

2011 POST-VINTAGE BULK WINE REVIEW

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This article reviews the Australian bulk wine market in light of the 2011 vintage and discusses the major influences and uncertainties surrounding the current outlook for bulk wine. The key issues that are addressed include an analysis of the 2011 crush, a review of each of the major varieties, and the outlook for the 2012 vintage.



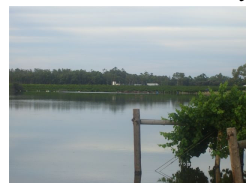
Genesis 7:17-19 *The flood continued ...And the waters prevailed so mightily upon the earth...*

It is old news now that the 2011 South East Australian vintage was wet, very wet. And the amount of rain was simply overwhelming: rain persisted throughout the vintage in Griffith and Renmark, for example, experienced 5 times the average rainfall this summer.ⁱ

Summer Rain (mm) – Renmark

Average	54.3
Previous Record	150.4
2010/11	272.4

Mildura fared even worse: over a 24 hour period during the weekend of 5-6 February, just as harvest was beginning, 187mm of rain was recorded. Some localities reported even higher volumes of rain, in excess of the *annual* rainfall for the region of 268mm. The results of such a catastrophic volume of rain is



clearly illustrated in this photograph of a vineyard near Lindeman's Karadoc winery, taken in the days following this single rain event. The rain continued to fall with monotonous regularity during the entire vintage, leading to a very nerve wracking experience for both growers and winemakers.

Meanwhile, in contrast to what was happening in Eastern Australia, the agricultural areas of Western Australia continued to experience severe drought conditions. The differences between vintages in the Eastern and Western Australia could not have been more stark.

Crush Size

The most recent report on the size of the 2011 Australian wine grape crop is 1.619m tonnes.ⁱⁱ There have been a number of other estimatesⁱⁱⁱ, but this one is the most accurate estimate, because it is conducted with a scientific survey methodology and, most significantly, is undertaken after vintage is finished, when all the grapes are crushed. In contrast with previous vintages:

Year	m Tonnes	Market reaction
2011	1.619	Small-ish
2010	1.603	Small-ish
2009	1.732	Large-ish
2008	1.831	Very large
2007	1.397	Very small

The 2011 crush is certainly higher than expected, so what is all the fuss about under-supply from Australia? When tabulated and compared with previous years as above, which is the obvious temptation, the 2011 crush number is actually a little misleading. There are 2 reasons why:

1. The 2011 crush number is the tonnage over the weighbridge, not the tonnage made into wine. We need to deduct the *extra* volume of grapes sent to concentrate this year to increase Baume of grapes picked earlier than usual due to the heavy rains this vintage. This practice is not typical in Australia, and certainly did not happen to any significant extent in the previous 4 years tabulated above, as drought and hot weather typically assisted sugar accumulation. My *very* rough estimate of this is a net loss of 100-150,000 tonnes of volumes available for winemaking during 2011.
2. We also need to deduct the volume of grapes made to wine that will end up not being of beverage quality. The range of quality outcomes in 2011 is very large compared with previous years and there will be a lot of wine that cannot be sold as varietal wine. As one winemaker described it to me: "in previous years the wines just made themselves", indicating little winemaking intervention was required to produce a respectable product. Not this year. A lot of poorer quality wines are yet to be released to the market as winemakers try to fix them up and make them better. A lot won't make it to beverage quality varietal wine at all. My *very* rough estimate of the tonnage of low quality wine: Another 100-150,000 tonnes.

Clearly, these estimates lack any scientific rigour. They are simply one person's view looking out the window of a rather kangaroo-battered Holden,



observing images such as the one opposite, meeting growers and winemakers along thousands of kilometers travelled this vintage trying to understand what was actually going on. However, if we are prepared to take a leap of faith and use the mid-point of these 2 *very* rough estimates, we need to deduct 250,000 tonnes from the 2011 vintage. This is quite a big number. So a very different picture emerges:

Year	m Tonnes	Market reaction
2011 Adjusted	1.369	Very small
2010	1.603	Small-ish
2009	1.732	Large-ish

On this analysis, the crush is smaller than 2007 and this is the main reason why prices are rising and supply of varietals is tight.

How many tonnes of grapes were left unpicked?

Despite the massive amount of grapes that succumbed to disease due to excessive rain, 1.6m tonnes made it over the weighbridge this vintage. The hectares that did get picked, tended to crop heavily, for two main reasons, both related to high rainfall:

1. A wet winter, leading to high soil moisture levels, followed by excessive rain right through vintage lead to large berries, with winemakers also reporting high juice yields. Berry set was average to below average, but bunch size was very big, and in some bunches the berries were so large and so tight that they took on a square shape!
2. Picking at low Baume reduced weight losses due to shrivel ordinarily associated with typical Australian ripening conditions.

So I am *guessing* there was 1.8 - 2.0m tonnes grown, since this is the upper end of crop potential based on historical crush data.

On this mathematics, this means 10-20% of the crop was left unpicked. Now that vintage is over and vines have defoliated, anecdotal visual assessments of vineyards left unpicked indicate that it could easily be higher.

Again, these numbers lack any scientific rigour, but are illustrative of the main drivers in the marketplace.

Australian Bulk Wine GFC

In late 2008 banks around the world stopped lending, causing the world's banking system to freeze, and crystallise a Global Financial Crisis. A similar thing happened in the Australia wine industry during the early part of 2011: wineries stopped selling bulk wine, and caused the bulk wine market to freeze for several weeks.



How did this happen? In late 2010 the rain kept falling, disease pressure mounted and potential yield losses grew. Many wineries withdrew inventory from the market as a hedge against the uncertainty of the 2011 harvest.

As vintage commenced, a few wineries rubbed their hands with glee as the disease pressure released them from taking contracted grapes that they did not really want. However, as the rains continued during harvest and the supply outlook deteriorated even more, the disease pressure was so great that

they could not buy the grapes they now needed. A lot of wineries were left short.

International buyers, particularly bottlers, were suddenly scrambling to cover their immediate bulk wine needs, as wineries were unable to supply. Such buyers were used to buying in a generally downward trending spot market since the end of 2008 vintage, and the market changed too quickly for them. In some very extreme instances wineries threatened to default on contracted volumes to buyers, although we did not witness or even hear of any actual default events. However we did witness soaring inquiry levels and there was no wine available on the spot market to service such inquiries. The picture was looking bleak for many importers potentially facing out-of-stock situations and massive penalties from their big supermarket customers as the tide of Australian wine rapidly receded: many players were on a knife edge.

Conflicting Bulk Inventory Trends

Interestingly, and despite the Australian Bulk Wine GFC experienced during the 2011 vintage, from about midway through vintage we witnessed steadily rising bulk wine inventories: every week more and more bulk wine was placed on the market as crops continued to come in, and wineries continually reassessed their individual stock position. Quite a confusing time followed as different wineries displayed dramatically different behaviour as they tried to make sense of what was occurring during vintage. Firstly, white wine inventories increased as salvage efforts on white wines proved that commercially serviceable wines could be made from generally depressingly diseased grapes. This was largely driven by Chardonnay since the crop data shows a return to over 400,000 tonnes over winery weighbridges, up from the very short 2010 crop of 329,000 tonnes.

Later on when red wine inventories were due to come onto the market, they did not. Reds were much harder to understand, because the release of red bulk wine by wineries was very patchy. Wineries were unsure of the volumes they had for sale, until their traditional annual buyers had made their purchase (or rejection) decisions. Many wineries privately worried whether their red wines would turn out good enough to release at all. Adding to the confusion, many winemakers had a lot more work to do before their red wines were ready for sale anyway. Significantly Shiraz intake was down due to the large losses that this variety experienced as a result of disease.

History repeating itself, but we have learnt

The pattern of bulk wine inventories listed with our company during the 1st half of 2011 is very similar to the 1st half of 2008, which was a larger than expected vintage following the disastrously short 2007 vintage.

2008 could be described as the last hurrah of Australian wine brand owners before a lot of them gave up, exited unprofitable segments, or sold their businesses. This was a common response when the economics of Australian wine quickly returned to the generally depressing and downward trending state they had been since about 2001. In 2008 vintage, Australian wine brand owners scrambled to secure supply and this caused the price of grapes to skyrocket to beyond what the market was prepared to pay for wine. Only we didn't know it until afterwards, because our habits and decision-making processes were rooted in the outdated assumptions arising from the extraordinary export-led growth of the 1990's. Back in 2008 we believed that the strength of our wine brands could sustain widespread price increases in light of the extraordinarily tight supply circumstances that we suddenly faced due to water scarcity. Today, a lot of those decision makers have gone, and supermarkets become the largest brand owners in our industry. Until the production cycle tightens, and wine consumers, both here and abroad reject substitution of Australian wine with wines from other countries, the supermarkets are in control of our industry. Sadly their business models demand that their investment is in car parks and shelf space, not vineyards and wineries.

Pricing response

Accordingly, the grape price response during the 2011 was much more muted compared to the 2008 vintage. Grape prices did not increase all that much, and many prices paid were still below the costs of grape growing, although higher than 2010. However, both this year and last year, grape prices were still clearly unsustainable for many grape growers, who are the custodians of our precious vineyard resources.

The pricing response for bulk wine can be broadly categorized as follows:

- Inland wineries, now with their large exposures to international bulk wine markets, are creeping their prices upwards, generally in increments of 5 cents per litre, and awaiting signals from buyers. Cautious and sensitive to their buyer's price constraints, wineries are typically dealing with the lack of good wine in 2011 according to the track record of buyers, including shipping and payment punctuality. Wine supply is tightest for buyers whose track record is poorest and less tight for those whose track record is the best.
- On the other hand, dry land wineries appear to be less cognizant of the price sensitivity of their products. They are much more aggressive with their price increases, with increases typically in the vicinity of 50-200 cents per litre. Unfortunately the fundamentals of excessive wine grape production have not changed with the 2011 vintage. My sense is that a lot of dry land wine will remain unsold if producers are too aggressive with their price increases,

because these wines are too expensive to export in any great volume, and their main customers, Australian domiciled brand owners are very careful about over paying. This is because the margins of Australian brand owners have been severely squeezed in recent years, and they recognize the reduced pricing power that their brands can currently command. After all it was only 18 months ago, in January 2010, that the last of the major companies announced a multi-million bulk wine inventory write-off. A little remembered fact from our very recent past.

Evolution of split pricing for varietal wine

A further permutation of the pricing response that deserves discussion is the likely price evolution during the course of 2011.

So far during 2011, listings of wine have been increasing, but so have prices of the good quality varietal wine and these are the batches that are currently selling. As these good wines are sold, their removal from the market will cause prices to continue to edge up, which is likely to create a market opportunity for generic dry white & red, for which there are currently few buyers.

Later this year, I expect pricing for wines of the same region and variety will be more reflective of their quality than they are now. Currently sellers are asking similar prices for wildly different quality levels, and buyers are passing over the poorer quality offerings. As the poorer quality varietal wines fail to sell they will eventually be downgraded to dry white & red - although this process can take 6-18 months, depending on the decision making processes of each individual seller.

In much the same way as sellers are currently asking the same price for poorer wines, it will be tempting for buyers to ask for good varietal quality wine at the dry white/dry red price level. I can't see too many buyers or sellers falling for the respective negotiating tactics used by their counterparts, so it is best for both buyers and sellers to be realistic in their expectations early on: it will save a lot of heartache!

What's up with Chardonnay?

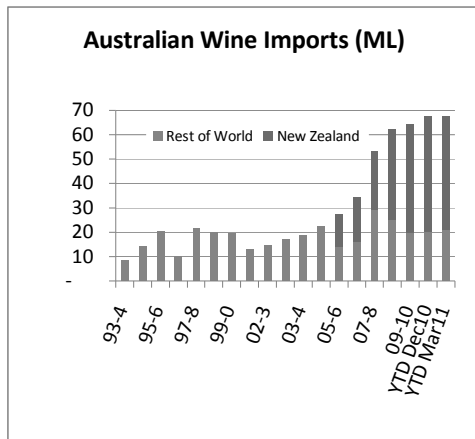
This year, Chardonnay over-the-weighbridge^{iv} returned to its 5-year average of around 400,000 tonnes^v after a decline of over 20% in 2010. We ran out of good quality Chardonnay by late 2010 and prices firmed as a result. After the WFA published its report on the 2011 vintage size in early June, we witnessed an immediate softening of price expectations for Chardonnay. Our Chardonnay inventories are currently quite healthy, as many bulk wine participants prefer to "get out of Chardonnay" as soon as possible, but I think there is a reasonable likelihood that we will again run out of good quality Chardonnay before 2012 stock becomes available.

Marlborough Sauvignon Blanc

An analysis of the fundamentals of Australian Chardonnay is not complete without an analysis of imports from New Zealand. Driven by Marlborough Sauvignon Blanc, the massive growth of New Zealand wine imports, have been the equivalent of an Exocet^{vi} missile to the economics of Australian Chardonnay over the last few years.



Marlborough Sauvignon Blanc is now an established part of the retail offering in Australia after impressive import growth during the last few years. But that growth appears to be slowing, as the chart below illustrates, potentially good news for growers of Australian Chardonnay.



However, the 2011 NZ wine grape crop was very large, at 328,000 tonnes, up 23% on last year.^{vii} So it remains to be seen if this triggers additional market penetration into Australia.

Colombard & Semillon

Colombard and Semillon, both with their usual big crops with big, tight bunches, were particularly susceptible to disease this year. Weighbridge tonnes for both varieties were actually up on 2010 (12% and 4% respectively), but this is not reflected in bulk inventories for both these varieties, which remain very tight. This *could* be a carry over of higher demand for these varieties arising from last year's short 2010 Chardonnay crop until this year's vintage allocations are completed, typically by the end of July.

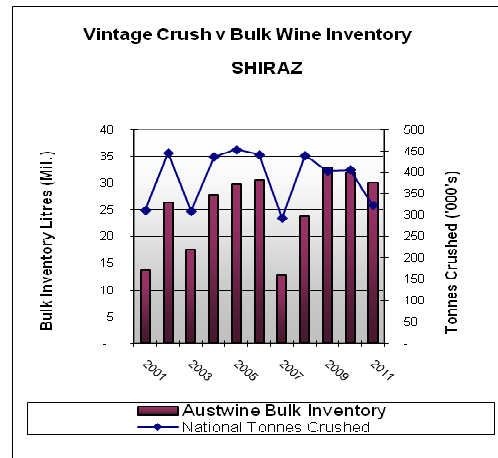
It is unclear what proportion of Colombard and Semillon were sent for concentrate to increase baume of other grapes picked too early. Anecdotally, it appears likely that such tonnages were quite significant.

Shiraz

Shiraz was smashed by disease this vintage. Both crush and inventory are down significantly, as illustrated in the graph below.

Like many 2011 reds, a lot of Shiraz batches are currently hidden from view as winemakers try to fix them up. A lot will be able to salvage beverage quality varietal wine from their current inventory, but a lot will not be able to.

Inland Shiraz prices have been creeping towards A\$1.00 for the last couple of months and now almost all asking prices exceed this level, particularly for the better quality wines.



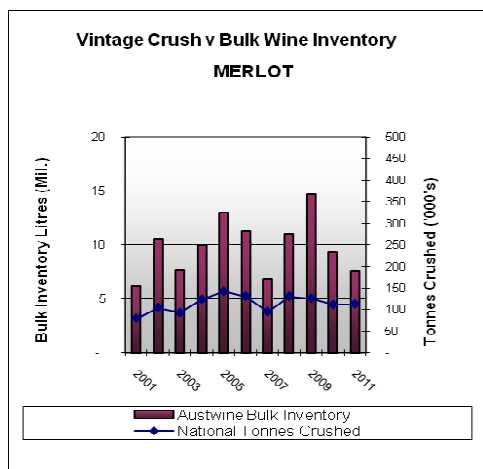
Cabernet Sauvignon

Cabernet Sauvignon fared better this harvest for 2 reasons. It typically has thicker skin than Shiraz and it was not as ripe as Shiraz when the earlier rains fell during harvest, and so avoided some early disease pressure. But as soon as sugar levels increased beyond 10 or 11 Baume, moulds and botrytis also took a significant toll on this variety.

Inventory is very tight and prices now exceed \$1.00 per litre for inland Cabernet Sauvignon. Invariably, there will be parcels released by sellers as the year progresses, but the timing of such releases, together with the quality, volume, and asking prices remains to be seen.

Merlot

Merlot is in clear short supply this season. Significantly, our inventory levels have halved in the last 2 years (see the chart below). Merlot is the one variety that several winemakers have disclosed a demand for immediately following this harvest and competition for this variety is high.



Moscato

Moscato is hot. Inventory is extremely tight and accordingly transactions are few. We expect some sporadic releases of bulk Moscato during the balance of this year as winemakers seek to raise cash in time for grape payments.

There is much resistance to increased asking prices, which is mainly retailer driven. The retailers seem to be asking every man and his 4-legged friend to try and find Moscato at less than \$1.00 per litre. I see that as quite a challenging endeavour in the current tight supply environment.

Moscato is the one variety that we expect significant price increases during the course of this year on current trends: it is indeed a refreshing change to report an increasing price evolution to levels that are profitable to both winemaker and grape grower.

Vineyard Removals, A\$ & 2012 Outlook

What area of vineyards will be removed from production this winter? This is a really tough question and there are no statistics released yet for 2011, just lots of anecdotes and opinions about what may happen. So here is mine:

Despite the bad vintage 1.6m tonnes of grapes were picked, not, say 1.2m or 1.4m tonnes. Yes, a significant proportion were downgraded and sent to for concentrate, which reduced vineyard returns. And, yes, a significant number of growers will be unable or unwilling to fund another crop as another year of terrible economics in the wine industry drags on. Accordingly, it may be that the financial pain felt across the grower community is significant enough to stimulate vineyard removal.

But if, due to the larger than expected 1.6m tonne crop, there is not *widespread and systemic* vineyard removal, then the current industry economics will not change to any significant degree. Unless, of course, wine sales increase significantly, unexpectedly and quickly. Most growers will fight to hang on

to their vineyards if they can, so my sense is that there will probably be insufficient vineyard removals to avoid another difficult year in 2012, all other things being equal.

Furthermore, as a result of the very wet weather, soil moisture levels are higher than they have been for several years. Moreover, this winter looks like having at least average rainfall. It is a long time until next vintage, and many influences are yet to play out, however moist soils and average winter rainfall auger well for a higher than average vine cropping response.

When one looks at the market place and the drivers of price, the A\$ dominates any analysis. This is because ~60% of wine industry sales volumes are now exported. The A\$ is still at very high levels against both the US\$ and the Euro, which remain our two biggest wine markets. Therefore, the current high levels of the A\$ will work against any large stimulation of wine sales.

At best 2012 grape prices *might* be \$25-\$50 per tonne higher than 2011 in the inland irrigate areas. However, on the above analysis, it is presently unclear where the stimulus for such increase in grape prices might come from. Any grape price higher than those experienced in 2011 will invariably keep vines in the ground and so stimulate production.

As a result of all this, we can expect any recovery in both grape prices and bulk wine prices to be a long and tortuously slow process.

Summary

The analysis and discussion above can be neatly summarised into a Baker's dozen of key observations:

1. The 2011 vintage was very wet, leading to large crop losses and significant quality degradation.
2. The 1.6m tonnes crush number is providing a false market signal on the volume of wine available and needs to be adjusted downward for the extra grapes used for concentrate this year, as well as for wine of that is not of beverage quality. Such adjustments, however inaccurate, help explain why bulk wine prices are rising.
3. 10-20% of the 2011 wine grape crop was likely to have been left unpicked.
4. Due to the extremely difficult conditions, wineries temporarily stopped selling bulk wine during the 2011 harvest.
5. Bulk wine inventory listings increased during the 1st half of 2011, in a pattern reminiscent of 2008, as the size of the vintage unfolded.

6. Prices of inland bulk wine are creeping up. But there is currently little differentiation in asking prices for wines of significantly different quality levels, a situation that is likely to change as the year progresses.
 7. Dryland asking prices have risen significantly but are supported by relatively few sales, compared to the volume that is on offer.
 8. Bulk Chardonnay inventory is the longest of the four biggest varieties (being Chardonnay, Shiraz, Cabernet Sauvignon & Merlot). But we may still run out of Chardonnay before 2012 becomes available.
 9. Imports of New Zealand Sauvignon Blanc into the Australian market are now very significant, but growth has slowed, reducing the downward pricing pressure on Chardonnay.
 10. High Colombard & Semillon crush figures are not supported by high bulk wine inventory levels. Supply of both these varieties is currently fairly tight.
 11. Shiraz, Cabernet Sauvignon and Merlot are all in various states of tight supply.
 12. Moscato is hot and supply is very tight.
 13. 2012 vintage promises more of the same due to the likely modest level of vineyard removals, at least average winter rainfall on top of already moist soils and a persistently high Australian dollar.
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About the author:

Jim Moularadellis is Chief Enthusiasm Officer (CEO) of Austwine, Australia's Bulk Wine Specialists. Established in 1993, Austwine celebrates 500 million litres of bulk wine transactions in 2011. 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 has been in the top 25 Fast Movers for South Australia, an index of South Australia's Fastest Growing companies. Jim joined Austwine in 1998, is a Certified Practising Accountant and holds an Honours Degree in Law from the University of Adelaide. He can be contacted on +61 (0)8 8363 5188 or jim.moularadellis@austwine.net.au

References:

ⁱ Summer in temperate part of Australia begins 1 December and ends 28 February.

ⁱⁱ 2011 WFA Crush Report, Winemakers Federation of Australia

ⁱⁱⁱ For example, ABARE estimated 1.53m tonnes in April 2011, which is before harvest finished.

^{iv} I use the term "over-the-weighbridge" since we do not have reliable statistics on the tonnages sent to concentrate for sweetening low baume grapes. See earlier discussion on this topic.

^v 2011: 405,000 tonnes, 5-year average 396,000 tonnes.

^{vi} The Exocet is a French built anti-ship missile whose various versions can be launched from surface vessels, submarines, helicopters and fixed wing aircraft. Hundreds were fired in combat during the 1980s.

^{vii} NZ Winegrowers, June 2011