

# Post-vintage bulk wine review reveals Chardonnay price decline

Jim Moularadellis, principal of Australia's leading bulk wine broker, Austwine, looks at the four main varietals that dominate Australian wine production, and wraps up bulk wine supply post-vintage 2005



Jim Moularadellis

Four main varietals now dominate Australian beverage wine production: Chardonnay, Shiraz, Cabernet Sauvignon and Merlot. I'll take a look at how these are performing on the bulk wine market and I will compare wines from cooler climates, with their warm inland counterparts and show a mismatch in their respective market opportunities, compared with the supply of each.

## Chardonnay

About a year ago, prices of \$1.50 - \$2 per litre ex-works were being achieved for inland irrigated Chardonnay on the domestic spot market, and in some isolated cases Chardonnay sales were tied to red varietals. At that time we had less than 4 million litres of Chardonnay for sale (from all regions and all vintages, with and without asking prices)<sup>1</sup>.

Then, in late 2004 the domestic spot market slowed to a halt. Early in 2005, in anticipation of the new crop, Chardonnay prices fell considerably and inland irrigated Chardonnay settled in the low to mid \$1 range for (then) current vintage 2004 wine. The fall was quite spectacular and caught us by surprise, albeit about a year later than we had originally expected, given the large growth in Chardonnay production that was widely anticipated for the 2004 vintage.

Consider the chart (Figure 1) which tracks the total Australian vintage crush of Chardonnay against Austwine's total Chardonnay bulk wine inventory as at June each year, for the past five years. It can be seen that production has almost doubled within three years from just over 200,000 tonnes in 2003 to just over 400,000 tonnes in 2005<sup>2</sup>. So, it is no surprise that prices have fallen quite dramatically.

Chardonnay passed another milestone earlier this year: for the first time in several years, there was more Chardonnay on the bulk market than Merlot.

Chardonnay is now the third biggest variety in our inventory, behind Shiraz and Cabernet Sauvignon. But in 2005 it was actually the second biggest grown variety, overtaking Cabernet Sauvignon production and exceeded only by Shiraz. Our inventory of Chardonnay has now ballooned to 15 million litres, (almost four times the volume a year ago) and we are listing new parcels every day. Thus it is our expectation that our Chardonnay inventory will continue to increase. We do not think it will be long before our Chardonnay inventory will grow to exceed Cabernet Sauvignon and settle in second place on our inventory list, consistent with its production ranking.

Time is needed for producers to introduce new products and programs that can utilise the (mostly profitless) lower pricing now available. We are seeing the beginnings of larger volumes being exported, particularly since Chardonnay from Chile has gone up in price, basically swapping pricing positions with Australian Chardonnay during the last 12-18 months.

An increase in international competitiveness is good news for Australian Chardonnay, but domestically the Chardonnay bulk market is pretty lifeless. Everybody seems to have it and nobody

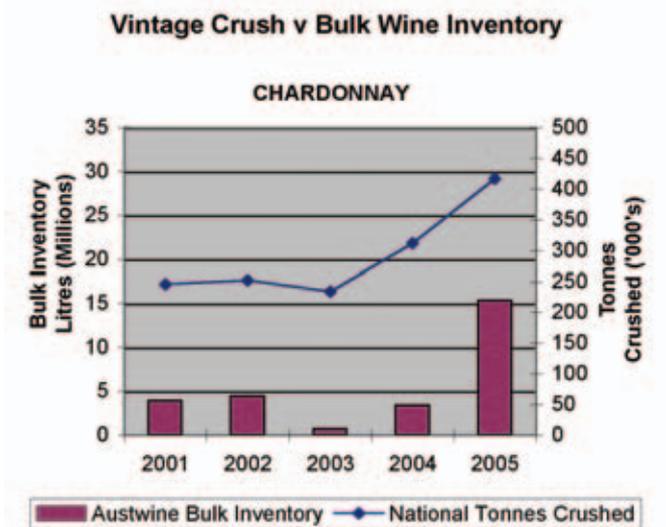


Fig. 1. Vintage crush vs bulk wine inventory, Chardonnay.



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seems to want it. Although we have sold about two million litres of 2005 Chardonnay domestically under longer term and pre-harvest commitments, we have sold very little 2005 Chardonnay on the domestic spot market.

Chardonnay is now at the same place where Cabernet Sauvignon was after the large 2002 vintage: few buyers and lots of supply at a still relatively high average grape cost. Expect further Chardonnay grape price falls in 2006.

Chardonnay's downward pricing pressure is also likely to influence other (non-fragrant) white wine styles that were used as blend stretchers when Chardonnay was less abundant. Furthermore, popular blends such as Semillon Chardonnay and Colombard Chardonnay may move from standard 80:20 blend ratios closer towards 50:50 blend ratios in order to utilise excess Chardonnay, which in some cases will be the cheaper component of such blends. This, of course, is likely to release Semillon and Colombard onto the bulk market.

### Shiraz

Currently, we have about 30 million litres of Shiraz for sale (from all regions and all vintages, with and without asking prices). Compared with a year ago we had about 28 million litres, so the situation has not really changed all that much during the last 12 months. This is reflected in the graph (Figure 2) which shows a similarly modest change in tonnes of Shiraz crushed over the last two years.

What is interesting to note, however, is that there is now more Shiraz than Cabernet Sauvignon (Figure 3) listed for sale, a reverse of the status quo that existed between 2001 and 2004. Although Shiraz production has exceeded Cabernet Sauvignon production by a comfortable margin in each of the past five years, Cabernet Sauvignon bulk wine inventory was always higher until this year.

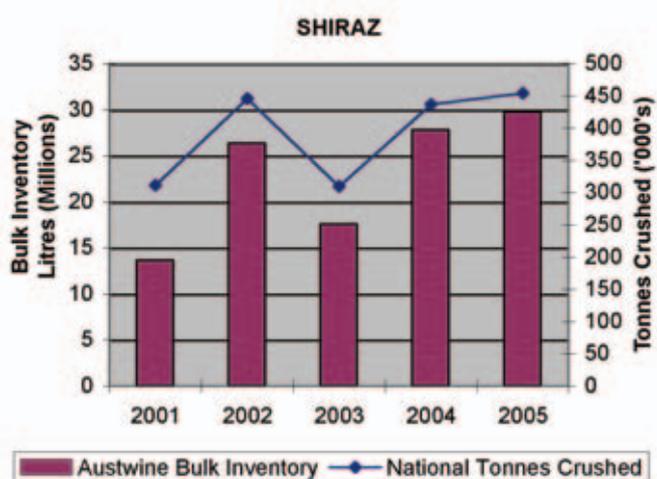


Fig. 2. Vintage Crush v Bulk Wine Inventory, Shiraz.

### Cabernet Sauvignon

Currently, we have 23 million litres of Cabernet Sauvignon for sale (from all regions and all vintages, with and without asking prices). Compared with a year ago when we had a huge 34 million litres listed the situation has improved markedly, but this is not yet reflected in higher market prices.

Anecdotally, we think average prices are probably a touch softer, but we expect them to firm in due course. The 2005

vintage crush of Cabernet Sauvignon was down slightly compared with 2004, unlike Chardonnay, Shiraz and Merlot which all experienced increases in production.

Furthermore, unlike Shiraz, Cabernet Sauvignon is not recognised as Australia's flagship or signature variety, so from about 2002 industry participants acted quickly and zealously to reduce their surpluses of this variety wherever possible. Some of the action taken included:

- using Cabernet Sauvignon (instead of Shiraz) as the lead variety in Cabernet Shiraz and other red blends.

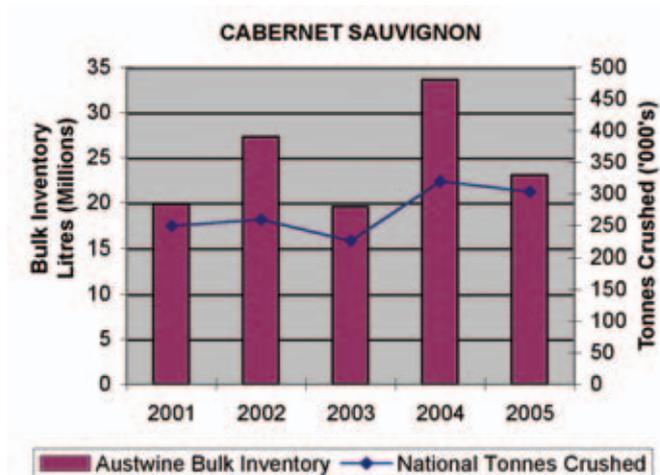


Fig. 3. Vintage Crush v Bulk Wine Inventory, Cabernet Sauvignon



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- grafting over to other varieties, such as Chardonnay.
- using Cabernet Sauvignon to make white wine for lower priced (cask) programs.

As a result of such measures, we think that this variety will soon come out of gross oversupply into plain, ordinary oversupply. In the meantime, wineries will generally continue to pay the least for this variety, hoping the grapes will go somewhere else.

**Merlot**

Merlot is the baby of the big four varietals – annual production is less than half of the next largest variety, Cabernet Sauvignon. But Merlot production is still about 45% higher than the next most prolific variety, Semillon, whose 2005 crush was 98,000 tonnes.

Each of the big four varietals discussed in this article has been graphed on the same scale, to give a picture of the relative size of each variety. Merlot's small crush tonnage is clearly evident in the chart (Figure 4). The crush tonnages for 2005<sup>2</sup> are: Merlot 144,000 tonnes, Cabernet Sauvignon 304,000 tonnes, Chardonnay 416,000 tonnes and the big daddy of them all, Shiraz 454,000 tonnes.

We have about 13 million litres of Merlot for sale (from all regions and all vintages, with and without asking prices). These 13 million litres represent about 18,000 tonnes, or about 12.5%

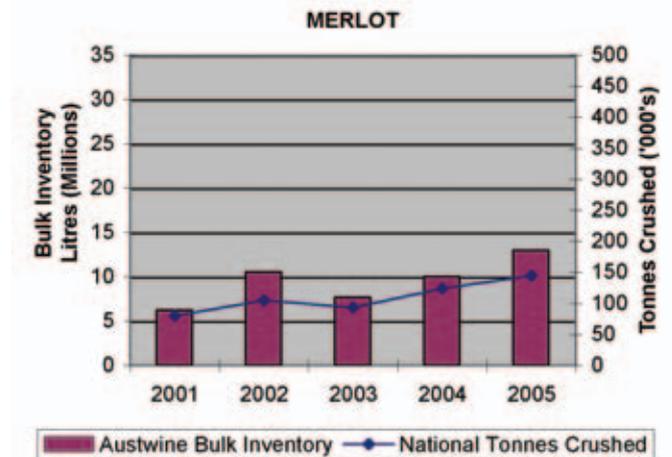


Fig. 4. Vintage Crush v Bulk Wine Inventory Merlot

of the 2005 vintage Merlot crush. This is the highest ratio of bulk inventory to 2005 vintage crush of the big four varietals, which the chart (Figure 5) illustrates well. Therefore, Merlot now has the worst fundamental oversupply position of the big four.

This chart also shows that Merlot's position has only changed recently, and this is mostly due to the reducing oversupply of Cabernet Sauvignon. Like Cabernet Sauvignon, Merlot is not a signature variety for Australia, but luckily, Merlot has a relatively small production volume.



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**Bulk Wine Inventory As a Percentage of Current Vintage Year Crush**

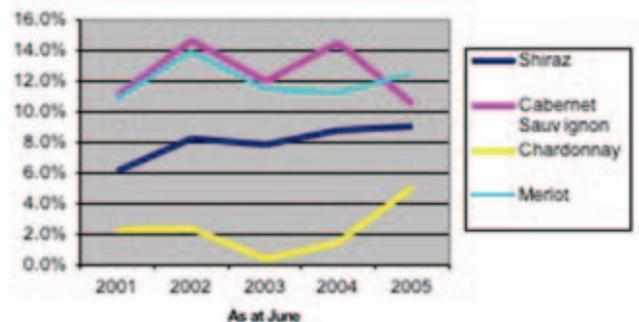


Fig. 5. Bulk Wine Inventory as a Percentage of Current Vintage Year Crush.

**Supply/demand Imbalance: cooler climates versus warm inland regions**

Our total current bulk wine inventory — all varieties, vintages and regions, listed with and without asking prices — is currently about 107 million litres. Of this volume 77% is from cooler climates and the remaining 23% is from warm inland regions<sup>3</sup>.

This is almost a complete reversal of the production profile of the Australian wine industry, which is approximately 40% cooler climates and 60% warm inland regions by volume.<sup>4</sup> The magnitude of this mismatch is illustrated graphically (Figure 6).

Why has this occurred? Simply because sales of wines from cooler climates are inadequate to absorb the available supply, thus the excess supply finds its way into our bulk inventory.

Let me develop the analysis further by proposing an arbitrary value of \$1.30 per litre (or about \$1000 per tonne as wine) as a profitable and sustainable price level for both wineries and

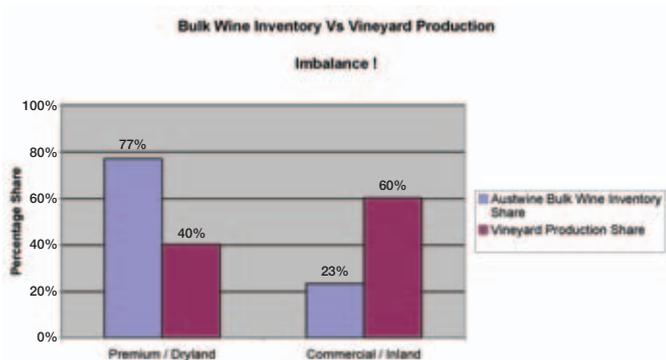


Fig. 6. Bulk wine inventory v vineyard production (imbalance!)

growers for warm inland wines, but not for cooler climate wines.

Since January 2004, almost 76% of our domestic spot market transactions were below \$1.30 per litre, despite this volume being only 23% of our current inventory. Put another way, over three-quarters of our sales come from less than one-quarter of our available bulk inventory.

If we assume for a moment that our inventory profile roughly reflects the availability mix of the industry, only about one-quarter of all surplus bulk wine has a chance of profitably fitting into the price points below \$1.30 per litre. So, a large component of our inventory is simply not selling. Below \$1.30 is where the volume growth is occurring but wines from the cooler climates are not profitable at these levels. This is a serious mis-match between the economics of available supply versus the current market demand.

There are at least two conclusions that can be drawn from these observations. First, that we are in for a few more years of tough times in the cooler climates. Second, that although the warm inland regions are better placed than their cooler climate counterparts, things are still pretty tough, as a lot of bulk wine prices achieved for warm inland wines are at seriously below \$1.30 per litre.

**So, rug up!**

The ice cold winds of marketplace reality are biting us hard. However, it is always darkest and coldest before dawn. Natural selection will ensure that our industry is better equipped for the next wine industry ice age, expected to arrive in about 10-15 years time!

**References:**

- (1) Austwine Bulk Wine Database, July 2005.
- (2) 2005 WFA Vintage Report, June 2005.
- (3) I have used the same classification and nomenclature employed by AWBC: "warm inland" is defined as the growing districts along Australia's major rivers (SA Riverland, River Murray Valley in NSW & Vic and NSW Riverina) and "cooler climates" is defined as all other regions.
- (4) Australian Wine and Brandy Corporation, July 2005.

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