

Australian Wine Industry – State of Play

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Australian Government

Wine Australia



Presentation outline

- The objective of this presentation is to examine the current state of the Australian wine industry, including
- Factors impeding sustainable returns to growers and wine producers
- A global overview of market performance and supply
- An overview of Australian demand and supply key indicators

■ **The Macro View**

■ Global Picture

■ Australian demand key performance indicators

■ Australian supply key performance indicators

The toughest period in decades

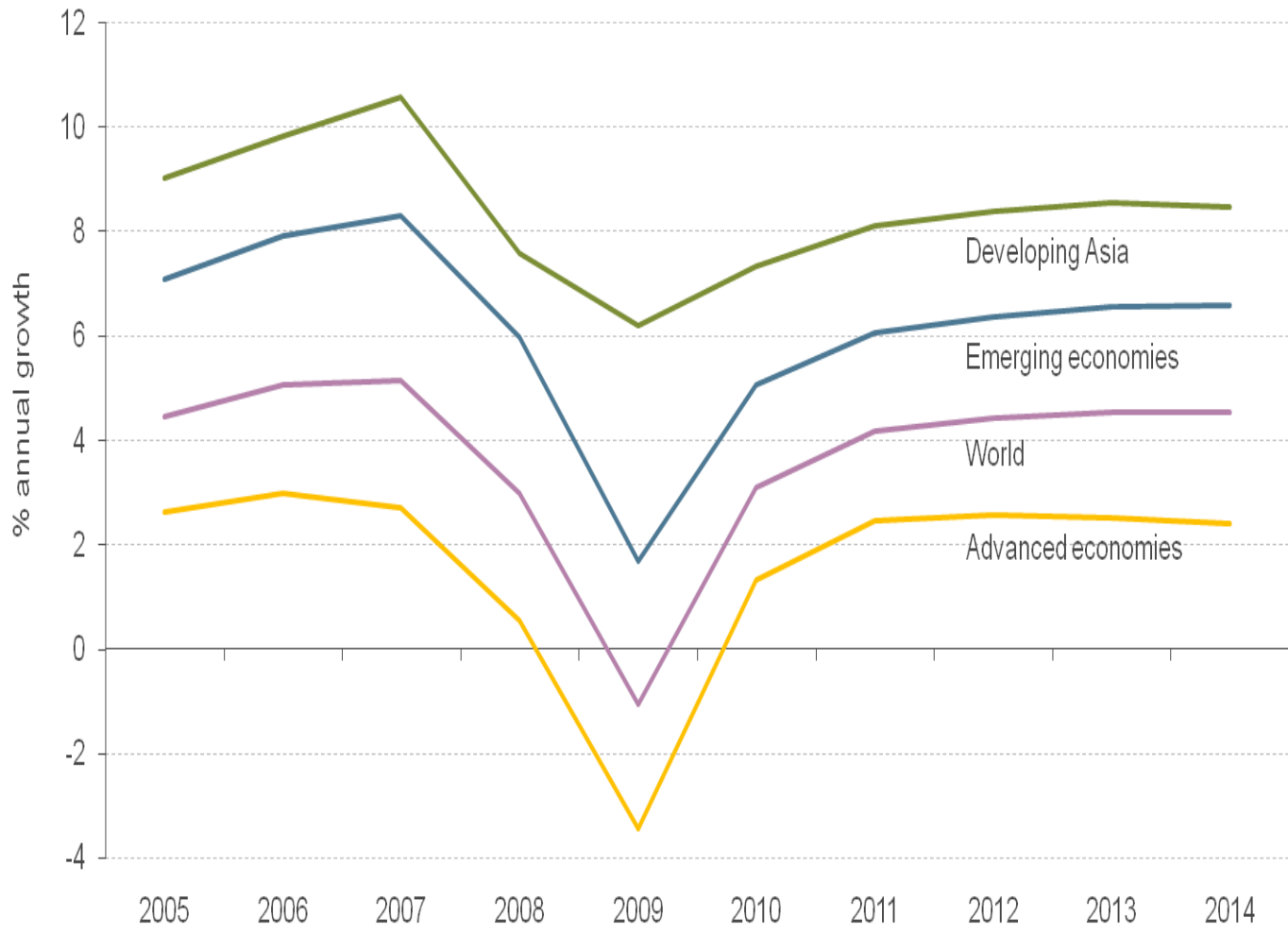
- It is widely acknowledged that the Australian wine sector is enduring its toughest period in decades
- There are numerous factors inhibiting returns to the sector, many outside our control, such as
 - foreign exchange rates impacting on the competitiveness of the Australian category both abroad and 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

Emerging markets to drive fragile recovery

Real GDP Growth 2005-2014



Negative Real GDP Growth

2009



89 countries

2010



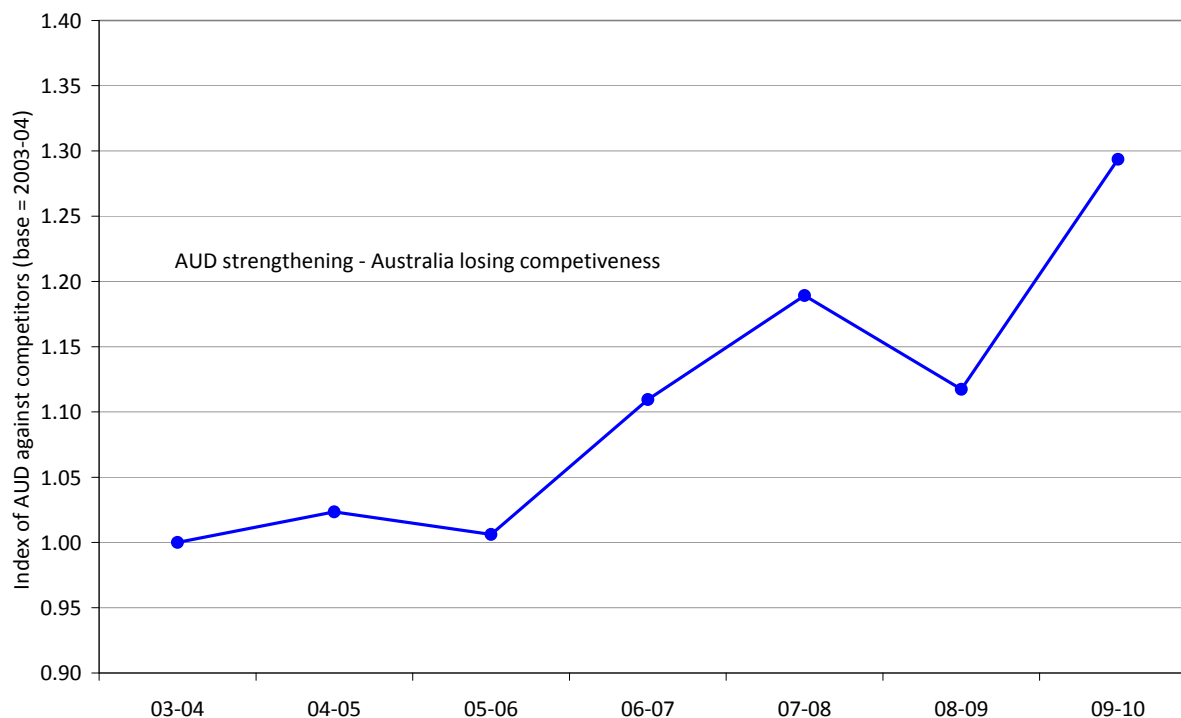
18 countries

AUD is at an all-time high

- AUD is at an all-time high against not only the currencies of many of our major export markets but also against our major wine producing competitors

High AUD due to:

- High commodity prices driven by Chinese demand for our iron ore
- Strong terms of trade – highest level since 1901
- Capital inflows to Australia - booming resources sector plus the significant interest rate differential between Australia and other major economies



■ The Macro View

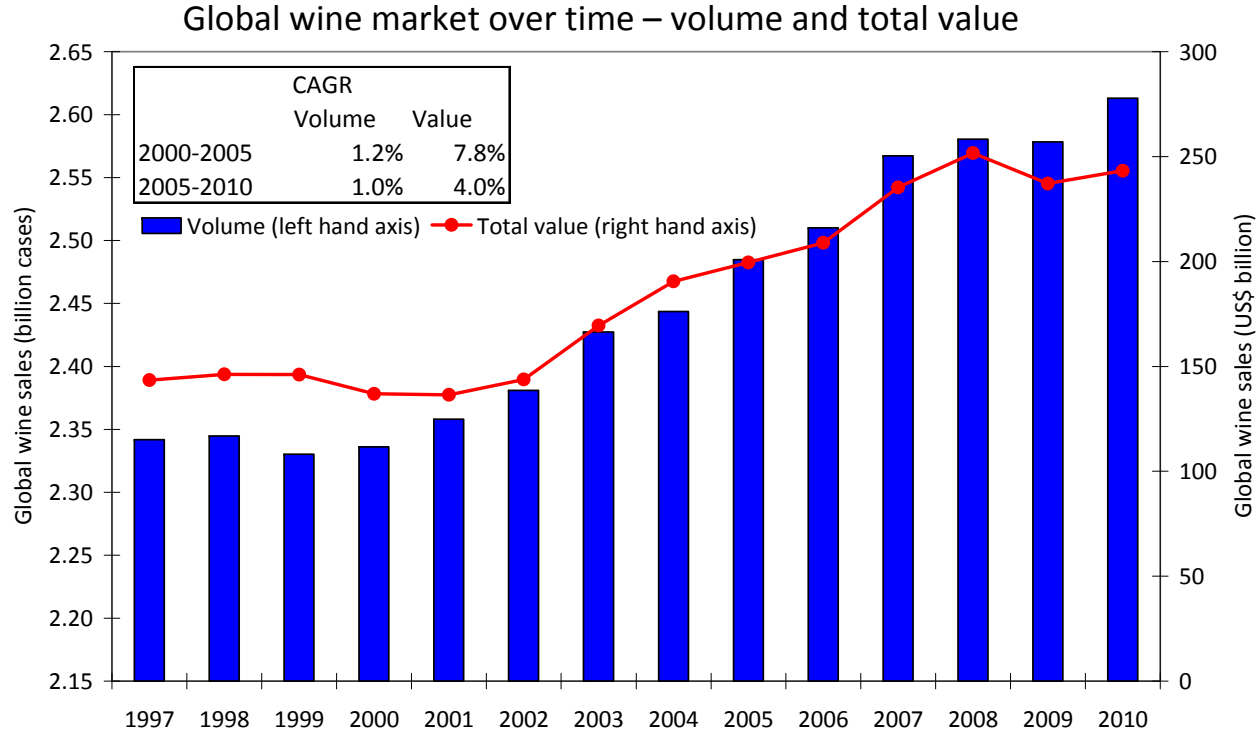
■ **Global Picture**

■ Australian demand key performance indicators

■ Australian supply key performance indicators

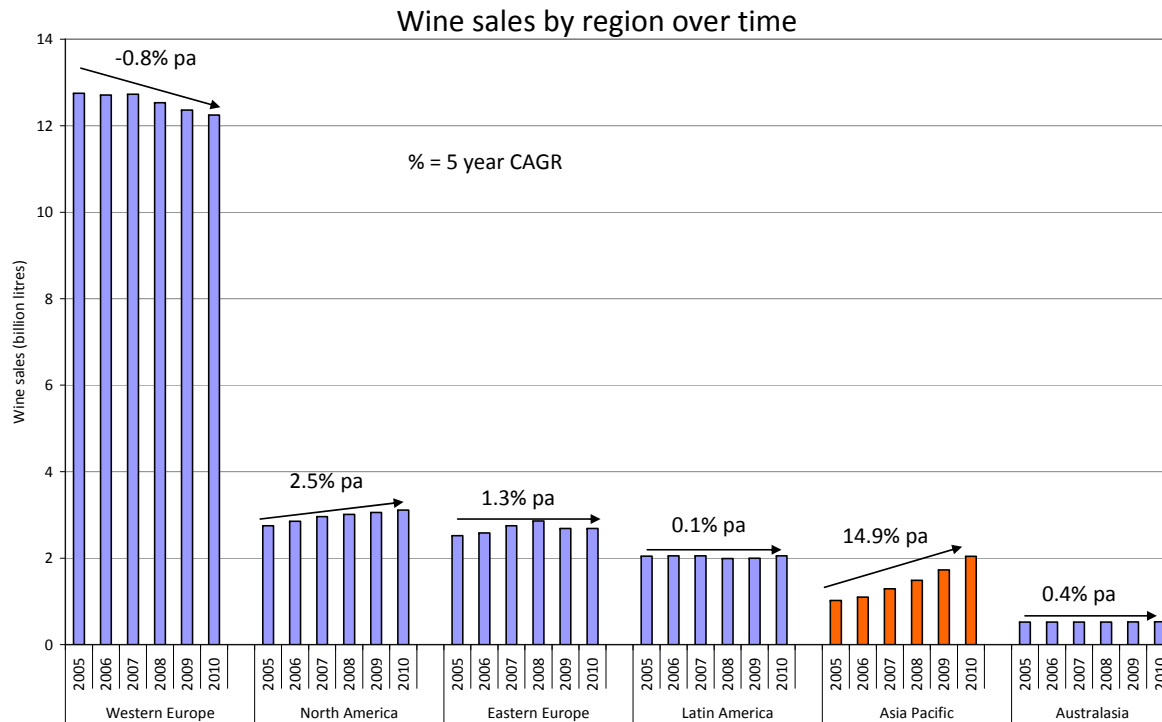
Global wine sales recovering

- After declining in 2009, global wine sales rebounded in 2010
- Global total value growth in 2010 (up 3%) stronger than volume growth (up 1%) but still less than 5 year CAGR
- Total value was also less than 2008 peak
- Global per capita wine consumption at 3.3 litres is less than 2007 (3.6 litres)



Asia Pacific is the fastest growing region

- Asia Pacific is comparatively small in size but wine sales are growing at by far the fastest rate
- Western Europe in decline
- Eastern Europe had been growing but in decline since GFC
- North America steady growth
- North America steady growth
- Australasia very little growth



Global wine surplus but declining

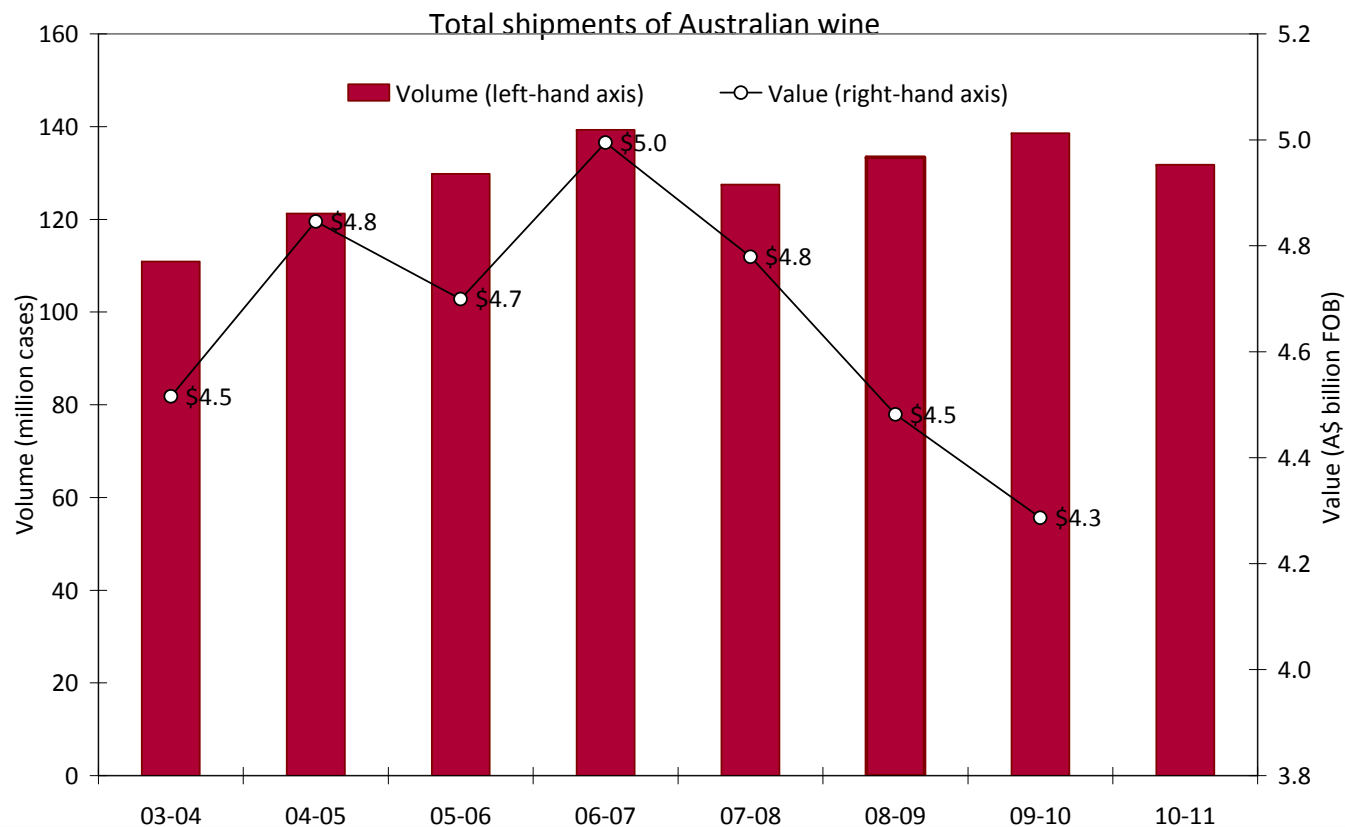
- There is a global wine surplus but there are signs that it is being reduced
- There are several factors that suggest that the global wine over-supply may fall in the future. On the supply-side, the on-going efforts to reduce vineyard area in the EU as well in Australia may see global vineyard area fall. On the demand-side, global wine consumption may increase, or at the very least stabilise, as the world emerges from the economic downturn and wine consumption continues to increase in emerging markets such as China.



- The Macro View
- Global Picture
- **Australian demand key performance indicators**
- Australian supply key performance indicators

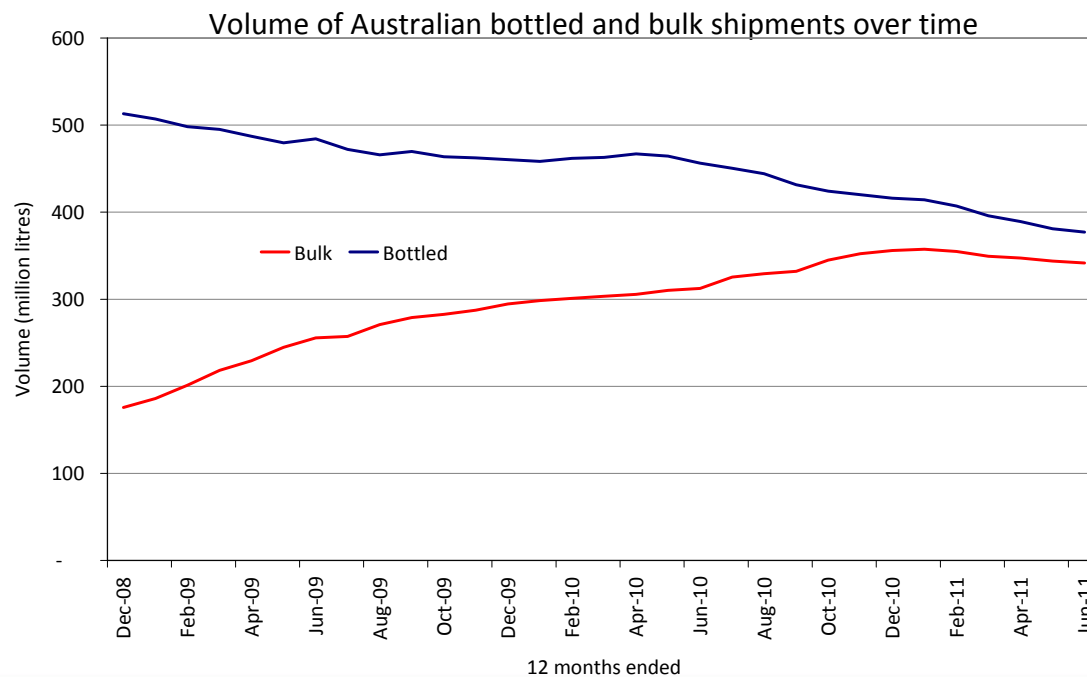
Total Australian shipments – vol & value ↓

- 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



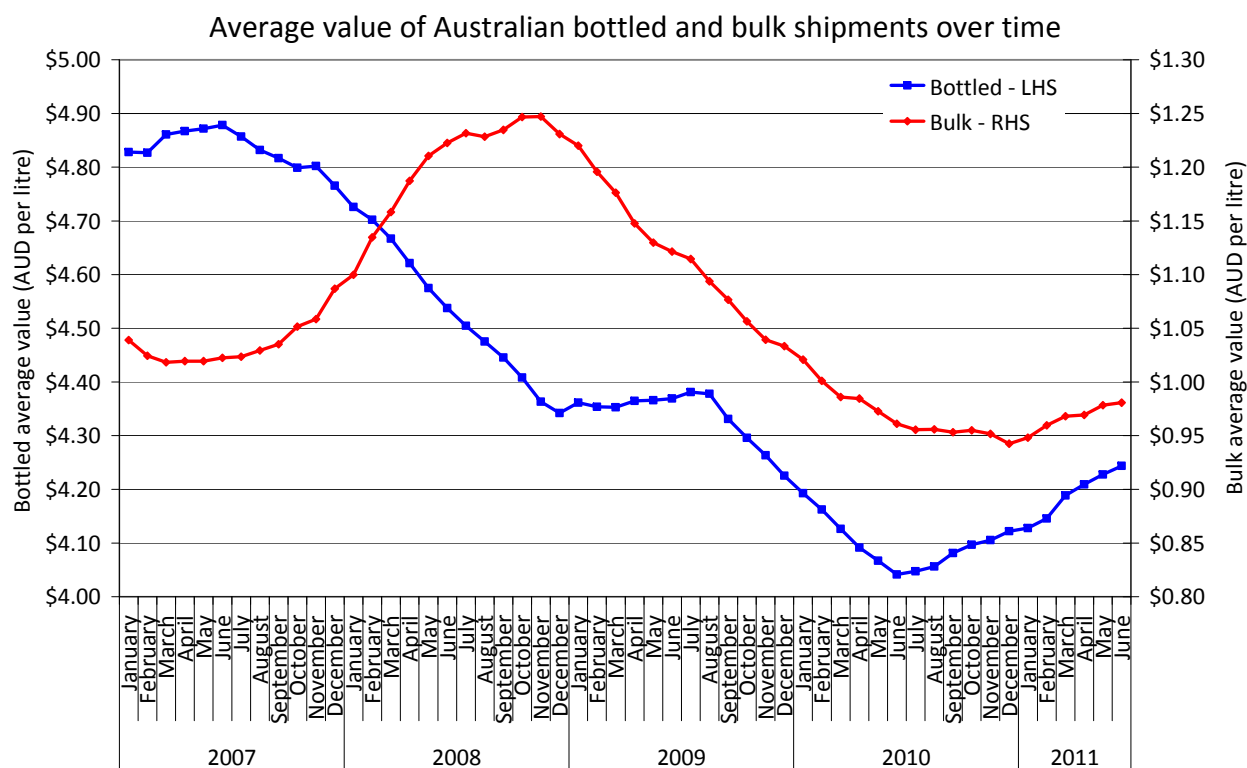
Exports – bulk growing at the expense of bottled

- 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

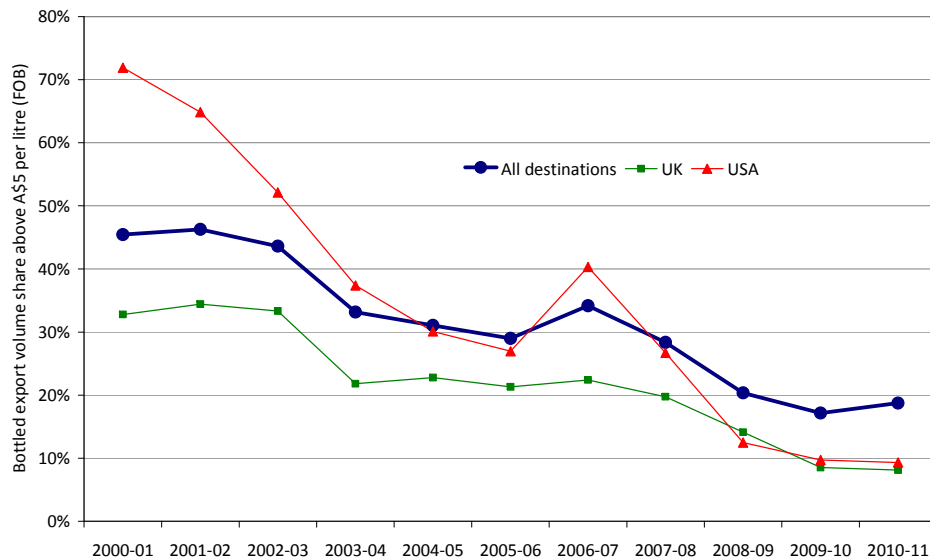
- An improvement in the average value of bottled exports has been recorded for 12 consecutive MAT periods, and the average value is now higher than what it was 12 months ago – driven mainly by a decline of bottled shipments at the low price end
- After falling below A\$1 per litre for the first time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



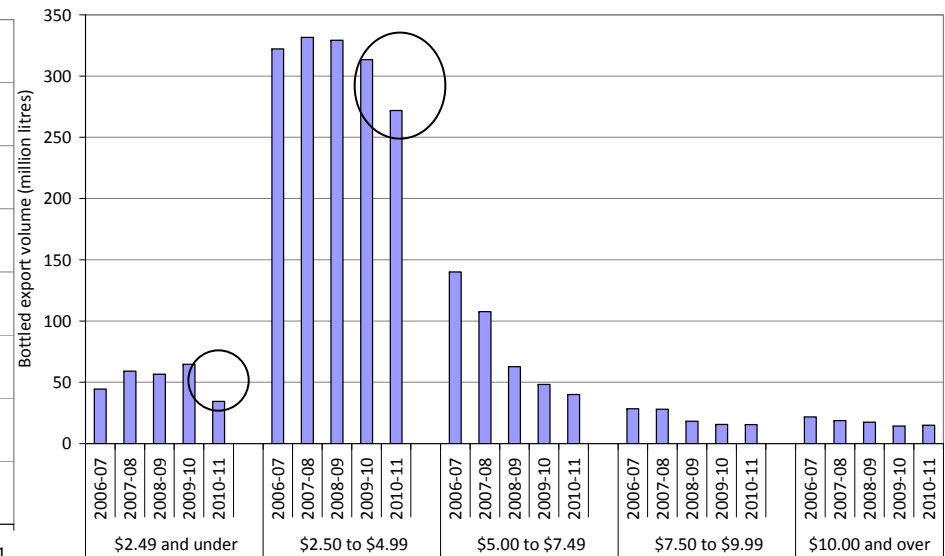
Bottled exports – share above A\$5/L falling

- 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)

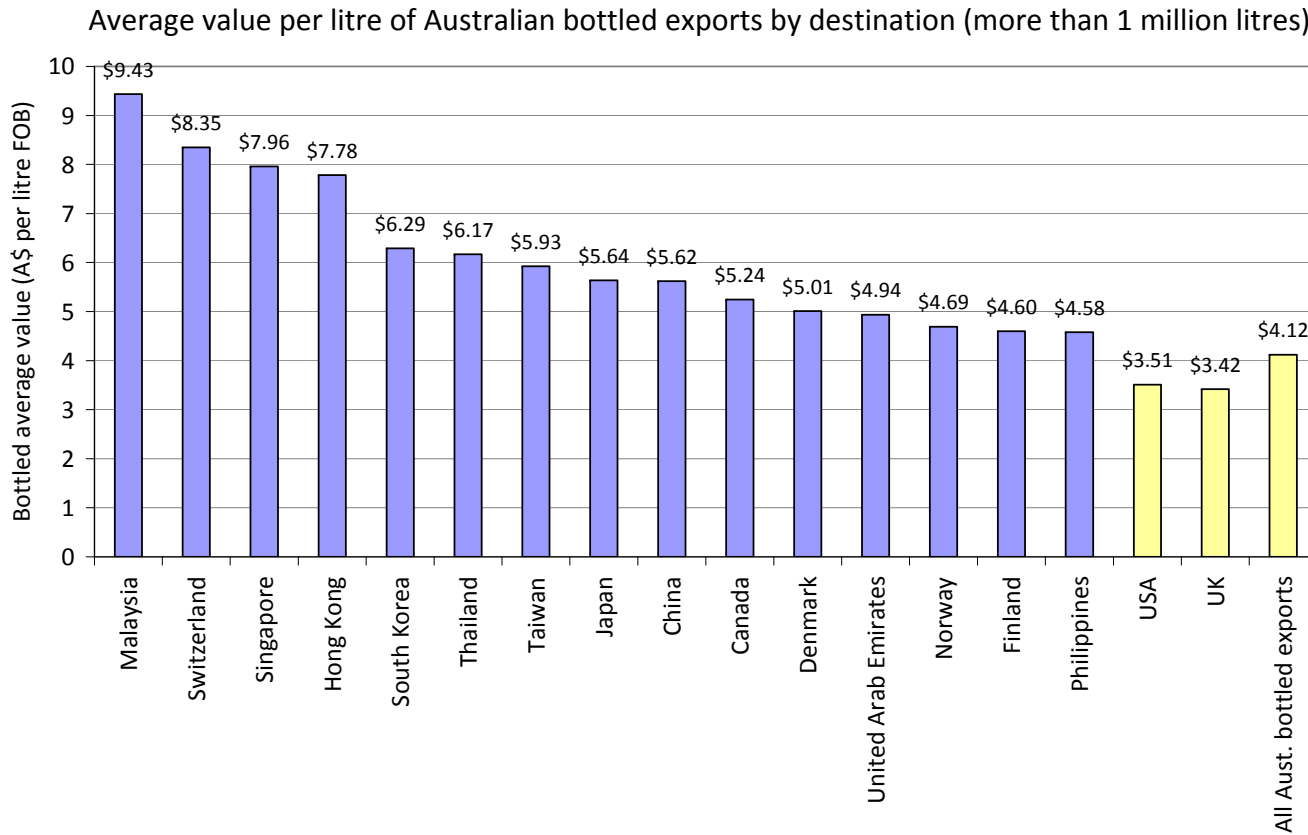


Australian bottled exports by price point



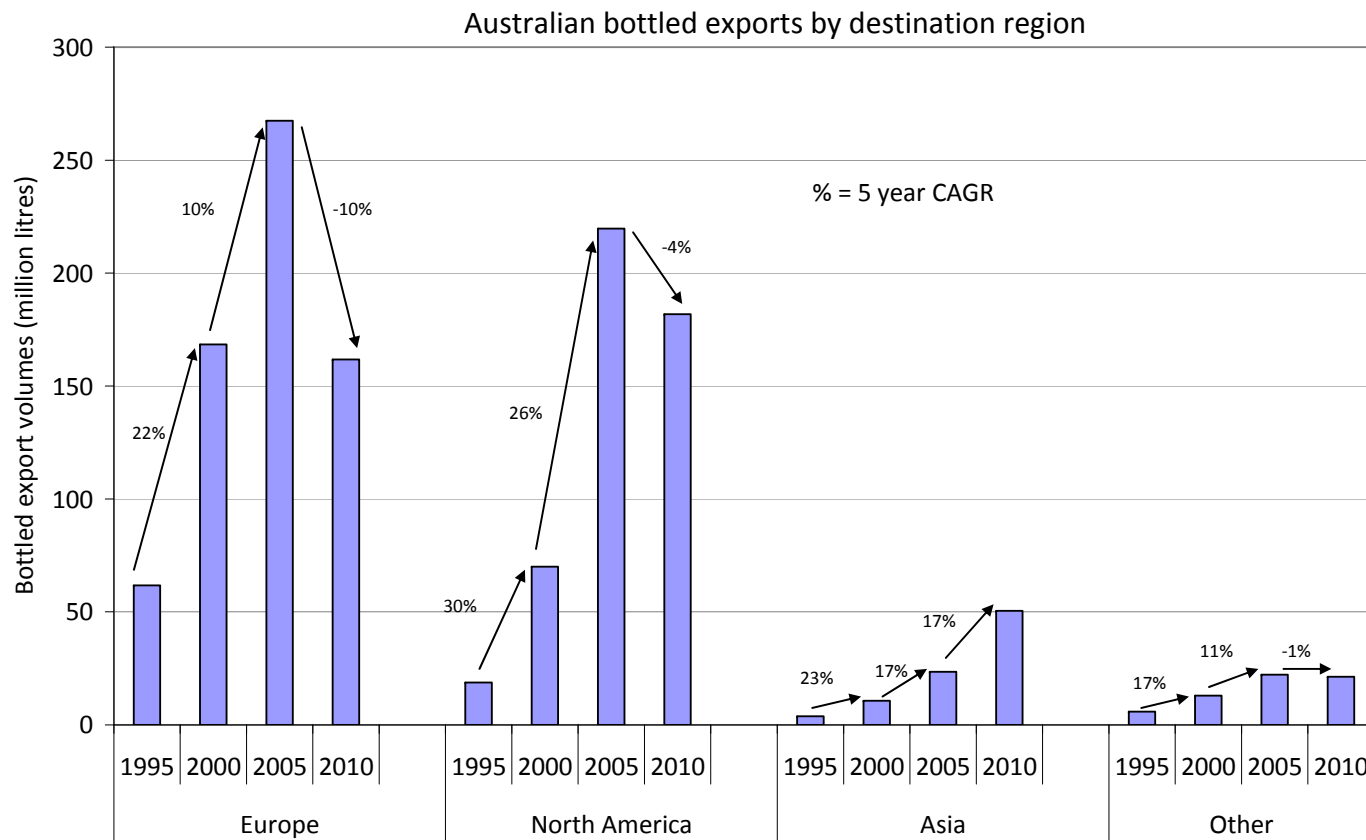
Bottled exports – higher average A\$/L to Asia

- Of the destinations where Australia ships more than 1 million litres of bottled wine, 10 of the 15 highest average values per litre were achieved in Asian markets
- Bottled exports to our two biggest destinations, the US and the UK, posted below average values per litre



Bottled exports – Asia small but growing

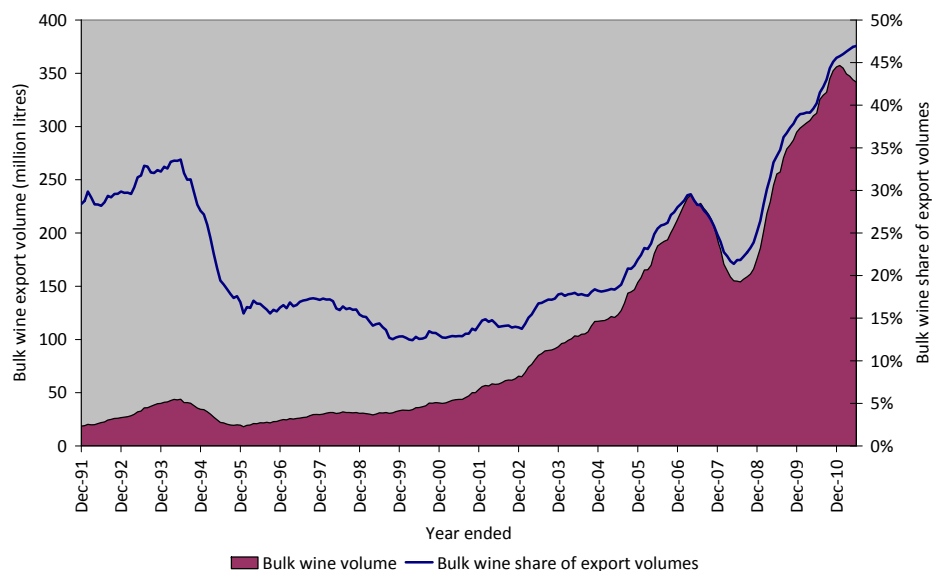
- Asia is the growth centre for Australian bottled exports BUT
- The growth is off a small base – 4% share in 1995; 12% share in 2010
- Europe and North America down but still account for a combined 83% share of bottled exports



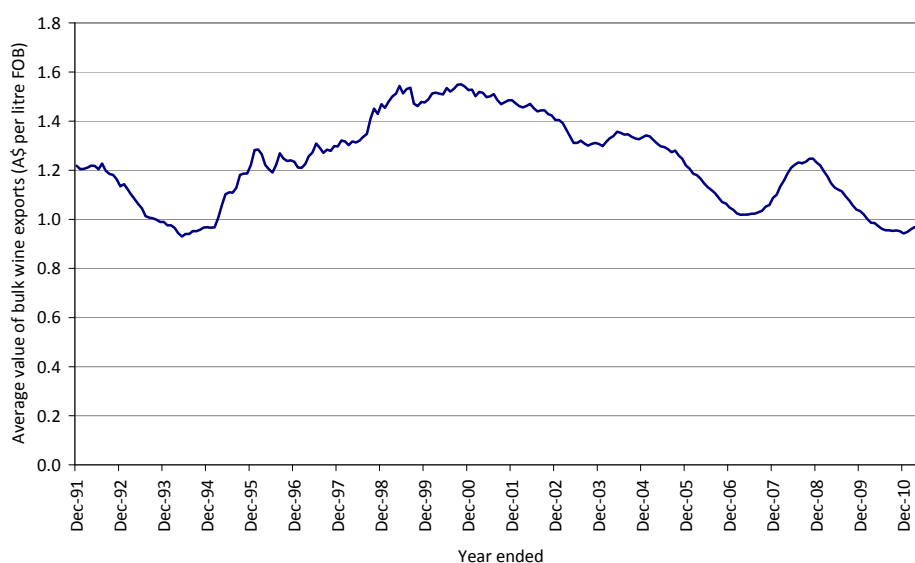
Bulk export volumes at record high

- 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

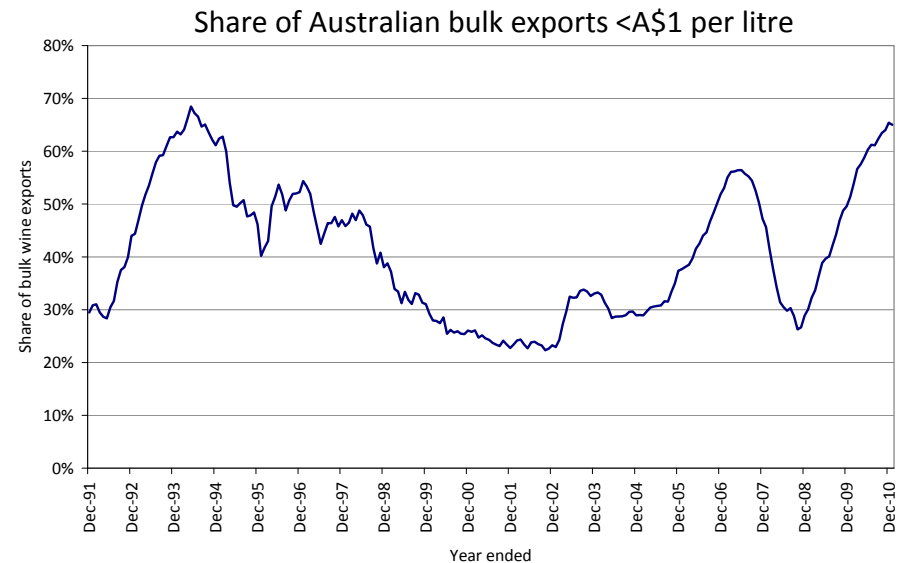
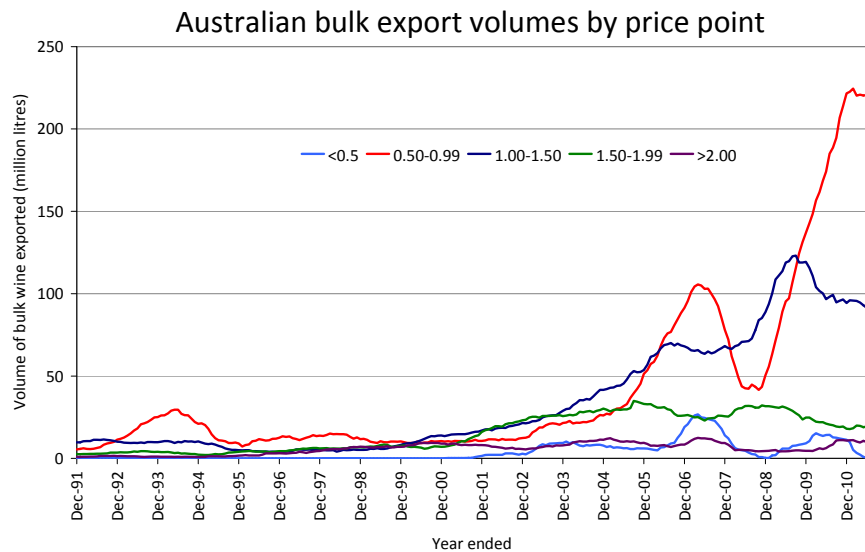


Australian bulk export average values per litre over time



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.



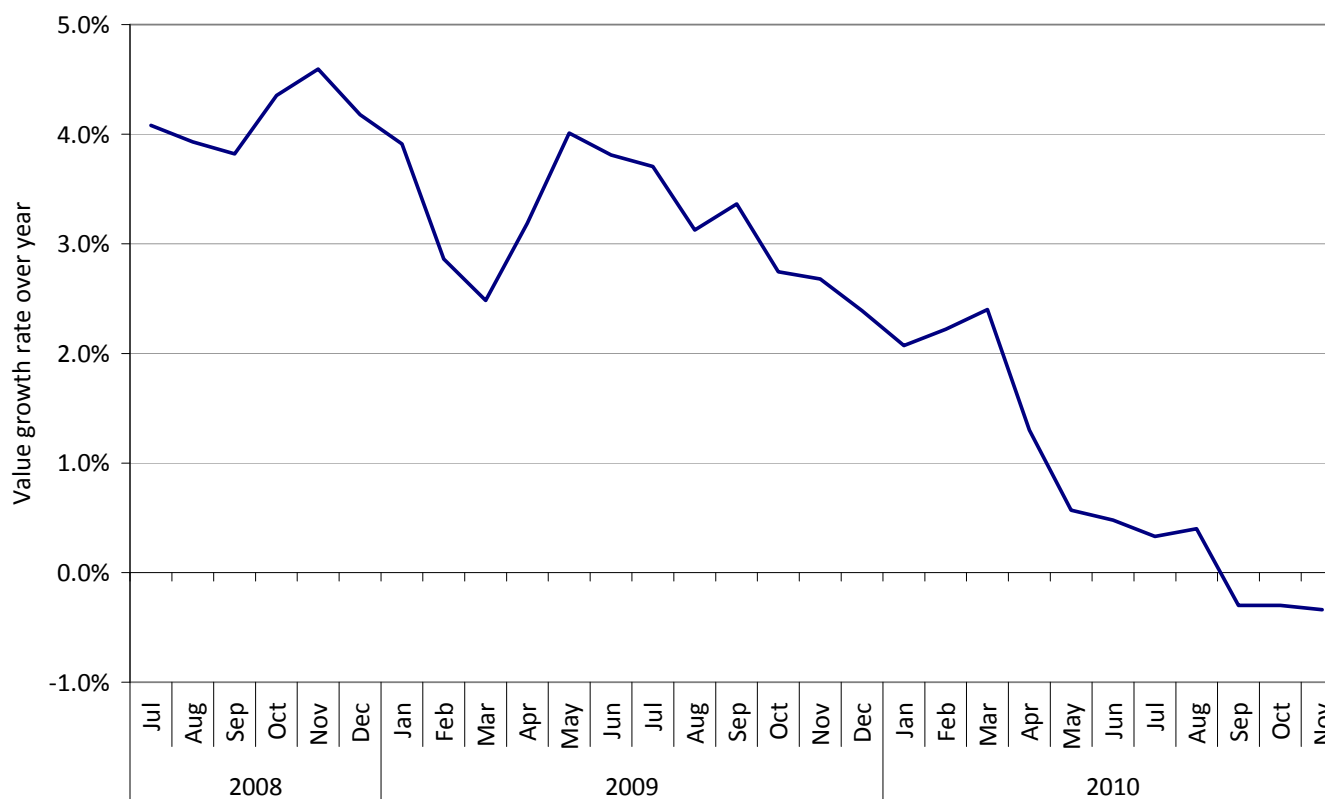
Are bulk exports at <A\$1/L sustainable?

- 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 domestic market value declining

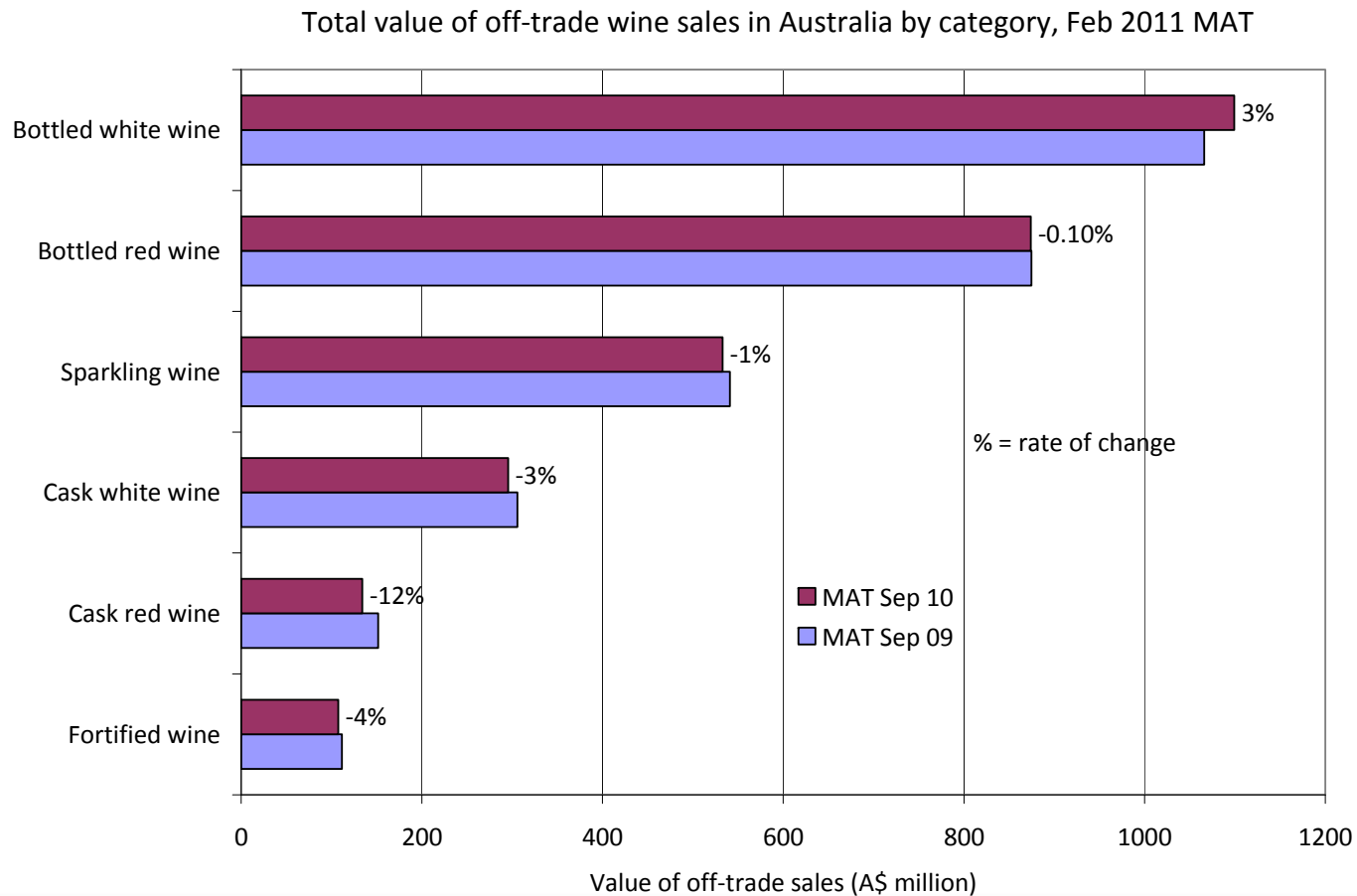
- There has been a gradual slowing of total value growth in the Australian market over the last 18 months
- Last three MAT periods have seen total value decline after 6 years of steady growth

Total value growth in off-trade wine sales in Australia



Bottled white only category to grow value

- All categories except bottled whites recorded a decline in total value of sales in the Australian off-trade market
- Strongest decline in cask sales



Sauv Blanc, Shiraz drive bottled growth

- Sauvignon Blanc is the leading varietal in terms of both total value and total value growth
- Chardonnay falling further behind Sauv Blanc
- Shiraz is closing in on Chardonnay



Buyers own brands taking share

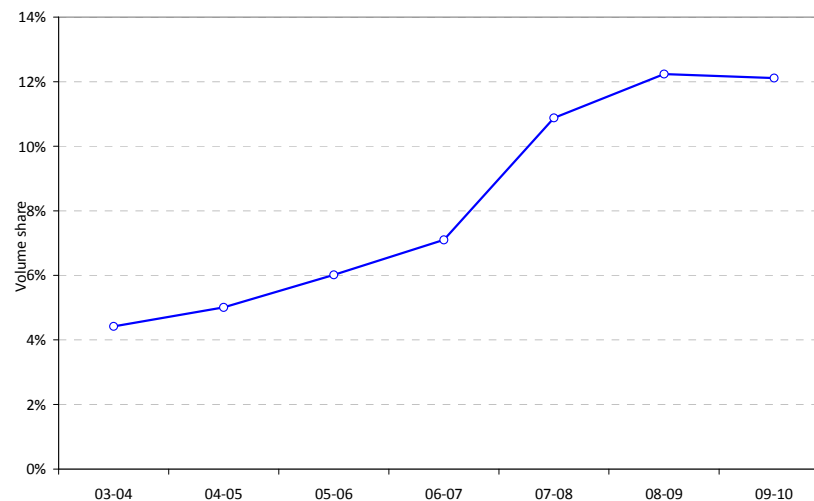
- Retailer consolidation is ongoing with Coles and Woolworths targeting higher store numbers, which increases buying power over Australian wine companies.
- Additionally, retailers are increasingly competitors with strategies to offer best prices via private label and importing, which negatively impacts on wine company 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%)

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

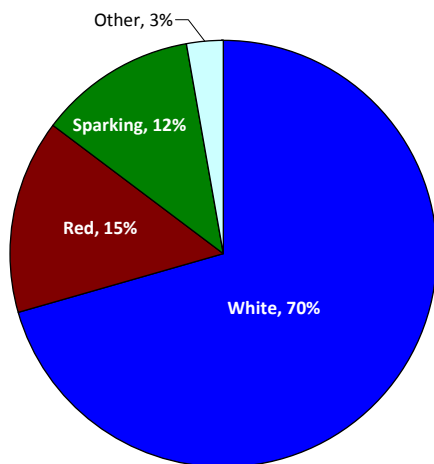
Market share of imports has grown

- Over last five years, imports to Australia have grown at a CGAR of 23% for volume and 19% for total value
- Imports share has grown from 4% to 12%
- New Zealand continues to dominate with a 70% share of imports
- France and Italy the other major importers
- The three account for 91% of imports to Australia
- White wine remains the dominant category

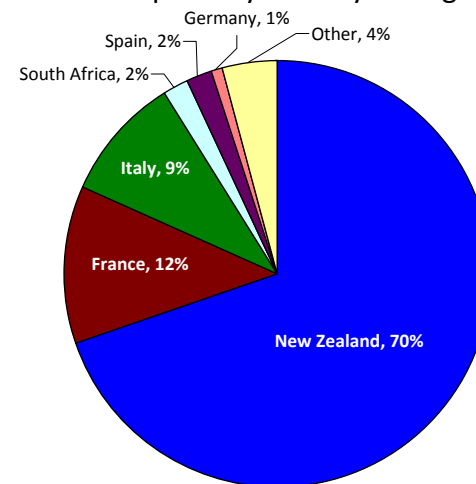
Imports share of wine sales in Australia



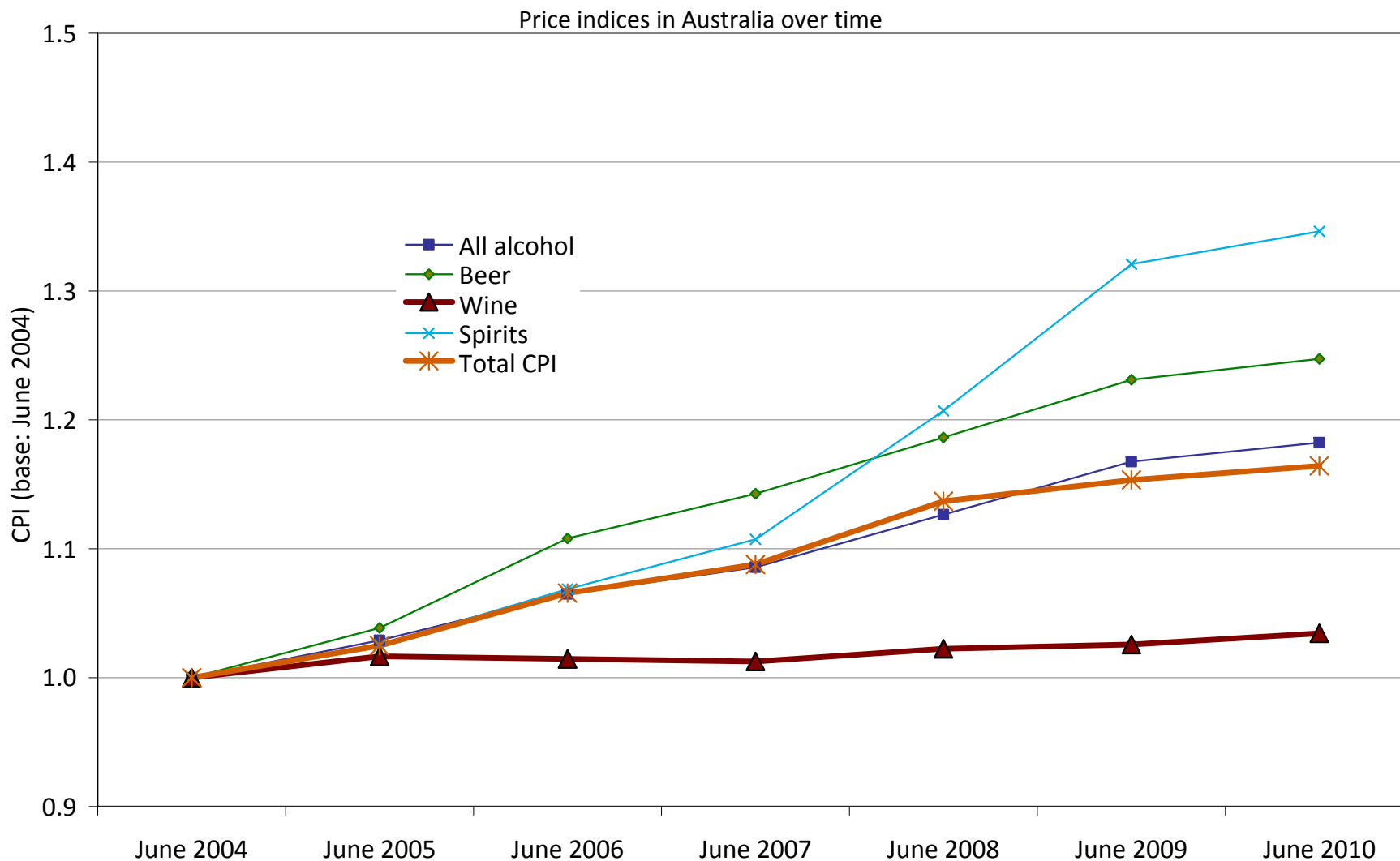
Share of imports by category



Share of imports by country of origin



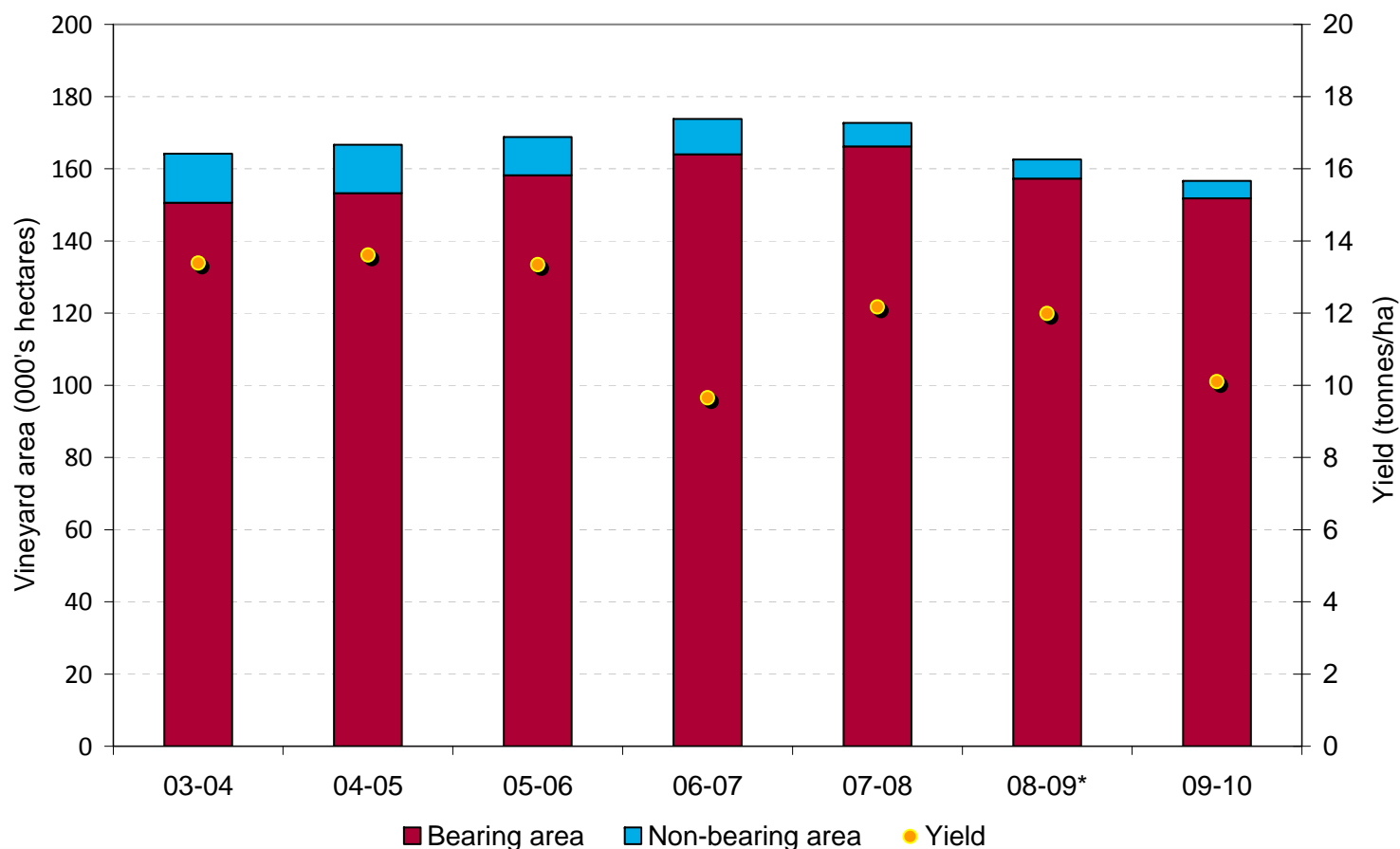
Wine prices increases lag cost increases



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- Australian demand key performance indicators
- **Australian supply key performance indicators**

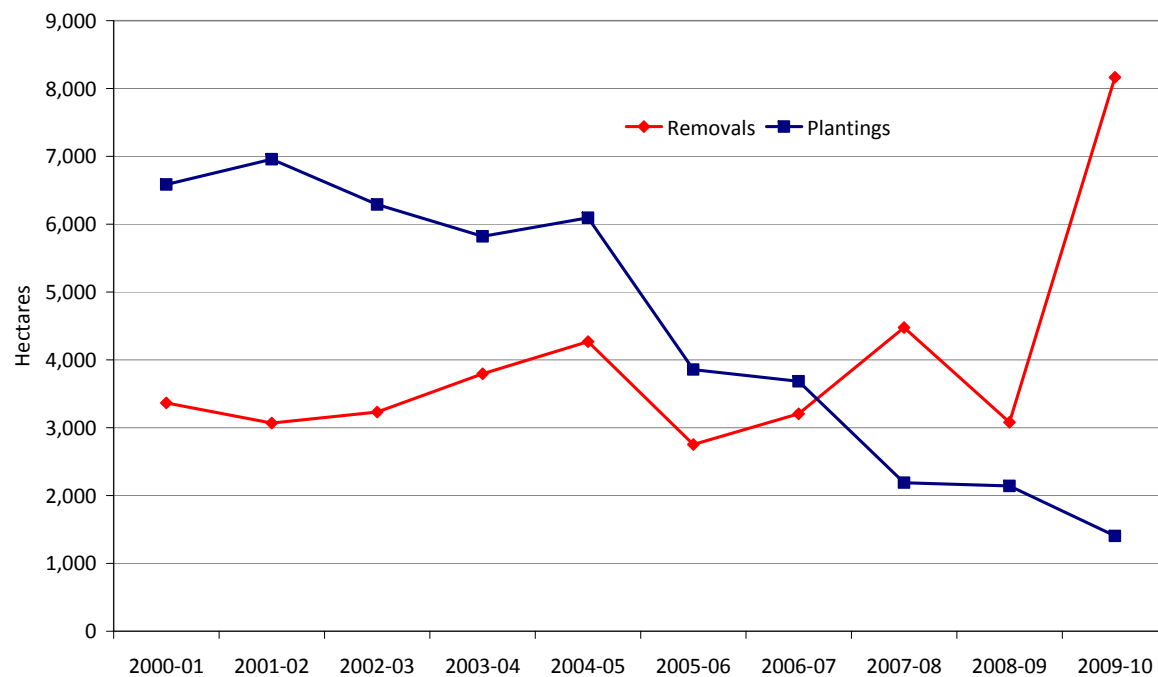
Australian vineyard area in decline

- 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



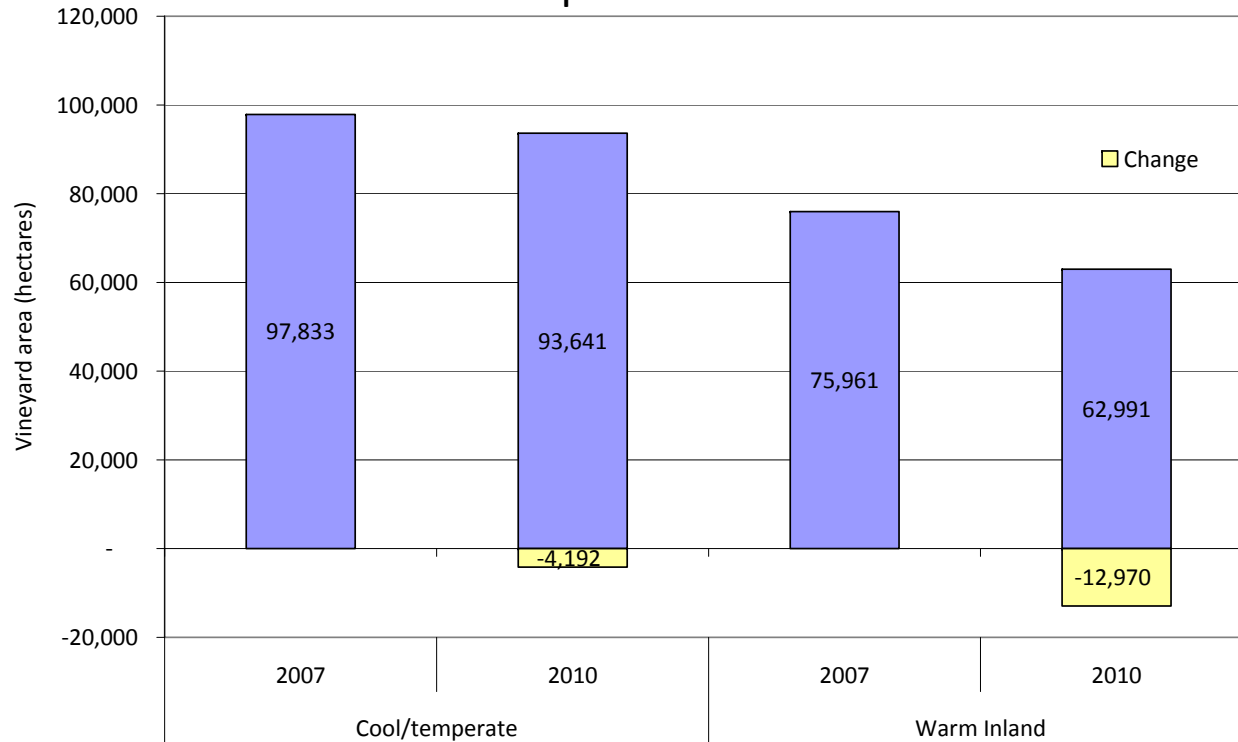
Net removals for 3 successive seasons

- 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



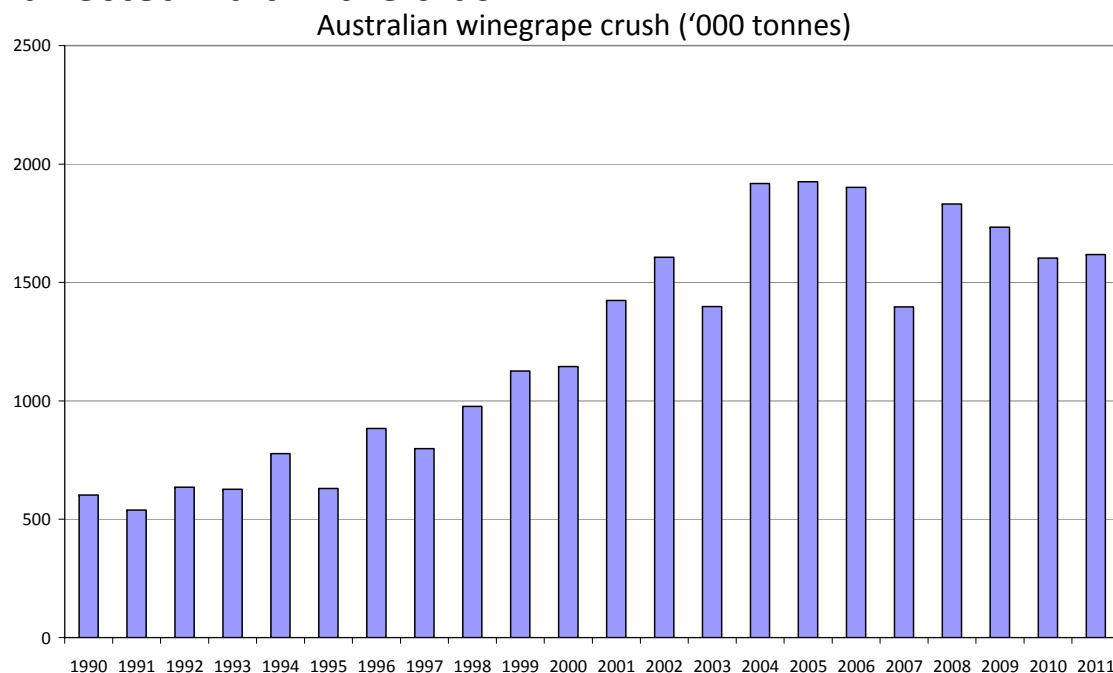
MD-SH the major contributor to removals

- 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.



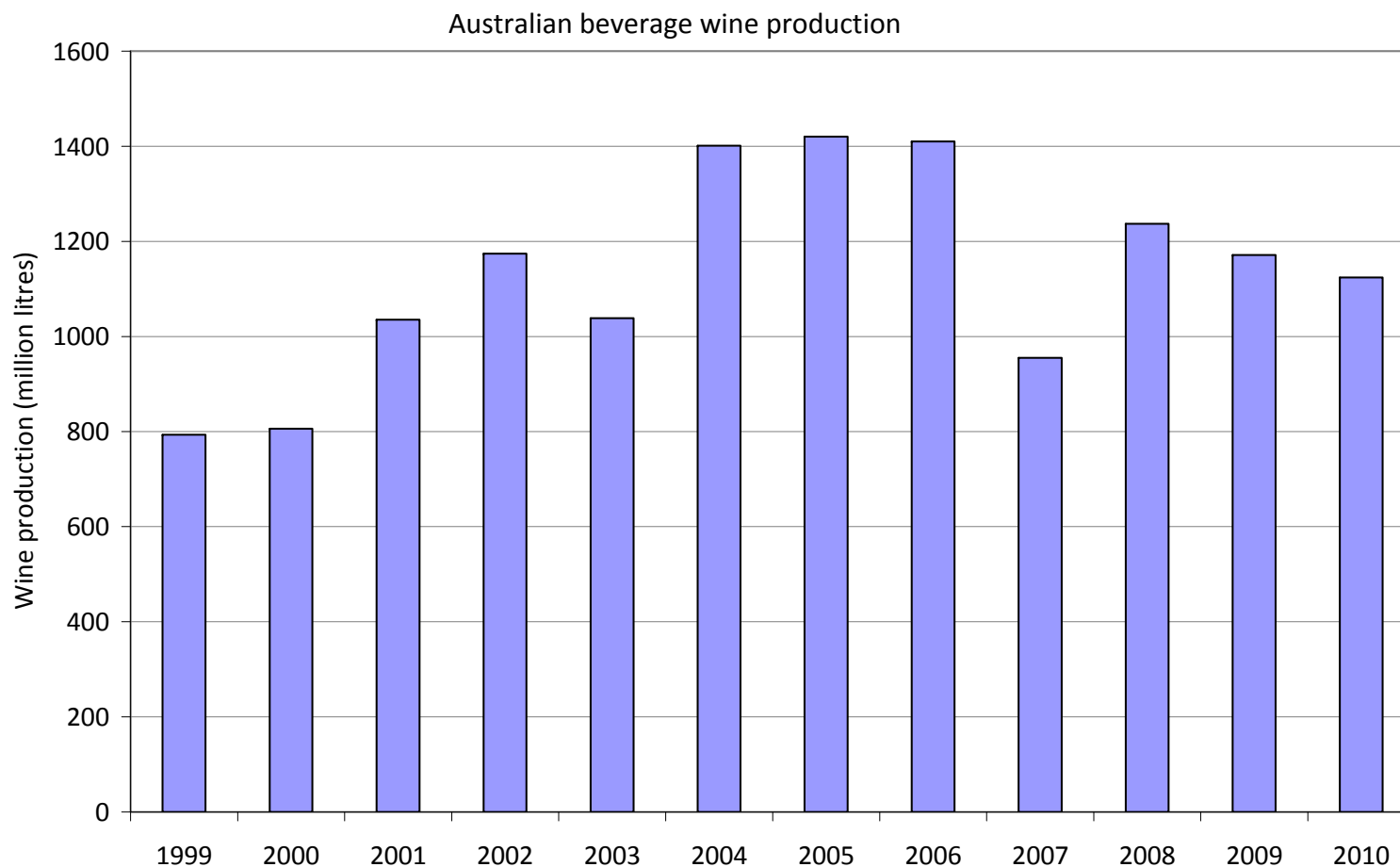
Australian winegrape crush up in 2011

- 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

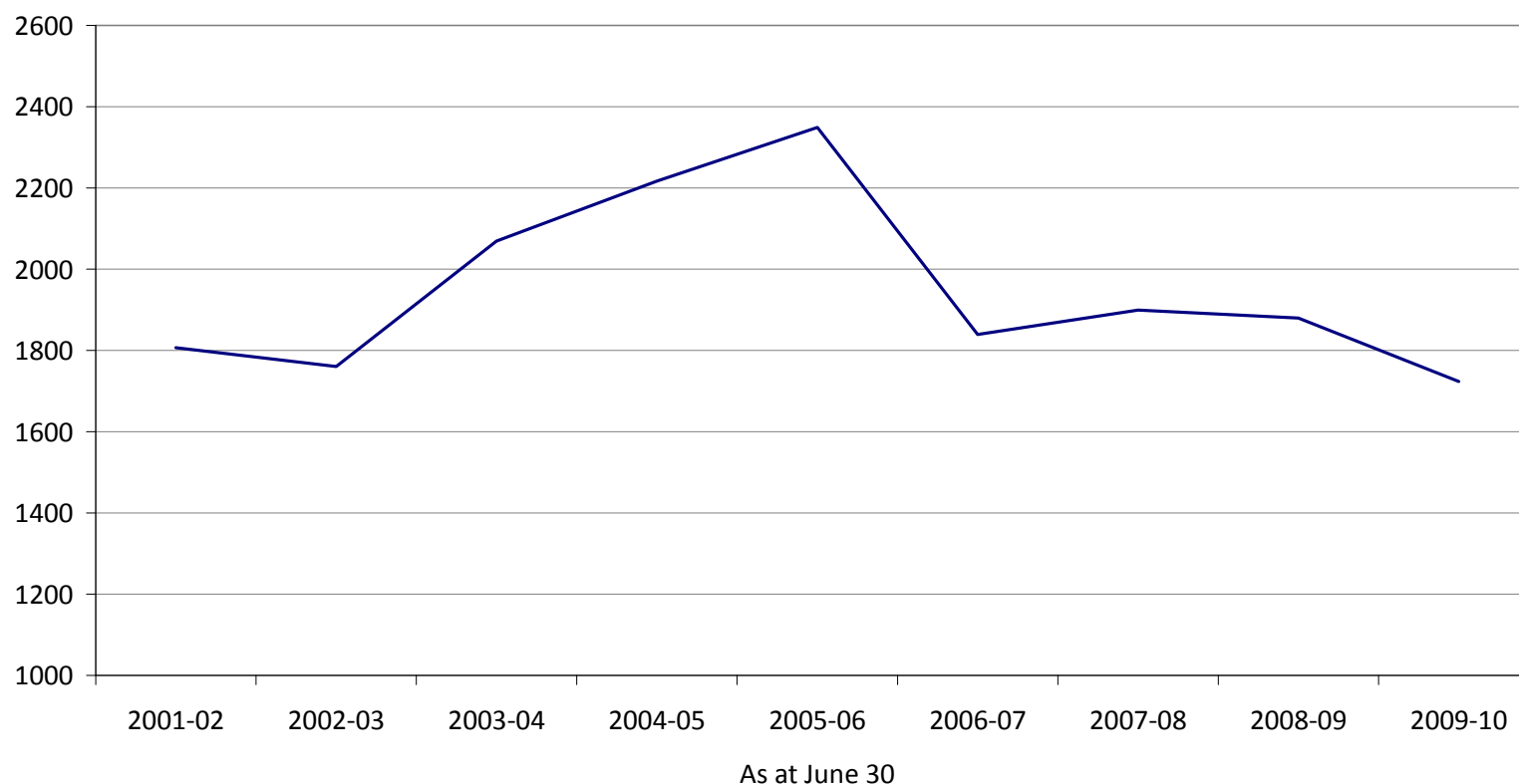
- Australian wine production of 1.12 billion litres in 2010, down from 2005 peak of 1.42 billion litres
- Has declined over the past two years – expect it to be lower in 2011



Australian wine stock levels have fallen

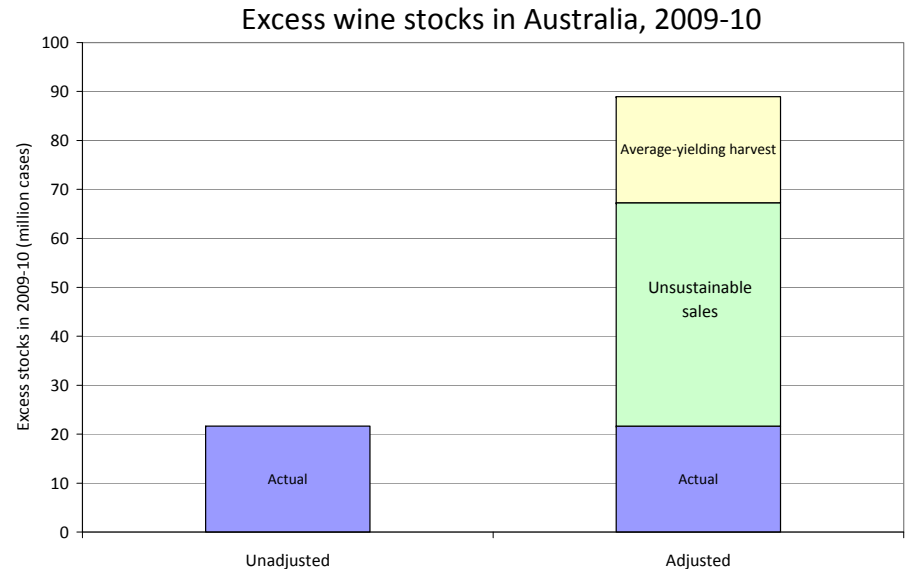
- With shipments up and production down in the previous year, Australian wine stock levels fell in 2009-10, down to 1.7 billion litres at June 2010
- With wine production likely to be slightly down and sales also down in 2010-11, there is likely to be little change in the stock levels at June 2011

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.

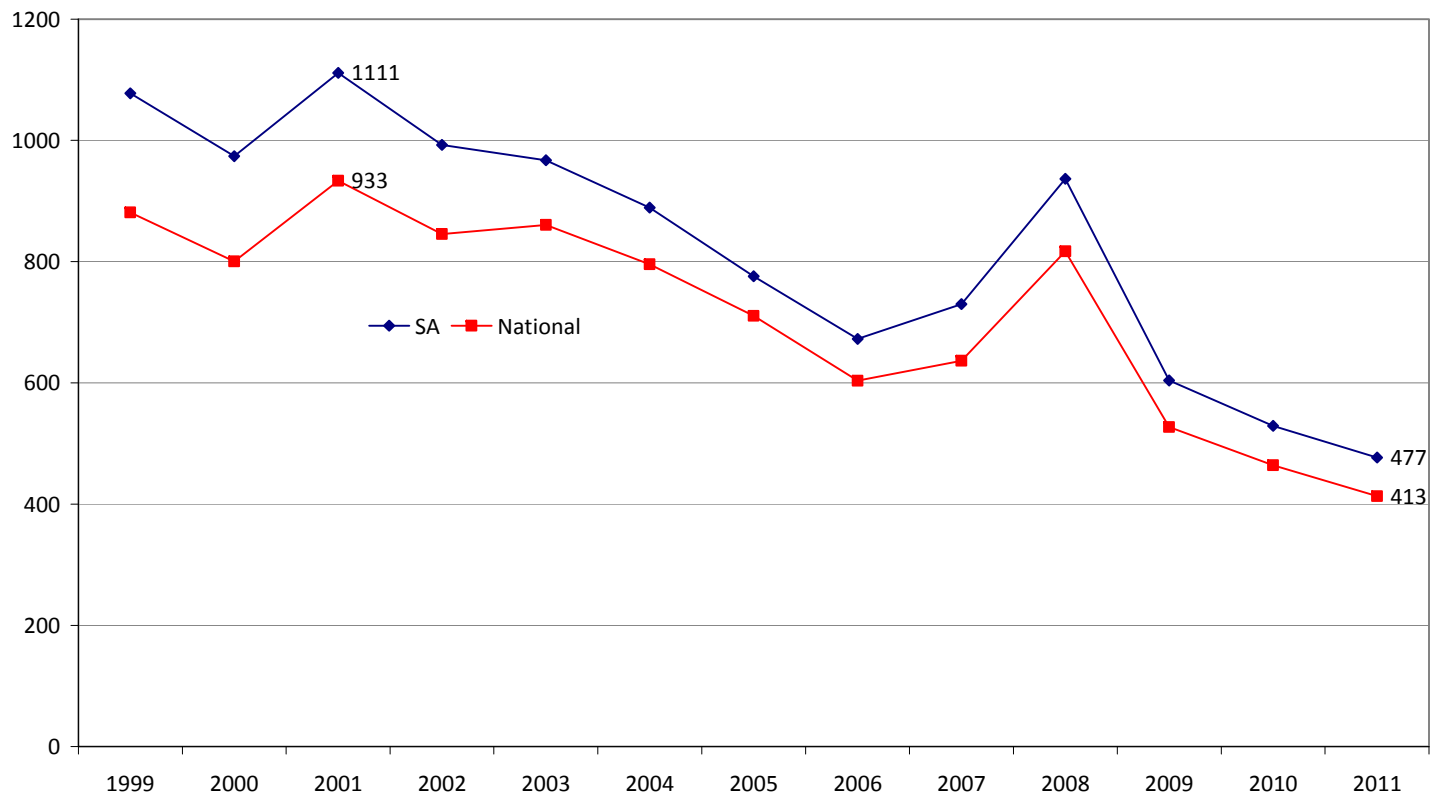


- What this suggests is that there is still the potential for a harvest bigger than was recorded in last 2 years which could add to the existing over-supply.
- Further adjustments are required to move towards a sustainable base

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
- 2009-10 prices were the lowest for the decade

Winegrape purchase prices – National v SA (\$ per tonne)



Over 3/4 of purchases below cost in 2010

- Depending on underlying assumptions, 82% of warm inland and 68% of cool/temperate winegrapes were sold at below cost of production in 2010
- Translates to 78% of total winegrapes sold at below COP
- Separate broad national analysis is consistent with regional analysis (77% < COP)
- Even worse if a sustainable grower margin is included

	Regional analysis			All
	Warm	Cool/temperate	Total	
Cost of winegrape production (\$/ha)	\$5,750	\$7,500		\$6,500
Yield (t/ha)	16.6	6.8		10.9
Cost of production (\$/t)	\$346	\$1,103		\$596
Tonnes purchased in 2010	687,002	231,037	918,039	918,039
Tonnes purchased below cost	563,342	157,105	720,447	706,890
Share of purchases below COP	82%	68%	78%	77%

