

One Too Many Cream Puffs: 2013 Post Vintage Bulk Wine Review

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Australian winemakers started the 2013 vintage with empty tanks and large appetites for grapes. Optimism & prices were on the rise following last year's medium sized, good quality vintage and winemakers were hungry for more wine inventory. So during the 2013 vintage, most winemakers crushed as many grapes as they could lay their hands on and Mother Nature delivered grapes in great abundance. Now, most winemakers have a bit too much excess bulk wine in their tanks. Even those who judiciously restricted their intakes are complaining of higher than ideal inventory levels.

....Sometimes we folk in the wine industry can identify with the 8 year old at a kid's birthday party hungrily surveying the sweets table, who then helps herself to a whole plate of cream puffs. The little girl then later complains of a bad tummy ache after, perhaps, one too many cream puffs.....



2013 Crush Overview

The 2013 Australian winegrape crush was the biggest for several years, weighing in at an estimated 1.833m tonnesⁱ. It was about the same size as the 2008 crush and, depending on

the source of the dataⁱⁱ, only three vintages have been larger: 2004, 2005 & 2006. Some key features of this year's vintage include:

- 2013 was a pretty high yielding year: about 12.6t/Ha if we use the latest estimate of current vineyard bearing area of around 145,000 Ha. The 3 big vintages of 2004-2006 all yielded between 12.0-12.7t/Ha.
- Winemakers seem pretty pleased with the quality of wines from 2013 and from what we have seen, we agree. There were few extreme heat wave events this past summer, leading to widespread development of good colours and flavours, and few heat related crop losses.
- Generally it was a hot dry summer, (unlike Griffith in 2012, or most regions in 2011) which meant low disease pressure. In fact, there had been very little rain since early spring, despite reasonable rains last winter. A notable exception was the Hunter which experienced a number of rain events during harvest, despite a generally dry growing season.
- Due to the generally hot and dry conditions during the growing season, overall it was a very high water-use year. Irrigation water was generally abundant and this contributed to good crop levels. A notable exception to this was the Barossa.
- There were few reported frost events (an exception was parts of the Clare Valley in mid-October).
- A few, but only a few, grapes were left unpicked on the vine this year.

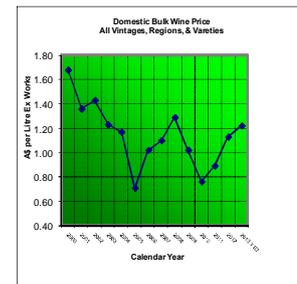
A Big Crop & Higher Grape Prices

The 2013 crush was large and despite its size, most grape prices were higher. This is what also happened in 2008. Apart from 2008 being almost identical in size to 2013 at ~1.8m tonnes, why did this happen, what does it mean and will 2013 be as tough for winemakers as 2008?

- Why did this happen?

Both the 2013 and the 2008 crops were bigger than expected and planned for. Following earlier smaller wine grape crops, the lead up to both vintages was characterised by general buoyancy in the bulk wine market for an extended period of about 2-3 years. The accompanying chart shows the evolution of domestic bulk wine prices since 2000 and it can be seen that bulk wine prices were clearly on the rise before both 2008 and 2013.

The pre-vintage buoyancy of the bulk wine market prior to both the 2008 and 2013 vintages resulted in higher grape prices at harvest. Winemakers felt they could sell all they could make, so they helped themselves to the abundant grapes on offer to try and their fill tanks.



Generally, they succeeded admirably.

- What does it mean?

Winemakers experienced margin squeeze as bulk wine prices sagged immediately after both the 2008 and 2013 harvests. This year, most players have at least some bulk stock to sell. Some players have a lot to sell. If the history following 2008 is any guide, a few wineries will be experiencing cash flow problems, a few will announce inventory write downs some way down the track, and others will reduce future grape intake to re-balance their inventories.

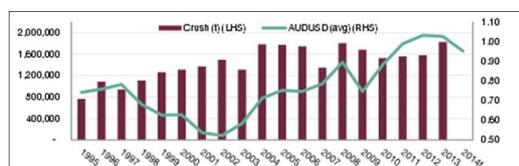
On this trajectory, and in the absence of a significant stimulus otherwise, such as widespread frost or other calamity, it is not unreasonable to expect grape prices to fall next year.

Not good news for either winemakers or growers, but customers and consumers will be happy.

Of course, there were some exceptions in 2013 (e.g. the Barossa) where yields were severely restrained due to dry conditions, bulk wine supply is extremely tight and prices are up significantly.

- Will 2013 be as tough for winemakers as 2008?

Set out below is a fascinating chart, courtesy of one of the major Australian banksⁱⁱⁱ.



It shows the large size of the 2013 crush and, critically, that it coincides with a very high exchange rate. Despite the A\$ falling by 10-15% in recent months, we have never had such a tough combination of a very high exchange rate and a very big crop.

The chart highlights the challenge that Australian winemakers have ahead of them following the 2013 vintage, since 60% of Australian wine production is exported.

However, Australian winemakers have dealt with large crops in the past, and what is not detailed in the above chart is that grape prices were much lower in 2013 than they were back in 2008. About 30% to 40% lower.

(In 2008, grape prices increased significantly as a result of extreme drought and crazy water prices. Not that growers did particularly well from the high grape prices in 2008: most of the grape price increase was paid out to cover the extremely high cost of irrigation water prevailing at the time.)

For example, consider 3 key varieties from an inland irrigated region such as SA Riverland, to highlight the impact of 2013 grape prices, compared with 2008. The difference per litre is very large indeed and in excess of \$0.30 per litre and this significantly improves the apparent competitiveness of Australian wine internationally. See the data in the table below:

Grape Prices 2008 v 2013	2008		2013		Variance		
	Per Tonne	Per Litre	Per Tonne	Per Litre	Per Tonne	%	Per Litre
SA Riverland Chardonnay	\$ 552	\$ 0.36	\$ 291	\$ 0.18	-\$ 261	-47%	-\$ 0.18
SA Riverland Shiraz	\$ 622	\$ 0.39	\$ 396	\$ 0.24	-\$ 226	-36%	-\$ 0.15
SA Riverland Cabernet Sauvignon	\$ 626	\$ 0.39	\$ 402	\$ 0.25	-\$ 224	-36%	-\$ 0.14

Source: SA Phyloxera Board, Calculated Average Purchase Value per Tonne

Yes, 2013 has been tough so far for winemakers, and it is likely to continue to be tough due to the large size of the 2013 crop. A further reduction in the exchange rate would certainly be welcomed by winemakers, but it is not all bad as grape prices are not at the inflated levels of 2008.

Bulk Wine Round Up

- Still Good Bargains Around

There are plenty of good quality 2013 wines to choose from the inland irrigated or *öwarmö* regions^{iv}.

Many of the parcels that we have listed are very attractively priced and are of generally good to excellent quality. So it is still relatively easy to find good value in the Australian

bulk wine spot market at present, especially for 2013 SE Australian wines.

This is in marked contrast to last year, around March, when the bulk wine market stopped suddenly for several weeks after Griffith was hit with widespread flooding: wineries stopped selling bulk wine altogether for fear of giving up valuable inventories.

- Buyer strategies

This year, it's the buyer's turn: buyers have understood that the 2013 vintage is larger than desired and many have delayed making purchasing decisions, negotiated very aggressively on price, or bought shorter, to try and do the best for their businesses.

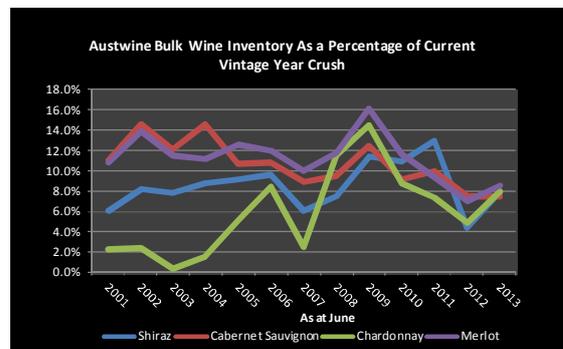
This is on top of the savings associated with recent falls in the value of the A\$.

Some of the more canny buyers have picked the very best quality parcels and beaten their competition by moving early, whilst also enjoying excellent savings in prices paid. Some of the wines that we sold early this year were nothing short of outstanding: in any market, there are rewards for the buyers that move fast, decisively and early.

- Austwine Inventory Levels

Last August, the Austwine inventory list was currently just over 70m litres, a level not seen since the severely drought effected 2007 vintage. Now our list is at just over 90m litres: higher, but not excessively so.

As a ratio to the size of the current year's crush, the volume of bulk wine on our list is also not at overwhelming levels (see chart below).



Furthermore, the volume of bulk wine on our list is also not at the levels that we used to see during the 3 big crops of 2004-2006 of around 150-180m litres.

So on this evidence, it appears that this year it is a buyer's market, but not overwhelmingly so.

However, another big crop in 2014 could change all that and would take inventory levels back towards historically high levels.

- What's Hot?

Currently, some of the harder to find items are:

- SE Aust. Pinot Grigio from 2013.
- SE Aust. Shiraz & Cabernet from 2012.
- Limestone Coast Shiraz & Cabernet, at \$2.00-\$2.50 per litre, from 2012 or ø3.
- Barossa Shiraz & Cabernet, from any vintage



- What's Not?

Currently, some of the harder to sell items are:

- 2013 Regional Riesling.
- Almost anything from 2011.
- Merlot from any vintage or region.
- Gordo, grapes, juice & wine, from anywhere and any vintage.
- Most older whites.



2014 Crop Outlook

- Good Winter Rains

In the 3 months to the end of July 2013, key wine growing centres experienced at least average rainfalls, as shown in the data table below. In fact, the data highlights that every centre has experienced at least average rainfall for the last 3 months.

Winter Rainfall (mm)

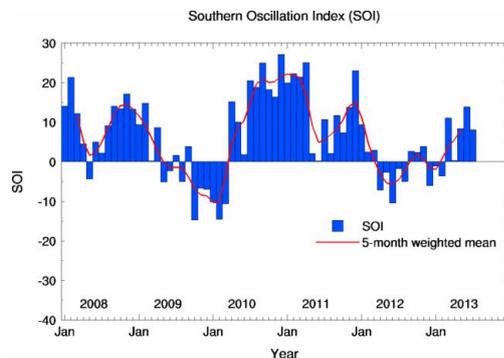
Month	Adelaide		Nuriootpa		Coonawarra	
	Average	2013	Average	2013	Average	2013
May	79	55	55	55	51	42
June	76	76	56	63	76	55
Jul	69	120	66	73	80	139
Total	224	251	178	190	207	236
	Renmark		Mildura		Griffith	
	Average	2013	Average	2013	Average	2013
May	25	41	25	29	35	26
June	25	33	23	34	33	39
Jul	23	20	26	14	34	38
Total	73	94	74	77	102	103

Source: Australian Government, Bureau of Meteorology

Anecdotally, driving around the country side recently, it seems that winter cereal crops (including vineyard cover crops) appear to be growing well, if not vigorously, as a result of good recent rains.

- Southern Oscillation Index

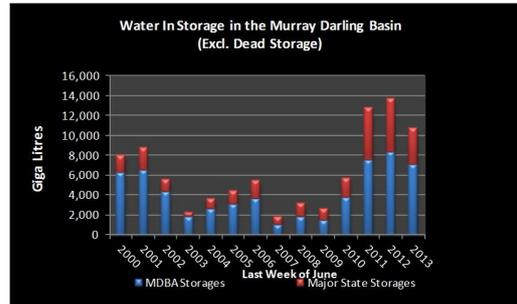
Consider also the chart^v of the Southern Oscillation Index which shows^{vii} a high correlation with the recent dry summer of 2012/13 (negative values in the chart) and the recent wet conditions during winter 2013 (positive values in the chart).



Depending on the intensity and duration of the current trend of good recent rainfalls, this may indicate that South Eastern Australia is in for a relatively wet spring and summer.

- Good Water in Storages

Should the good winter rainfall cease anytime soon, there is plenty of water in storage to meet seasonal irrigation demands. It can be seen from the chart below that water in storage this year, and during the last 3 years, is relatively abundant.



- Good Water Allocations

Final water allocations for the year ending 30 June 2013 were at 100%, and given the relative abundance of water in storage the same outcome is very likely for the year ending 30 June 2014. Furthermore, interim allocations are already quite high and these are detailed in the table below.

State Water Allocations	Last Year	This Year
	Final	Interim
	As at 30 Jun 2013	As at 15 August 2013
New South Wales (High Security)		
Murray Valley	100%	97%
Murrumbidgee Valley	100%	95%
Lower Darling	100%	100%
Victoria (High Reliability)		
Murray Valley	100%	57%
Goulburn Valley	100%	95%
South Australia (High Security)		
Murray Valley	100%	100%

Source: Murray Darling Basin Authority

- Reduction in vineyard area?

The most recent estimate of vineyard bearing area is about 145,000Ha.^{viii} Given that growers have experienced better prices each successive year since the lows of 2010, it is unlikely that there has developed any great new stimulus for vineyard removal. In fact, quite the opposite: higher grape prices since 2010 have resulted in better inputs by growers on their vineyards, all designed to enhance vineyard yields.

Specifically:

- Greater use of fertilizers, implementation of more rigorous spray programs and higher water use.

Furthermore:

- Higher grape prices have also lead to previously neglected or abandoned vineyards being rehabilitated back into full production.
- Anecdotally, I have also observed abundant buds left at pruning, especially in inland irrigated areas. This was similar to observations last winter as growers tried to chase yield to try and stay afloat.

- Overall 2014 Crop Outlook

There is a long way to go until the 2014 crop is harvested, and we have yet to see the outcomes of budburst, flowering and set. However, the signs so far seem promising:

- Good winter rainfall to date.
- The possibility of good rains continuing into Spring.
- Abundant water in storages.
- Generous water allocations.
- A similar vineyard bearing area to 2013.
- Better vineyard inputs by growers.
- Rehabilitation of previously neglected vineyards.
- Bud levels similar to last winter.

Therefore, apart from the obvious threats to the size and quality of the 2014 vintage such as frost, disease and other agricultural risks, there seems no reason why next year's crop shouldn't be at least as big as 2013.

2014 Grape & Bulk Wine Prices

Given the current likelihood of another abundant crop (and in the absence of any stimulus to the contrary), it seems unlikely that grape prices will continue their recent run of increases. On the balance of probabilities, a decrease in grape prices is more likely. In addition to the analysis detailed above, also consider the following:

- We have recently seen another large stock write down from one of the stock exchange listed winemakers.
- A number of large private companies have also recorded poor results recently, mostly as a result of the recent high A\$, until very recently.

So it seems that winery cheque books are likely to be firmly locked away, at least for the foreseeable future, as far as the possibility of higher grape prices go!

Anecdotally, wine grape price reductions of 20-30% are being openly talked about in the marketplace, especially for SE Australian Chardonnay and Gordo, for 2014.

Conclusions

Here are my top 10 conclusions arising out of 2013 vintage:

1. 2013 was an overall high yielding year, of generally good to excellent quality, resulting from a hot, dry summer with few extreme heat wave events.
2. Grape prices were higher and the crop was bigger than expected in most regions, leading to bulk wine prices falling after vintage.
3. 2013 was very similar to 2008: higher grape prices than the previous year, accompanied by a bigger than expected crop. 2013 also features a high exchange rate (despite recent falls in the A\$), but much lower grape prices than 2008, leading to increased international competitiveness.
4. There are still good bargains around from the 2013 vintage and many buyers have delayed making buying decisions in the hope of lower prices. Some buyers will achieve this, but the best parcels always sell first and the cream of 2013 is being sold briskly.

5. The Barossa is in a bit of a world of its own, with a shorter crop there stimulating higher grape prices and higher bulk wine prices post vintage.
6. Austwine inventory levels are nowhere near as high as they have been during past similarly large vintages, although this may change if 2014 vintage is large also.
7. The outlook suggests another good crop in 2014, with good winter rainfall so far and good water allocations supported by good water in storage.
8. The prospect of a good crop in 2014 is further enhanced due to vineyard area remaining similar to 2013, better vineyard inputs, rehabilitation of previously neglected vineyards and bud levels similar to last winter.
9. In the absence of a major agricultural calamity during the 2014 growing season, the recent run of increasing grape prices since the lows of 2010 looks like it will not continue into 2014. Grape price falls are more likely than rises in 2014.
10. Some wineries are openly talking about lower 2014 grape prices being 20-30% lower for certain oversupplied varieties. This is a result of perhaps one too many cream puffs during 2013 – a mistake winemakers will be keen to avoid making again next year.

About the author:

Jim Moularadellis is Chief Enthusiasm Officer (CEO) of Austwine, Australia's Bulk Wine Specialists. Jim was named 2007 Entrepreneur of the Year, Services, for South Australia by Ernst & Young and in 2008 Austwine was announced the winner of the Business SA Agribusiness Award. In 2007 and 2008, Austwine was in the top 25 Fast Movers for South Australia, an index of South Australia's Fastest Growing companies.

Jim joined Austwine in 1998, five years after the company was founded in 1993. He is a Certified Practising Accountant, holds an Honours Degree in Law from the University of Adelaide and is married with four children. He can be contacted on +61 (0)8 8363 5188 or jim.moularadellis@austwine.net.au

ⁱ Winemakers Federation of Australia, June 2013.

ⁱⁱ Various agencies produce statistics on Australian vintage crush size: ABS, ABARE & WFA.

ⁱⁱⁱ Commonwealth Bank of Australia, research dated 28 June 2013, A. McLennan et al.

^{iv} Warm Regions = Inland Irrigated Regions of SA Riverland, NSW & Vic Murray Darling, Swan Hill and MIA. Cool Regions = All other regions.

^v Courtesy, Australian Government, Bureau of Meteorology www.bom.gov.au

^{vi} The Southern Oscillation Index (SOI) is calculated from the monthly or seasonal fluctuations in the air pressure difference between Tahiti and Darwin.

^{vii} Sustained negative values, which often indicate El Niño episodes mean increased probability of drier conditions and positive values are associated with La Niña episodes. In Australia (particularly eastern Australia), El Niño events are associated with an increased probability of drier conditions and La Niña increased probability of wetter conditions.

^{viii} Australian Bureau of Statistics, October 2012, Vineyards, Australia 2011-12 Cat No 1329.0.55.022