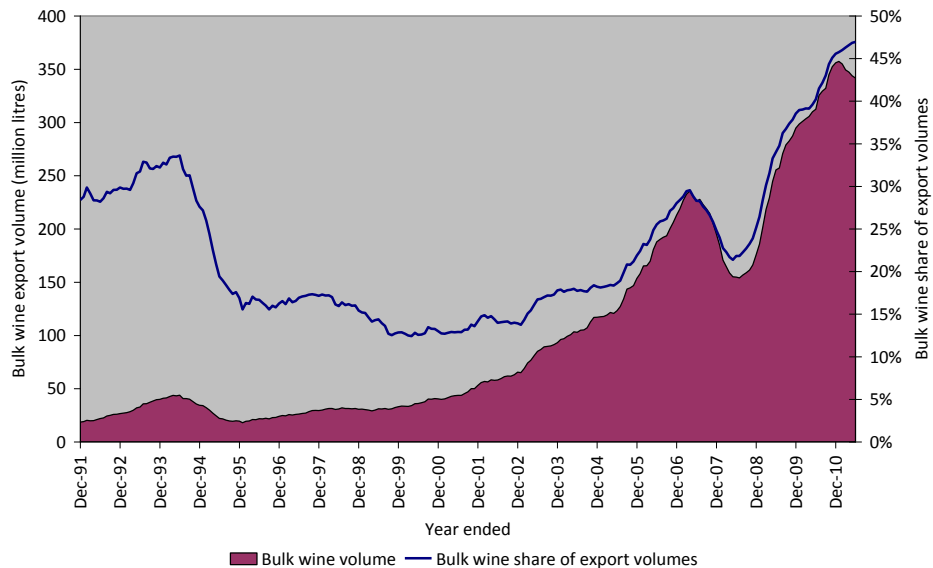
Australian bottled exports by price point



# Bulk export volumes at record high

- In the past two years, the volume of Australian wine shipped in bulk has more than doubled, from 155 million litres in 2007-08 to 342 million litres in 2010-11. At the same time, the bulk wine share of exports increased from 22% to 48%.
- Both the current volume and share of bulk wine are the near the highest on record.
- The increase in bulk wine volumes has come at the expense of average value per litre. The average value of bulk wine steadily declined between November 2008 and December 2010, dropping below A\$1 per litre in March 2010 for the first time on a year-end basis since February 1995. Since Dec 2010, there are signs of improvement.

Australian bulk export volumes over time



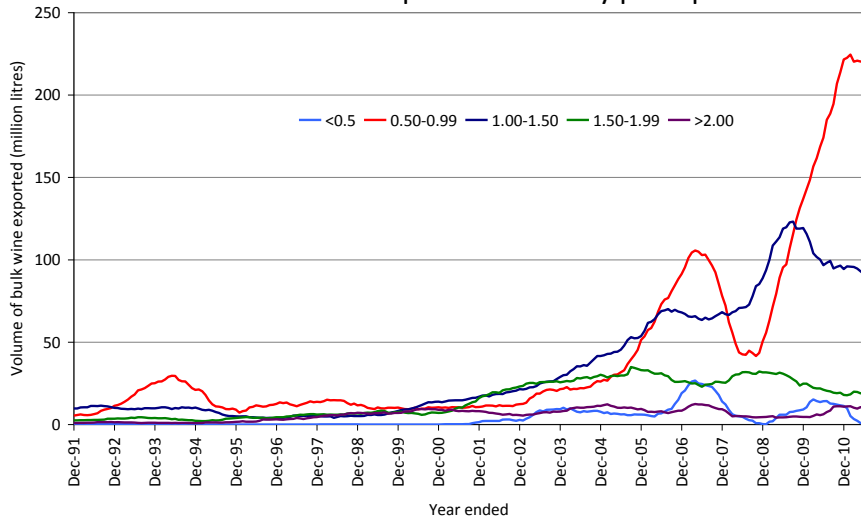
Australian bulk export average values per litre over time



# Bulk export growth coming at <A\$1/L

- The decline in the average value of Australian bulk wine exports over the past two years has been driven by a considerable increase in volumes shipped at below A\$1 per litre.
- Overall, 221 million litres of bulk wine was exported at below A\$1 per litre in the last year, which was more than five times greater than the volumes exported in this price segment two years ago.
- Consequently, over the same time period, the below A\$1 per litre price segment's share of bulk wine exports doubled from 30% to 65% and accounted for 90% of the growth in total bulk wine exports.

Australian bulk export volumes by price point



Share of Australian bulk exports <A\$1 per litre



# Are bulk exports at <A\$1/L sustainable?

- The average value of bulk wine shipments in 2010-11 at below A\$1 per litre was A\$0.70 per litre.
- Assuming processing, winemaking and holding costs of A\$0.40 per litre and an extraction rate of 700 litres per tonne, a winery would need to source fruit at A\$180 per tonne to achieve a gross margin of 5% on sales of bulk wine.
- This fruit cost is below the average cost of production of all regions. Therefore, the sustainability of the high volumes of bulk wine exports currently exported below A\$1 per litre is debateable.

# Australian market value growth sluggish

- There has been a gradual slowing of total value growth in the Australian market over the last 18 months but showing signs of recovery in recent months
- Negative growth in Sep-Nov 2010 but up slightly since Dec 2010

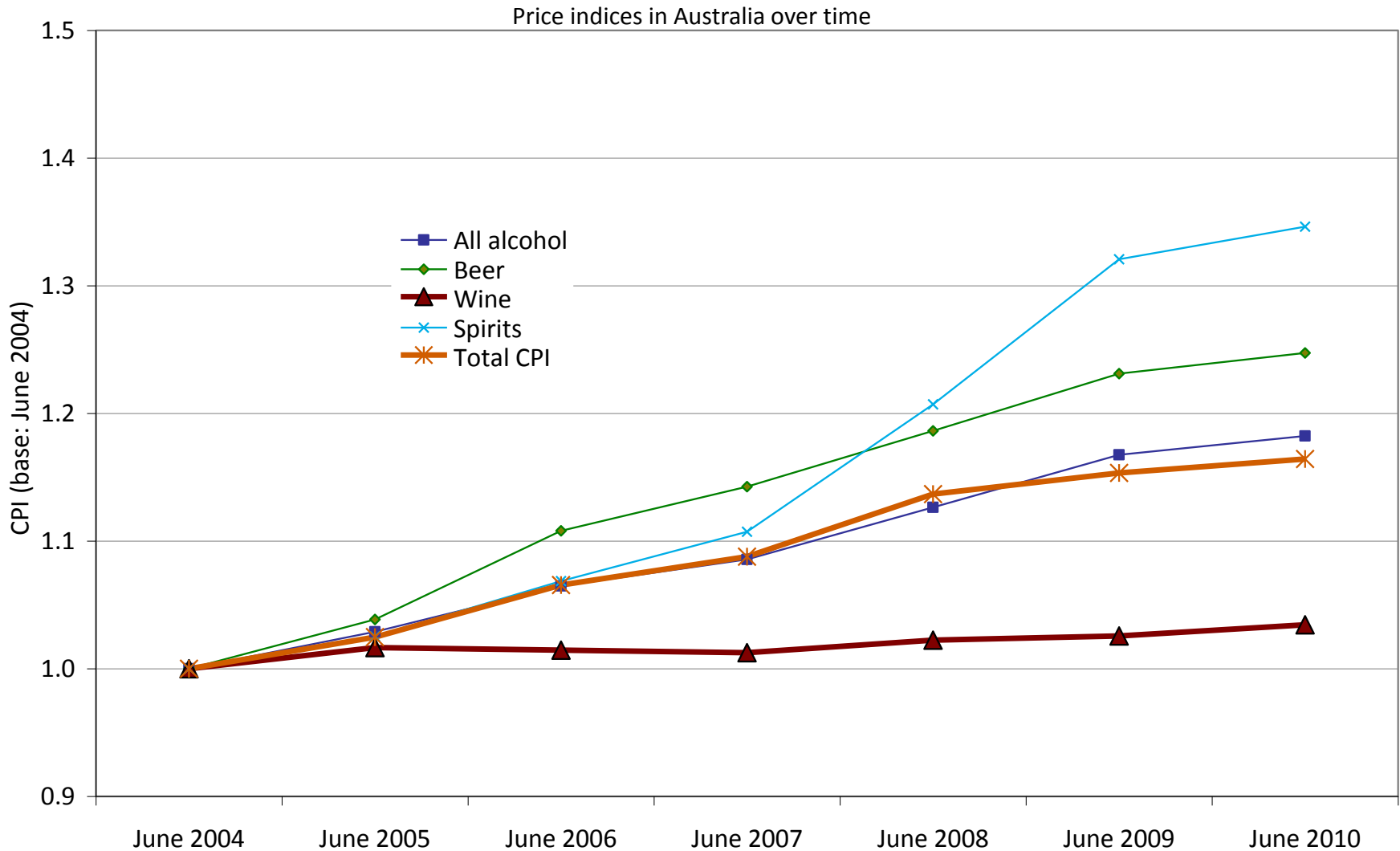


# Private labels taking share

- Retailer consolidation is ongoing with Coles and Woolworths targeting higher store numbers, which increases buying power over Australian wine companies.
- Additionally, retailers are increasingly competitors with strategies to offer best prices via private label and importing, which negatively impacts on returns.
- Buyers own brands/private label share of Australian domestic market is on the rise – from a 3% total value share in 2007 to 11% in Aug 2010 MAT (volume share of 19%)
- Placing downward pressure on pricing

	Val % Share	Val % Growth YA	Vol % Share	Vol % Growth YA
<b>Private Label &amp; Retailer Controlled</b>	11.1	15.7	18.6	23.7
<b>Mfr Marketed Bottled Wine</b>	88.9	0.1	81.4	0.8
<b>TTL WINE BOTTLE</b>	100.0	1.7	100.0	4.4

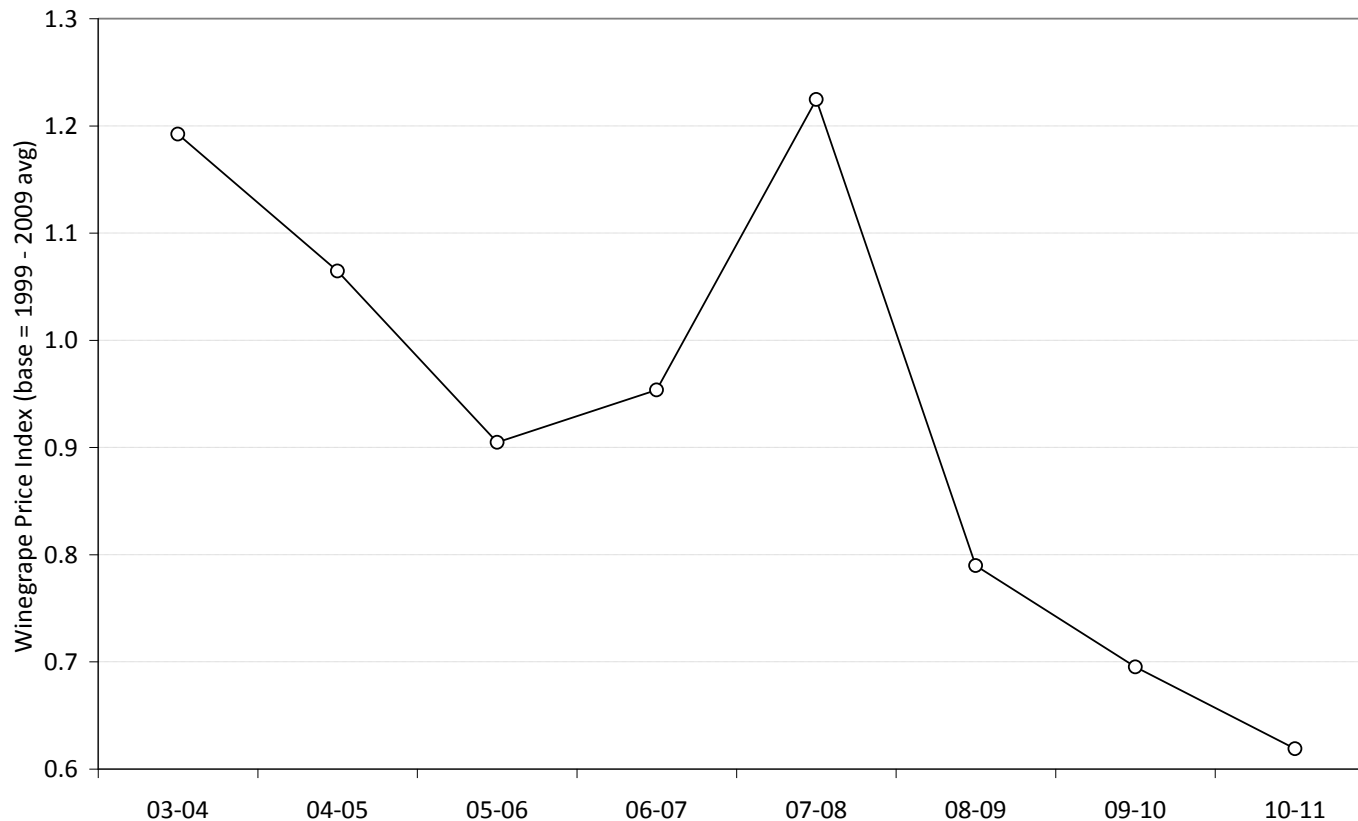
# Wine prices increases lag cost increases



# Winegrape prices at decade-low levels

- Apart from increases in 2006-07 and 2007-08, Australian winegrape prices have shown a downward trend since 2000-01
- 2010-11 prices were the lowest for the decade
- Since 2007-08, this represents an aggregate loss of income for wine grape sector of \$2.2 billion

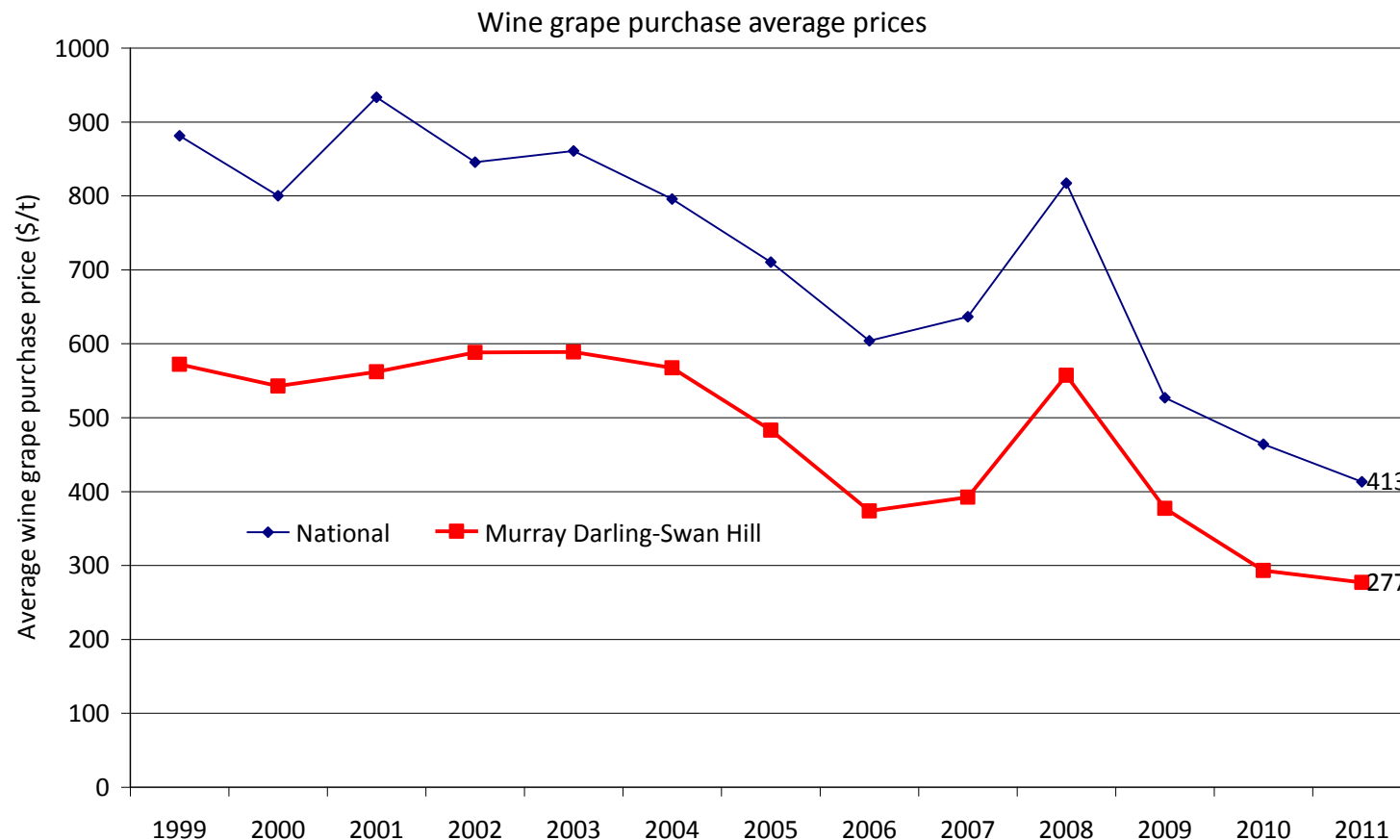
Australian winegrape purchase price index



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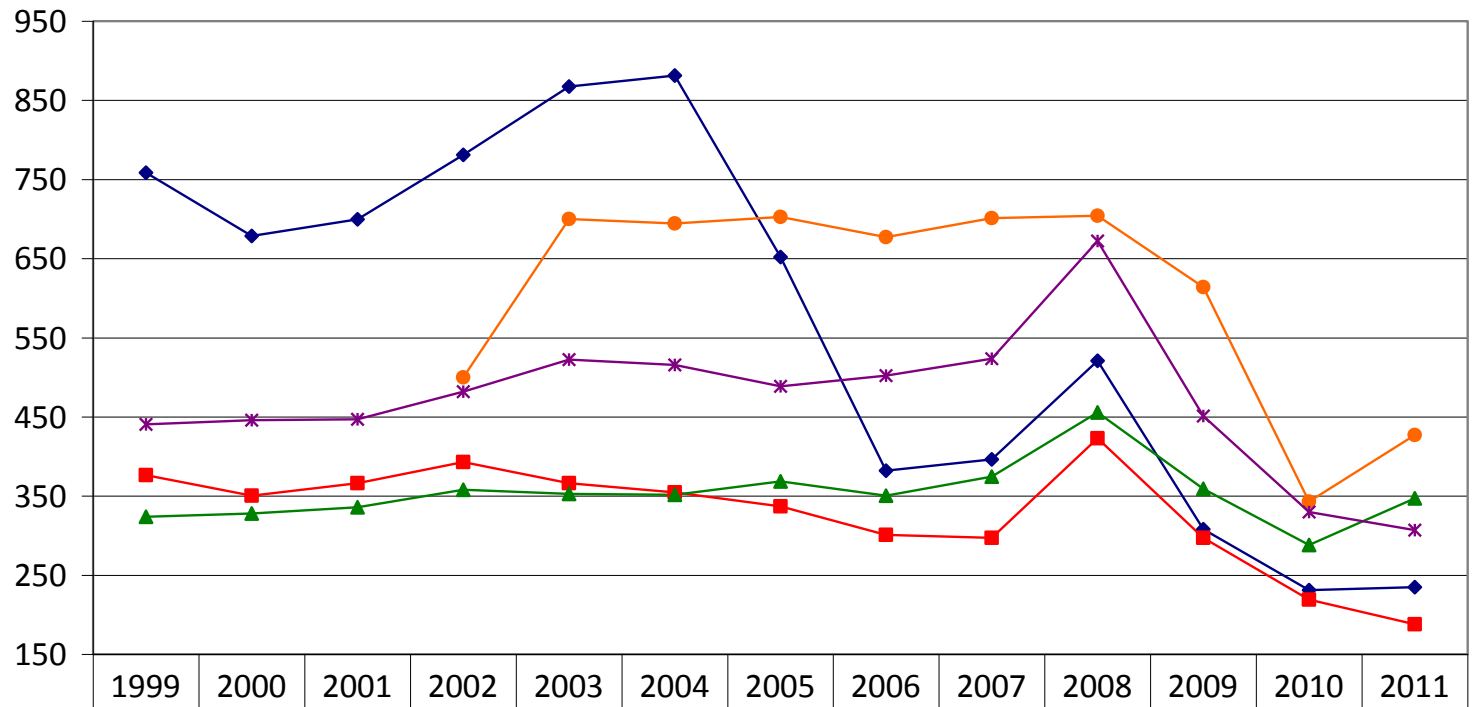
# Murray Darling-Swan Hill income halved

- The average price paid for Murray Darling – Swan Hill wine grapes has fallen below \$300/t - from around \$600/t in the early 2000s to \$277/t in 2011
- Income for the region has more than halved in 3 years - from \$230 million in 2008 to \$90 million in 2011



# Key white varieties

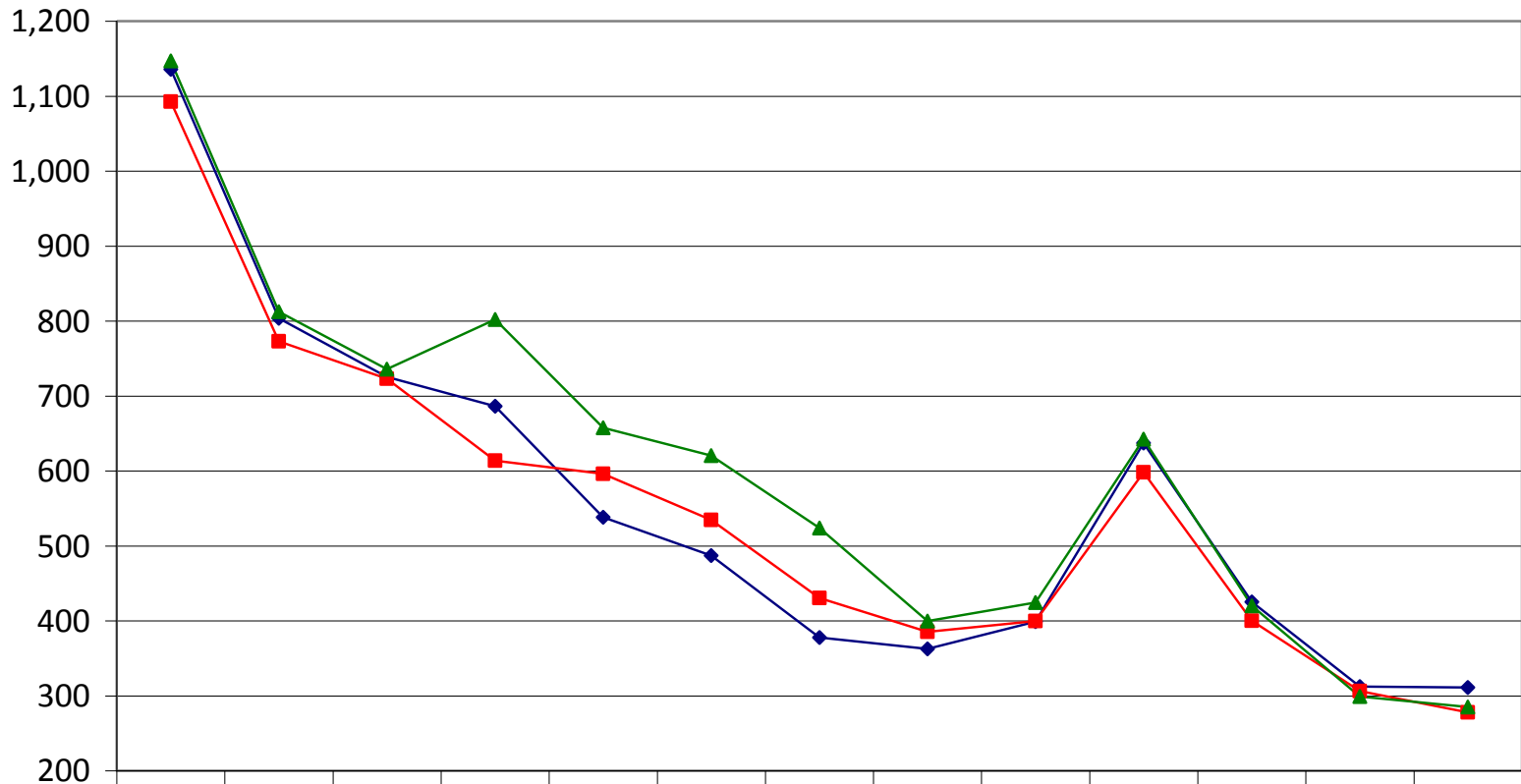
Murray Darling-Swan Hill wine grape purchase average prices for key white varieties (\$ per tonne)



◆ Chardonnay	758	679	699	781	867	881	652	382	396	521	308	231	235
■ Colombard	376	350	366	393	366	354	337	301	297	423	297	219	188
▲ Muscat Gordo Blanco	324	328	336	358	353	352	368	350	374	456	359	288	347
● Pinot Gris				500	700	694	703	677	701	704	614	343	427
* Sauvignon Blanc	441	446	447	482	523	516	489	502	524	672	451	330	307

# Key red varieties

Murray Darling-Swan Hill wine grape purchase average prices by key red varieties (\$ per tonne)



	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
◆ Cabernet Sauvignon	1,136	804	726	686	538	487	378	362	399	637	425	312	311
■ Merlot	1,093	773	723	614	596	535	430	385	400	598	400	306	278
▲ Shiraz	1,147	812	736	802	657	620	524	399	424	642	420	299	285

# Key takeouts

The sector is in the midst of the toughest period in decades with a range of factors impeding returns

Structural excess wine supply is a key factor in contributing to low wine grape prices

Adjustments to the supply base have taken place but more are required to move towards a sustainable sector

Value of Australian wine sales continues to decline

There is some improvement in average bottled and bulk export prices but prices remain relatively low

There are large volumes of bulk wine shipped at unsustainable prices

Value growth in the domestic market is sluggish

Growth in private labels is placing increasing pressure on margins

Wine prices are not keeping up with CPI putting more pressure on margins

Wine grape prices are at decade low levels

Murray Darling – Swan Hill wine grape income has more than halved in 3 years

Prices are depressed for most varieties from Murray Darling – Swan Hill

