
Opportunities and alternative routes to market

A numbers game

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Opportunities and alternative routes to market – a numbers game

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EXECUTIVE SUMMARY

Are there viable alternative routes to market that could clear 'oversupply'?

This paper makes the case that despite contraction in the national vineyard area since 2008-09, the Australian wine industry remains oversupplied – partly because of higher harvests in recent years and partly because of the continued decline in the volumes of Australian wine sold overseas.

Recognizing however, that supply in excess of demand will be sold, and the only question is at what price, the analysis here explores the viability of alternative routes to market that sit outside the traditional trade in proprietary brands and mainstream channels to clear the oversupply/underdemand¹. Potentially, if profitable alternative routes to market exist, the industry may not be oversupplied at all – just oversupplied in mainstream proprietary brands.

The opportunity for alternative routes to market was identified in a prior paper titled 'A framework for grower opportunities in the Australian wine sector: global and Australian supply and demand analysis, 2000 to 2013' which can be found on the Wine Grape Growers Australia website (wgga.com.au). The routes identified in the paper are the massive growth in recent years of global bulk wine trade and clean skins or retailer-owned-brands that are a result of the growing power of major retailers. For the Australian wine sector both represent a shift, or potential shift, in its wine market dynamics.

The questions asked here about the potential to access these alternatives goes to profitability at the extremes. Mainstream product in the industry is proprietary-branded wine and in simple terms, the oversupply that is talked about in the industry is oversupply of proprietary-branded wine. While the 2014 Wine Industry Outlook Conference addressed very well the marketing of these wines (the marketing presentations were outstanding), it did not address the prospects of wine at the margins. These prospects involve currently distressed fruit and alternative routes to market and alternatives to 'marketing' per se (rather, other ways to improve market prospects such as innovation).

The findings of the analysis are mixed in respect to the viability of alternative routes to market. While there is some opportunity for oversupply to be dealt with viably, the cost imperative is likely to exclude these alternatives as a complete solution with current settings in the Australian wine sector. This outcome will only be different if significant changes occur in business models in the industry and the amount of attention given to improving the prospects of the opportunities discussed here.

¹ The description of supply and demand balances in this paper does not enter into the debate about whether 'oversupply' represents supply that is in excess or demand that is in deficit ('oversupply and/or under-demand'). Clearly, supply and demand are both contributing factors and ideally, balance will be achieved as a result of adjustment in both. For simplicity, the current situation in the wine sector will be described as oversupply for short-hand purposes, in preference to the cumbersome 'over-supply and/or under-demand'. The use of this shorthand does not in any way imply that supply is the causation. This use of the term is pejorative just as 'under-demand' would be if used in the context of marketing underperformance as the cause of under-demand.

The paper explores these issues by posing a number of scenarios and feeding industry benchmark numbers through a value-chain model, from dirt to slurp. Subject to the assumptions in the modelling, the calculations reveal sets of circumstances that will characterize non-mainstream trade and whether it can be profitable.

The qualifications to this treatment need to be clear. The calculations are illustrative only. They rely on averages and the applicability to an individual business needs to be tested against that business's individual performances. A do-it-yourself calculator is provided at the end of the paper to start this process. In addition, some factors are not built into the calculations. Inevitably, some costs may not be accounted for, the WET Rebate is not factored into the value-chain and the influence of the AUD is not considered. Only a selected number of scenarios are considered. Nor are all potential routes to market modelled - for example, direct marketing is not modelled.

The paper provides no commentary on how the proposed alternatives would be fulfilled, it merely scopes their financial potential. The reader must assess the opportunity for their business circumstances and identify the means of getting there. The point is made strongly that as alternatives that push value-chain norms to their limits, appropriate business models may be required – and not many business models existing today will be suitable.

The 'how' for accessing the proposed opportunities will be ultimately defined by the creativity of collective RD&E and the ingenuity of commercial operators who throughout the history of ages, have found ways to make things work when all seemed lost.

BACKGROUND

Another larger-than-required harvest in 2014

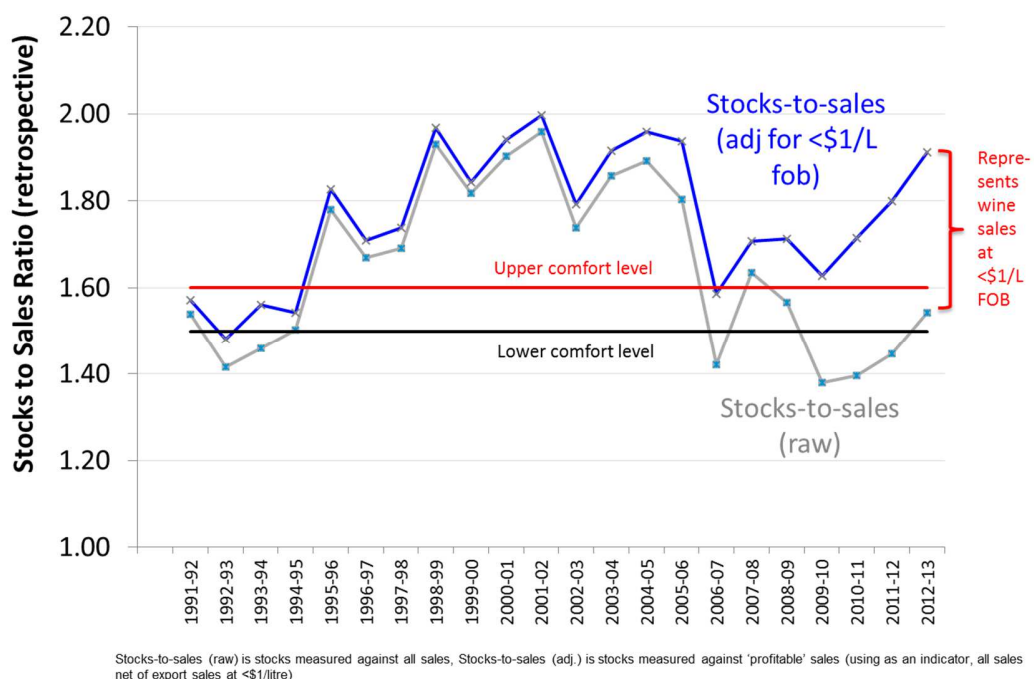
The Winemakers' Federation of Australia, in their 2014 Vintage Report, estimated that the 2014 winegrape harvest was 1.7 million tonnes, roughly 3% down on the official 2013 crush reported by the Australian Bureau of Statistics. Two key questions arise from the 2014 harvest. First, what does it mean for supply and demand balance, and second, what are the likely sales prospects?

SUPPLY AND DEMAND BALANCE

Moving away from balance

The issue of balance is addressed by updating the stocks-to-sales ratio (SSR) for the national industry. This shows balances had deteriorated in the three years from 2011 to 2013 and although a slightly smaller 2014 harvest would deliver some reprieve, on the balance of declining sales of Australian wine and larger crops in recent years, the SSR (with sales <\$1/litre FOB removed – more about this in a moment) was around the levels last seen at the height of the industry's last big concern about supply-and-demand balances in 2005-06, a full eight years earlier (see Figure 1).

Figure 1: A view of 'balance' – inventory just 'better' or 'in balance'?



It is worth noting that this conclusion is in contrast to the optimism that has been expressed in recent years because of the decline between 2008-09 and 2011-12, in national inventory. Nevertheless, it rose again in 2012-13 (and national inventory numbers are not available for 2013-14).

Simple reporting of inventory, while perhaps an indicator of inventory worsening or improving, is grossly insufficient for determining 'balance'. In short, inventory is held to support forward sales and the relationship of inventory to sales is therefore vital to understanding balance. If held inventory is greater

than the sales they are intended to support, supply exceeds demand (or demand under-rates the supply) and vice versa.

Note that in relation to a 'comfort zone' of between 1.5 to 1.6 years of inventory to a year's sales, the illustration suggests that raw sales compared to inventory, would have seen the industry undersupplied for all of 2010 to 2012. Surely no-one believes this was the case. This outcome represents the fact that inventory is only held against *profitable* sales and if held wine has no prospects of being profitable, it is (or should be) cleared and not be counted as sales against which inventory is held. Hence, if unprofitable sales are removed from the SSR, the SSR will be higher on balance of the held inventory being divided by a smaller sales number. And thus it is so in Figure 1. The only unprofitable sales we have direct insight into, are exports at less than \$1/litre fob, and when these are removed from the sales number, a higher SSR and a more realistic measure of 'balance' results (see 'Stocks-to-Sales (adj for <\$1/L fob)' in Figure 1).

SCENARIOS FOR ALTERNATIVE AVENUES TO MARKET

SETTING THE SCENE - Market access for distressed warm inland fruit

In Figure 1, the gap between the two SSR lines (raw versus adjusted) represents wine exported between \$0.50 and \$1/litre fob. Note that if exports can be profitably shipped at \$0.50/litre fob – the industry would be in balance in 2012-13. The question that needs to be tested to support this concept is whether the limit for profitability is \$0.50/litre fob or \$1/litre fob as supposed in Figure 1? Testing these cut-offs for profitability will determine if the industry currently sits on 1.54 (comfortably in balance) or 1.91 (way out of balance) in 2012-13.

Is \$1/litre fob the dividing line between profitable and unprofitable exports?

The \$1/litre fob figure as a cut-off for profitability was explored by a whole-of-value-chain financial analysis using standard industry benchmarks of performance in terms of vineyard yields, source regions, processing costs and margins in the supply chain (see Attachment 1 for more detail).

To explore this question it is assumed that warm inland fruit has the best opportunity to access the market at this price point together with various least-cost alternatives for processing and packaging. Hence, the assumptions employed in Figure 2 include the following.

- Achievable warm inland vineyard yields of 19 tonnes per hectare.
- Warm inland net vineyard costs of production for these area (inclusive of operating costs and overheads) of \$6,500/hectare.
- Conversion of the grapes to wine in a mega-sized, processing facility for bulk wine, which is bench-mark for efficiency, capable of extracting 750 litres per tonne and converting it to wine at a cost of \$0.35 cents/litre.
- No aging or distribution costs that are normally associated with mainstream proprietary-branded wine (for example - oak, bottling, boxing, warehousing).
- Since this wine is exported, the Wine Equalisation Tax (WET)² and GST are not payable.

² The WET Rebate is not considered in any of the scenarios posed in this analysis on the basis that as an instrument of government policy, it cannot be assumed to be a realistic part of a business's finances. The government may at any time, and at its own discretion, remove it.

Figure 2: Is \$1/litre the dividing line between profitable and non-profitable exports?

Value chain	Units	Data input	Outcomes	Comment
YIELD	t/ha	19.0		Warm inland
TONNAGE	t		19	
WINE CONVERSION RATE	L/t	750		Mega/bulk wine processor
VINEYARD COST OF PRODUCTION	\$/ha	Warm	6 500	
VINEYARD UNIT COST OF PRODUCTION	\$/t		\$342	
GROWER NET MARGIN	%	12%		Significant margin sacrifice
GRAPE SALE PRICE			\$389	
GRAPE COST PER LITRE	\$/L		\$0.52	
WINE CONVERSION COST per LITRE (excl wg cost)	\$/L	\$0.35	\$0.35	Mega/bulk processing facility
WINE PROCESSING COST per LITRE (incl wg cost)	\$/L		\$0.87	
WINE - OAK AND MATURING	\$/L	None	\$0.00	
WINE BOTTLING, BOXING, WAREHOUSING, FREIGHT	\$/L	None	\$0.00	
WINE COMPANY TOTAL COST	\$/L		\$0.87	
WINE COMPANY NET MARGIN	%	13%		Significant margin sacrifice
WINE SALE PRICE pre-WET	\$/L		\$1.00	
WET	%	0%		No
WINE SALE PRICE BY WINE COMPANY	\$/L		\$1.00	
WINE SALE PRICE BY WINE COMPANY	\$/bottle		na	
DOMESTIC RETAILER MARGIN	%	na		
RETAILER WINE PRICE	\$/bottle		na	
GST	%	na		
SHELF PRICE	\$/bottle		na	

The remaining input into this analysis is margin. There will be three margins built in the value chain - the grower's margin, the wine company's margin and the retailer's margin. In this analytical framework, the margin represents to means of paying for the costs of capital, paying tax (hopefully) and providing the business owner with living expenses and finally the means to build wealth for business improvements and/or for future personal use. As a tool in the modelling exercise however, as in real life, margins represent the residual adjustment by which the final price-point might be achieved.

In normal circumstances, the sharing of margins between the three players in the value-chain will come down to bargaining power and/or skill. We know that neither of these attributes are distributed equally among the three players in the value chain although in some instances of the analysis, the proposed sharing may indicate this.

The reader should take what they can from the relative sharing of margins available. Not the least of the messages will be the importance of negotiating sharing arrangements for the available margin that ideally, will be equitable for all.

Conclusion

This analysis suggests that \$1/litre fob for bulk wine on the export market is achievable but at the cost of slim, unsustainable margins (see Figure 1). As such, this price point is serviceable as a dividing line between profitable and unprofitable given the imperfect nature of the modeling. It is nevertheless a conservative one - it does after all, represent a generous view of what is 'profitable'.

Can \$0.50/litre fob be profitable?

As stated earlier, if bulk wine exports at \$0.50/litre fob could turn a profit then this would address the placement of the wine, at profit, that was in excess of that required for proprietary brands. Hence the question "can \$0.50/litre fob be profitable?"

However, the answer from the analysis of the profitability at \$1/litre fob has already answered this question. Having pushed the assumptions to reasonable limits, \$1/litre fob is barely sustainable. Therefore, \$0.50/litre fob will not be.

Nevertheless, it is interesting to experiment with what might be achievable. The following two scenarios represent this.

The following scenario employs all of the assumptions used in Figure 2 and zeros the margin (breakeven) for both the grower and wine company. It can be seen that the price achieved is \$0.81/litre fob.

Figure 3: Seeking to achieve \$0.50/litre – breakeven

Value chain	Units	Data input	Outcomes	Comment
YIELD	t/ha	19.0		Warm inland
TONNAGE	t		19	
WINE CONVERSION RATE	L/t	750		Mega/bulk wine processor
VINEYARD COST OF PRODUCTION	\$/ha	Warm	6 500	
VINEYARD UNIT COST OF PRODUCTION	\$/t		\$342	
GROWER NET MARGIN	%	0%		Significant margin sacrifice
GRAPE SALE PRICE			\$342	
GRAPE COST PER LITRE	\$/L		\$0.46	
WINE CONVERSION COST per LITRE (excl wg cost)	\$/L	\$0.35	\$0.35	Mega/bulk processing facility
WINE PROCESSING COST per LITRE (incl wg cost)	\$/L		\$0.81	
WINE - OAK AND MATURING	\$/L	None	\$0.00	
WINE BOTTLING, BOXING, WAREHOUSING, FREIGHT	\$/L	None	\$0.00	
WINE COMPANY TOTAL COST	\$/L		\$0.81	
WINE COMPANY NET MARGIN	%	0%		Significant margin sacrifice
WINE SALE PRICE pre-WET	\$/L		\$0.81	
WET	%	0%		No
WINE SALE PRICE BY WINE COMPANY	\$/L		\$0.81	
WINE SALE PRICE BY WINE COMPANY	\$/bottle		na	
DOMESTIC RETAILER MARGIN	%	na		
RETAILER WINE PRICE	\$/bottle		na	
GST	%	na		
SHELF PRICE	\$/bottle		na	

Conclusion

While bulk wine exports at less than around \$1/litre fob are not likely to be sustainable in the current Australian operating environment and structure, there is a space, between \$0.80/litre fob and \$1/litre fob in which breakeven may be possible and hence, a clearing mechanism for distressed stock without suffering loss.

While available industry data does not allow exports between \$0.50/litre and \$1/litre to be broken-down any further, if the volume in this range were to actually reside between \$0.80/litre fob and \$1/litre fob, then the market clearing mechanism could be quite effective, although not profitable.

Notably, the volume of wine in this category has averaged around 220 mLs over the three years 2010-11 to 2012-13 and by standard industry benchmarks, would represent around 22,500 hectares – a measure of unprofitable vineyard area? Of course, some of this will be proprietary-branded wine destined for overseas bottling, and an estimate of unprofitable hectares would need to be discounted for this volume.

Under what circumstances might \$0.50/litre fob be profitable?

With two additional assumption to the scenario in Figures 2 and 3, that take the scenario from achievable to extreme –

- pushing average vineyard yields beyond reasonable and into unsustainable levels (for average yields, although not for some selected varieties) of 25 tonnes per hectare, which is akin to flogging the vines and perhaps harming their longer-term health, and
- extracting wine from the grapes at \$0.30/litre, and
- again tinkering with margins,

\$0.50/litre fob could be reached if grape sales occur at \$150/tonne. This represents a 73% loss for the grower rather than the standard 30% margin that might be expected, and achieving only breakeven for the wine company. This scenario is modelled because it is a phenomenon that has been frequently observed in the industry in recent years.

Figure 4: What's required to achieve \$0.50/litre?

Value chain	Units	Data input	Outcomes	Comment
YIELD	t/ha	25.0		Conjecture
TONNAGE	t		25	
WINE CONVERSION RATE	L/t	750		Mega/bulk wine processor
VINEYARD COST OF PRODUCTION	\$/ha	Warm	6 500	
VINEYARD UNIT COST OF PRODUCTION	\$/t		\$260	
GROWER NET MARGIN	%	-73%		Significant margin sacrifice
GRAPE SALE PRICE			\$150	
GRAPE COST PER LITRE	\$/L		\$0.20	
WINE CONVERSION COST per LITRE (excl wg cost)	\$/L	\$0.30	\$0.30	Conjecture
WINE PROCESSING COST per LITRE (incl wg cost)	\$/L		\$0.50	
WINE - OAK AND MATURING	\$/L	None	\$0.00	
WINE BOTTLING, BOXING, WAREHOUSING, FREIGHT	\$/L	None	\$0.00	
WINE COMPANY TOTAL COST	\$/L		\$0.50	
WINE COMPANY NET MARGIN	%	0%		Significant margin sacrifice
WINE SALE PRICE pre-WET	\$/L		\$0.50	
WET	%	0%		No
WINE SALE PRICE BY WINE COMPANY	\$/L		\$0.50	
WINE SALE PRICE BY WINE COMPANY	\$/bottle		na	
DOMESTIC RETAILER MARGIN	%	na		
RETAILER WINE PRICE	\$/bottle		na	
GST	%	na		
SHelf PRICE	\$/bottle		na	

Conclusion

In a qualified sense, this is acceptable to the wine producer - at least they don't lose money and they have the advantage of maintaining some control over unit fixed costs by maintaining volume through their processing infrastructure. This also has the advantage of providing better opportunities for sustainable profit on other products they process. However, it is unacceptable for the grower - who makes a loss (note that \$150/tonne purchases have been frequently cited in recent harvests).

These circumstances have a resonance with observations in the industry in recent years and may reflect the mechanism by which some oversupplied fruit reaches the market.

SETTING THE SCENE - Market access for distressed cooler-temperate fruit

Calculations were made for the ability of warm inland fruit to access export bulk wine markets, and a question hangs over its ability to do so viably. Given this result, higher-cost, cooler-temperate fruit will naturally be excluded from accessing this route to market for anything other than at a significant loss.

Nevertheless, the oversupply problem is particularly acute in the cooler-temperate districts. These districts experienced the biggest relative growth when the Australian wine sector's production base essentially tripled from the early 1990's to around 2008-09. A significant part of that growth was fuelled by cooler-temperate plantings that aspired to the less-than-10% of the market held by A- and B-grade wine but would clearly never fit into the small market segment.

What then, the sales prospects for distressed cooler-temperate fruit we know to exist?

The most likely outlet is through domestic retail since, as has been established above, off-loading onto overseas markets in bulk or generic form will be loss-making. In this context, retailer-owned-brands and clean skins via the major domestic retailers is worth exploring as an alternative route to market.

Figures 5, 6 and 7 illustrate the calculations.

For the purpose of these calculations, clean skin is defined as a bottled wine with varietal, but not regional, identification. On the other hand, retailer-owned-brands identify both the variety and source region (usually cooler-temperate regions with some brand asset and wow-factor for the consumer) and have labelling that clearly denotes non-proprietary ownership. A quick survey in late September 2014, of the range of such wines on offer by one major-retailer liquor store outlet, showed that average shelf prices for these products were \$3.91 for clean skins, \$8.36 for red wine, retailer-owned-brands and \$5.65 for white wine, retailer-owned-brands.

Cooler-temperate fruit accessing the clean skin market

The assumptions employed in Figure 5 are as follows.

- Vineyard yields of 9 tonnes per hectare.
- Net vineyard costs of production (inclusive of operating costs and overheads) of \$8,000/hectare.
- Conversion of the grapes to wine in a medium- to large-sized processing facility that is capable of extracting 700 litres per tonne and converting it to wine at a cost of \$0.70 cents/litre.
- No oaking or aging and after bottling, minimalist boxing and labeling.
- This wine will be subject to Wine Equalisation Tax (WET) and GST since the sale is in Australia.

Figure 5: What's required to reach the Australian clean skin market with a major retailer?

Value chain	Units	Data input	Outcomes	Comment
YIELD	t/ha	9.0		Cooler temperate
TONNAGE	t		9	
WINE CONVERSION RATE	L/t	700		Medium/Large processor
VINEYARD COST OF PRODUCTION	\$/ha	Temperate	8 000	
VINEYARD UNIT COST OF PRODUCTION	\$/t		\$889	
GROWER NET MARGIN	%	10%		Significant margin sacrifice
GRAPE SALE PRICE			\$988	
GRAPE COST PER LITRE	\$/L		\$1.41	
WINE CONVERSION COST per LITRE (excl wg cost)	\$/L	\$0.70	\$0.70	Medium/large processing facility
WINE PROCESSING COST per LITRE (incl wg cost)	\$/L		\$2.11	
WINE - OAK AND MATURING	\$/L	None	\$0.00	
WINE BOTTLING, BOXING, WAREHOUSING, FREIGHT	\$/L	Non-prem	\$1.10	
WINE COMPANY TOTAL COST	\$/L		\$3.21	
WINE COMPANY NET MARGIN	%	15%		Significant margin sacrifice
WINE SALE PRICE pre-WET	\$/L		\$3.78	
WET	%	29%		Yes
WINE SALE PRICE BY WINE COMPANY	\$/L		\$4.87	
WINE SALE PRICE BY WINE COMPANY	\$/bottle		\$2.83	
DOMESTIC RETAILER MARGIN	%	20%		Minor margin sacrifice
RETAILER WINE PRICE	\$/bottle		\$3.55	
GST	%	10%		
SHelf PRICE	\$/bottle		\$3.91	

Conclusion

The results for cooler-temperate fruit accessing the clean skin market is similar to the situation warm inland fruit faces when accessing the bulk wine export market at around \$1/litre. The calculations suggest that it is possible at the cost of slim, unsustainable margins for all players in the value chain. The analysis is consistent with the clean skin phenomenon being a manifestation of oversupply. It arises in circumstances of significant oversupply, in order to clear distressed fruit and wine, but with the poor margins available, tend not to be a permanent feature of the market.

Cooler-temperate fruit accessing the market via retailer-owned-brands

The prospects of red versus white wine are modelled in this instance. The key assumptions in Figures 6 and 7 are as follows.

- Vineyard yields of 8.4 tonnes per hectare for reds and 9.9 for whites.
- Net vineyard costs of production (inclusive of operating costs and overheads) of \$8,000/hectare.
- Conversion of the grapes to wine in a small local processing facility that is capable of extracting 600 litres per tonne and converting it to wine at a cost of \$1.33 cents/litre.
- Reduced oaking costs for reds, at \$0.15/litre, no aging and after bottling, minimalist boxing and labeling costs (\$1.10/litre).
- This wine will be subject to Wine Equalisation Tax (WET) and GST since the sale is in Australia.

Figure 6: What's required to access a major Australian retailer-owned-brand – red wine

Value chain	Units	Data input	Outcomes	Comment
YIELD	t/ha	8.4		Cooler temperate
TONNAGE	t		8.4	
WINE CONVERSION RATE	L/t	600		Small processor
VINEYARD COST OF PRODUCTION	\$/ha	Temperate	8 000	
VINEYARD UNIT COST OF PRODUCTION	\$/t		\$952	
GROWER NET MARGIN	%	30%		Standard margin
GRAPE SALE PRICE			\$1,361	
GRAPE COST PER LITRE	\$/L		\$2.27	
WINE CONVERSION COST per LITRE (excl wg cost)	\$/L	\$1.33	\$1.33	Small processor
WINE PROCESSING COST per LITRE (incl wg cost)	\$/L		\$3.60	
WINE - OAK AND MATURING	\$/L	Non-prem	\$0.15	
WINE BOTTLING, BOXING, WAREHOUSING, FREIGHT	\$/L	Non-prem	\$1.10	
WINE COMPANY TOTAL COST	\$/L		\$4.85	
WINE COMPANY NET MARGIN	%	30%		Standard margin
WINE SALE PRICE pre-WET	\$/L		\$6.93	
WET	%	29%		Yes
WINE SALE PRICE BY WINE COMPANY	\$/L		\$8.93	
WINE SALE PRICE BY WINE COMPANY	\$/bottle		\$5.19	
DOMESTIC RETAILER MARGIN	%	32%		Super-normal margin
RETAILER WINE PRICE	\$/bottle		\$7.60	
GST	%	10%		
SHELF PRICE	\$/bottle		\$8.36	

Figure 7: What's required to access a major Australian retailer-owned-brand – white wine

Value chain	Units	Data input	Outcomes	Comment
YIELD	t/ha	9.9		Warm inland
TONNAGE	t		9.9	
WINE CONVERSION RATE	L/t	600		Small processor
VINEYARD COST OF PRODUCTION	\$/ha	Temperate	8 000	
VINEYARD UNIT COST OF PRODUCTION	\$/t		\$808	
GROWER NET MARGIN	%	12%		Significant margin sacrifice
GRAPE SALE PRICE			\$918	
GRAPE COST PER LITRE	\$/L		\$1.53	
WINE CONVERSION COST per LITRE (excl wg cost)	\$/L	\$1.33	\$1.33	Small processor
WINE PROCESSING COST per LITRE (incl wg cost)	\$/L		\$2.86	
WINE - OAK AND MATURING	\$/L	None	\$0.00	
WINE BOTTLING, BOXING, WAREHOUSING, FREIGHT	\$/L	Non-prem	\$1.10	
WINE COMPANY TOTAL COST	\$/L		\$3.96	
WINE COMPANY NET MARGIN	%	17%		Significant margin sacrifice
WINE SALE PRICE pre-WET	\$/L		\$4.79	
WET	%	29%		Yes
WINE SALE PRICE BY WINE COMPANY	\$/L		\$6.18	
WINE SALE PRICE BY WINE COMPANY	\$/bottle		\$3.60	
DOMESTIC RETAILER MARGIN	%	30%		Standard margin
RETAILER WINE PRICE	\$/bottle		\$5.14	
GST	%	10%		
SHELF PRICE	\$/bottle		\$5.65	

Conclusion

These calculations suggest that the ability of cooler-temperate fruit to access retailer-owned-brands is broadly feasible at sustainable margins to all players in the value-chain. It is not clear from this analysis if the greater ease with which red wine achieves this, is due to a premium available for red wine over white – either in general terms or perhaps on a seasonal basis. And if the latter, whether this premium

may be reversed in the summer months when white wine will be in greater demand compared to the end of September when the survey of these products was conducted.

In terms of market dynamics, the ability of cooler-temperate fruit to access the market this way will be tempered by the overall size of the domestic market. Nevertheless, in general terms the profitability of this route to market suggests that it has the potential to be a more permanent part of wine retailing by the major retailers in current industry settings and structure.

SUMMARY

Calculations for the prospects of accessing alternative routes to market yielded mixed results in terms of viability. By torturing supply chain benchmarks, it may be possible to achieve some profitability down to around \$1/litre fob in export bulk wine but only with compromised margins that will be unsustainable in the long term. Between \$1/litre fob and \$0.80/litre fob, further margin sacrifice and eventually break-even are the outcomes. A weaker AUD will assist this trade but for the same reasons, will also represent a constant threat if it strengthens. Hence, in the current circumstances, this trade represents survival, not much more.

Distressed cooler-temperate fruit will logically seek alternative routes to market through major retailers as clean skins or retailer-owned-brands. For clean skins, the opportunity is similar to that of warm inland fruit accessing export bulk wine trade – basic survival. For retailer-own-brands, cost-cutting and optimising value-chain efficiencies could mean retailer-owned-brands are a viable option for distressed cooler-temperate fruit.

Based on the foregoing, it is supposed that clean skins will not be a permanent feature of the market place, but will come and go with periods of serious supply and demand mismatch, while retailer-owned-brands might have a more permanent place in the market.

Overall, the analysis suggests that capitalizing on the opportunities at the margins does not offer a panacea to oversupply/under-demand with the current industry settings but it could alleviate some of the pain particularly if ways can be found to improve the market prospects of wine that works at these margins. Things that could assist include lifting demand for the product through the national marketing function or innovation through the R&D function to also lift demand or to lower costs. Innovations could include market research, product innovation including style or packaging, or economic research into benchmarking, process efficiencies, business models or commercial practices.

Underlying the potential of all the above opportunities will be the need for any given Australian business trying to access the market in the manner suggested, to be structured in way that makes it possible to achieve the indicated benchmarks. The options are extreme and the structure of the business model counts.

FINAL COMMENT

All in all, it is apparent from the analysis that while improvement is possible by adaptation, change and improving market prospects, a rapid, short-term turn-around in the industry is not evident. Any business eroding saleable assets to survive or without access to the resources to make changes to adapt, runs the risk of a forced exit at a later point of time with significantly less to go on with. In these circumstances, staying or leaving needs to be carefully considered.

ATTACHMENT 1 – DO-IT-YOURSELF CALCULATIONS

Value chain	Units	Input cell identity	Data input	Outcomes	Comment
YIELD	t/ha	A	Enter yield assumption		<u>Standard values:</u> Warm inland, 22.5 Cooler temperate, 9 Classic cool climate, 7.5
TONNAGE	t	B		= A	Note: the model assumes 1 hectare
WINE CONVERSION RATE	L/t	C	Enter conversion rate		<u>Standard values:</u> Mega/bulk processing facility, 750 Medium/large processing facility, 700 Small processor, 600 Boutique processor, 590
VINEYARD COST OF PRODUCTION	\$/ha	D	Enter district category	Enter cost of production	<u>Standard values:</u> Warm inland, 6500 Cooler temperate, 800 Classic cool climate, 15000
VINEYARD UNIT COST OF PRODUCTION	\$/t	E		= D/A	
GROWER NET MARGIN	%	F	Enter grower margin	X%	<u>Standard margin:</u> X = 30
GRAPE SALE PRICE	\$/t	G		= E/(1-F)	
GRAPE COST PER LITRE	\$/L	H		= G/C	
WINE CONVERSION COST per LITRE (excl wg cost)	\$/L	I	Enter processing cost	= I	<u>Standard values:</u> Mega/bulk processing facility, \$0.35 Medium/large processing facility, \$0.70 Small processor, \$1.33 Boutique processor, \$2.00
WINE PROCESSING COST per LITRE (incl wg cost)	\$/L	J		= H+I	
WINE - OAK AND MATURING	\$/L	K	Enter wine category	Enter maturation costs	<u>Standard values:</u> Premium, \$0.38 Non-premium, \$0.15 Option, \$0.00
WINE BOTTLING, BOXING, WAREHOUSING, FREIGHT	\$/L	L	Enter wine category	Enter distribution costs	<u>Standard values:</u> Premium, \$3.00 Non-premium, \$1.10 Option, \$0.00
WINE COMPANY TOTAL COST	\$/L	M		= J+K+L	
WINE COMPANY NET MARGIN	%	N	Enter w/company margin	Y%	<u>Standard margin:</u> Y = 30
WINE SALE PRICE pre-WET	\$/L	O		= M/(1-N)	
WET	%	P	29%		If sold in Australia
WINE SALE PRICE BY WINE COMPANY	\$/L	Q		= O+(O*P)	
WINE SALE PRICE BY WINE COMPANY	\$/bottle	R		= O*0.75	
DOMESTIC RETAILER MARGIN	%	S	Enter retailer margin	Z%	<u>Standard margin:</u> Z = 30
RETAILER WINE PRICE	\$/bottle	T		= R/(1-S)	
GST	%	U	10%		
SHELF PRICE	\$/bottle	V		= T*1.1	