Winemakers' Federation of Australia

Australian Government
Australian Wine and Brandy Corporation

WGGA
Wine Grape Growers' Australia

Wine sector must continue to focus on transition

A statement to industry by the Winemakers' Federation of Australia, Wine Grape Growers' Australia, and the Australian Wine and Brandy Corporation

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Background

In November 2009 the national wine industry organisations launched a Wine Restructuring Action Agenda (WRAA) with the release of a statement to the wine sector about the need to confront the reality of grape and wine oversupply.

The key messages were that:

- Structural surpluses of grapes and wine were damaging the industry by devaluing the Australian brand, entrenching discounting and eroding profitability.
- At least 20% of bearing vines were surplus to requirements and the problem was not restricted to specific regions, varieties or price points.
- Australia could not compete in the global commodity wine market and needed to change its product mix to focus on sales that earn viable margins.
- The industry's rapid growth in the 1990s had added some vineyards of questionable value and even undermined the integrity of some regions.

This second statement reports on progress and outlines the next phase of initiatives designed to assist the industry's transition to a new structure based around long-term sustainability and market opportunity.

Issues and progress

<u>Oversupply</u>

There are signs of adjustment in vineyard area and wine stocks but these are by no means sufficient to suggest the "oversupply problem" has passed. It is particularly concerning that:

- A smaller harvest in 2010 was the biggest factor in the adjustment and thus there is potential for oversupply to rise again if harvest levels return to previous levels. Disease issues in late 2010 may have a short-term impact, but in the longer term the risk of an increase remains.
- The adjustment does not address imbalances in the quality, varietal mix and cost efficiency of vineyard capacity.
- Some cooler regions still believe oversupply is primarily an issue for, and the responsibility of, the warmer regions.

Australian Bureau of Statistics (ABS) data suggests a net reduction in vineyard area of 6600 hectares (8000 removed and 1400 planted) up until March 2010, with an additional 13,000 hectares not harvested during vintage 2010. [Removals may be understated as growers who have exited completely are unlikely to have responded to the survey]. These net removals represent a reduction of 4.3% of national vineyard area. However, if the hectares not harvested are permanently withdrawn the combined reduction is 13%.This compares with the 20% identified as the minimum necessary in the first WRAA statement.

The AWBC estimates a combination of decreased wine production and increased sales will see stocks fall from 1.9 billion litres to about 1.72 billion in 2009-10. However, an estimated 300 million litres of sales that led to this stock position are considered to be unprofitable and unsustainable and hence could be interpreted as distressed sales.

We also must recognise the increasing influence of businesses that are dumping cheap surplus wine on global markets, creating a false demand for fruit at unsustainable prices, undermining the image of Brand Australia, and delaying the adjustment process. This is not new but it has now become more entrenched and a more substantial influence.

In summary, despite clear market signals, adjustment is not proceeding at a sufficient pace. Larger and more commercially focused businesses are generally well advanced, having taken steps to clear surplus inventory and assets, realign their supply chain, revise brand portfolios and shift their market and price-segment targets. However, a combination of unrealistic expectations, non-commercial motives and short-term opportunism continues to motivate many operators to resist change.

Contributing factors include but are not limited to: the WET Rebate and/or off-farm income shielding otherwise unprofitable businesses; existing contracts causing complacency; barriers to exit (prohibitive costs, inability to recoup debt etc); a lack of alternative uses for land; demographic factors overriding business considerations; and a belief that oversupply is someone else's problem or that demand initiatives will solve it.

Demand

Export volumes have risen 10% since 2007-08 but value is down by 19%, with exports of bulk wine below $1/litre rising 85% to 187ML in 2009-10. Most disconcerting is the decline in high value exports; volumes halved between 2003 and 2010. We can anticipate continuing recovery from the GFC but it is slow and, as the table below indicates, there is evidence Australia is not benefiting to the same extent as our competitors.

Changes in exports for key exporters, 2010 (From Rabobank)

Country	Volume change (%)	Value change (%)	Period of measure
France	+41	+21.9	Jan- June
Spain	+17.4	+6.3	Jan- July
Italy	+6.1	+8.6	Jan- June
US	+6	+22	Jan- June
Argentina	-6	+18	Jan- July
Chile	+ 13.1	+ 13.8	Jan- Aug
Australia	+3.1	- 8.7	Jan- June
New Zealand	+18.1	+5.7	Jan- June

Source: Australian Wine and Brandy Corp., 'The Gomberg-Fredrikson Report', Instituto Nacional de Vitivinicultura (Arg), Observatorio Español del Mercado de Vino, South Africa Wine Industry Information System, French Federation of Wine and Spirits Exporters, Wines of Chile, The New Zealand Winegrowers Note: Value changes in local currencies

Domestic sales have grown by volume but imports continue to take a significant share of this. Of concern is the erosion of margins and profitability as cleanskins and retailer own-brands increase their share; Neilsen data shows a jump from 14.9% to 21.7% in just two years. While retailer power is the fundamental driver of this trend, the endemic oversupply is fueling it.

Recent developments further weigh against wine businesses. US monetary policy decisions have further strengthened the Australian dollar against the US dollar, impacting on competitiveness in one of our opportunity markets, while Australian interest rate increases will increase costs and reduce domestic demand.

Vineyard viability

A qualitative analysis of the physical performance of Australia's vineyards undertaken to identify any underlying issues that might cause a region to underperform made the following observations:

- Some celebrated regions have seen their overall performance diluted by rapid expansion and an increasing proportion of young vineyards.
- Most regions produce a wide range of varieties with limited specialisation, leading to a national varietal mix that is not delivering to our potential.
- In some regions site selection has too often been based on land availability rather than the potential to produce the best fruit, particularly during the recent planting surge.
- Vineyard operators need to ensure they meet best practice standards in vineyard layout and make appropriate adjustments to match changing climatic conditions.

The next steps

It is vital to maintain our momentum in specifying and pursuing the changes necessary to resolve the imbalances between Australia's current wine supply capacity and competitiveness (in terms of quantity, quality and environmental sustainability) and the market opportunities that can deliver ongoing profitability. The scope of these changes encompasses four areas.

Supply

- The overriding priority remains the need to address oversupply issues and at least meet the minimum 20% reduction in total area as set out in the first WRAA statement.
- Willingness to identify and then remove or redevelop vineyards that fall short of either physical (quality) or financial (cost) performance measures.
- Better align our vineyards and wineries to market opportunity
- Universal adoption of best practice in water use efficiency.
- Improve performance in addressing environmental custodianship.

Competitiveness

- Develop strategies to cope with rising production input costs for wineries (labour, capital, water etc).
- Adapt to the likelihood that the value of the Australian dollar will remain high and volatile.
- Better understand our advantages/disadvantages relative to competitors in each market.

Demand

- Increase emphasis on consumer access and engagement as an antidote to route-to-market consolidation.
- Introduce more differentiation into the Australian wine offer, in wine styles and in the strength of the brand propositions (eg regional).
- Specify new market opportunity metrics (geographies, channels, price segments).
- Switch wine business emphasis from sales volume to sales margin, even where this entails conceding unprofitable markets.

Marketing

- Reposition the Australian wine category to enhance credibility in the mid range and luxury wine segments.
- Change focus of market development strategy from individual brands promotion to category reputation building and market penetration.
- Prioritise high growth high yield markets for promotion effort.

WRAA priorities and actions

To support necessary industry developments, the WRAA partners have committed to the following specific initiatives:

- WFA and WGGA will more closely monitor and analyse reductions in vineyard capacity and shifts in performance to ensure the scale and direction of supply restructuring is consistent with future requirements.
- WGGA is upgrading and expanding its *Vinebiz* business support program to facilitate appropriate adjustment and build the capacity of growers to make independent judgments about (and promote) their produce to meet market requirements.
- WFA and WGGA will create tools to encourage and assist vineyard benchmarking.
- WFA is restructuring its *WineSkills* program to provide advice and information across the range of business development issues facing wine businesses and regions. Content will be developed in consultation with state and regional associations.
- WFA will continue to support the Australian Taxation Office crackdown on WET Rebate abuse and evaluate reform options to reduce market distortions.
- AWBC is preparing to implement strategies outlined in the China market research launched at the recent Wine Industry Outlook Conference and disseminate market intelligence, WFA and AWBC will commission research into other key Asian markets.
- AWBC has completed detailed market opportunity analysis for key markets which it will release before the end of 2010.

Related activities

- WGGA, WFA and AWBC are developing a new biosecurity framework for the grape and wine sector.
- WGGA and WFA will commission research to gain a better understanding of the impacts of proposed Murray Darling Basin reform and work to ensure due consideration is given to economic, social and environmental impacts and goals.
- AWBC has introduced additional compliance measures to address the risks associated with the increasing share of bulk wine exports in the total export mix, particularly to emerging markets in Asia.
- WFA, AWBC and WGGA are investigating an alternative approach to collecting and disseminating data and information that more effectively meets the needs of wine businesses than the current ABS collections.
- WFA, AWBC and WGGA will review the sector's R&D priorities to better align them with the restructuring imperative.