



*Austwine's*

# AUSTRALIAN BULK WINE MARKET UPDATE

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A Paradigm Shift in Fundamentals or just a  
Manic Depressive Market ?

# Executive Summary

## “ A Paradigm Shift in Fundamentals ?

“ During the last 2-3 years, the Australian Wine Industry has experienced two fundamental changes, both of which are likely to stimulate demand for Australian wine, as follows:

1. A significant fall in the A\$ against currencies of key wine export markets.
2. Three Free Trade Agreements have been signed by Australia, together with the very recent successful conclusion of negotiations on the Trans-Pacific Partnership.

## “ Or a Manic Depressive Market?

“ There is a very mixed outlook for Vintage 2016:

1. Bulk wine inventories have been growing for red wine, but falling for white wine.
2. Water is expensive and the weather outlook very dry, increasing the likelihood of smaller yields.
3. Grower sentiment is poor, vineyard inputs minimal due to recent low grape prices, but those closest to the final consumer are optimistic.

# Contents

## ” Fundamentals:

- ” No. 1      Exchange Rates
- ” No. 2      Free Trade Agreements

## ” Manic Depressants:

- ” Bulk Wine Inventories
- ” A Word about Water
- ” Grape Grower Sentiment
- ” Outlook for Vintage 2016

# Fundamental No.1

## - Exchange Rates

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Widespread falls in A\$ against the currencies of the top 5 markets for Australian wine.

# A\$ against US Dollar



“ 40% fall in 4 years in the AUD against the US Dollar, from US\$1.10 to US\$0.70

“ The US is the No. 1 market by value for Australian wine.

## A\$ against UK £



“ 35% fall in 2 years in the AUD against the UK£ from ~£0.70 to £0.45

“ The UK is the No. 2 market by value for Australian wine.

# A\$ against Chinese ¥



” **35% fall in 4 years** in the AUD against the Yuan from ¥7.00 to ¥4.50

” China is the No. 3 market by value for Australian wine.

# A\$ against Canadian Dollar



“ 10% fall in ~1 year in the AUD against the CAD from near C\$1.05 to C\$0.95

“ Canada is the No. 4 market by value for Australian wine.



# A\$ against Euro



“ 30% fall in 3 years in the AUD against the Euro from ” 0.85 to just above ” 0.60.

“ Combined, Eurozone countries are the No. 5 market by value for Australian wine.

# Market Fundamental No.2

## - Free Trade Agreements

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In recent times, Australia has signed 3 key FTAs in very quick succession with:

- " China
- " Japan
- " South Korea

Also, very recently, negotiations concluded successfully for the Trans-Pacific Partnership, which Australia is a party to.

# China



- “ China-Australia FTA signed 17 June 2015.
- “ Key Outcomes for Wine:
  - “ Tariffs of 14 - 20 per cent on wine will be eliminated within 4 years.
- “ Current Value of Exports:
  - “ Australian wine exports to China are currently worth \$280m.
- “ China already has FTAs in place with:
  - “ Chile (2005)
  - “ New Zealand (2008)

# Japan



- “ Japan-Australia Economic Partnership Agreement, in force from 1 January 2015.
- “ Key Outcomes for Wine:
  - “ Tariffs on bulk wine eliminated immediately.
  - “ Tariffs on bottled wine will be eliminated over 7 years.
- “ Current Value of Exports:
  - “ Australian wine exports to Japan are currently worth \$44m.
- “ Japan already has FTAs in place with:
  - “ Chile (2006)

# South Korea



- “ The Korea-Australia Free Trade Agreement came into force on 12 December 2014.
- “ Key Outcomes for Wine:
  - “ Korea eliminated its 15 per cent tariff on Australian wine immediately.
- “ Current Value of Exports:
  - “ Australian wine exports to South Korea are currently worth \$10m.
- “ South Korea already has FTAs in place with:
  - “ Chile (2004)
  - “ EU (2011)
  - “ US (2012)

# Trans-Pacific Partnership



- “ The 12 parties to the TTP negotiations reached an accord during early October 2015.
- “ Key Outcomes for Wine:
  - “ Large wine markets (Canada), small tariffs eliminated.
  - “ Small wine markets, large tariffs eliminated.
- “ Australia already has FTAs with a number of the TTP parties.
- “ The TTP will eliminate any remaining tariffs on wine between member countries.
- “ The elimination of tariffs will occur over a number of years, as follows:
 

Market	Export Value	Current Tariff
Canada	\$182m	1.87, 4.68c/Litre
Malaysia	\$42m	Various
Vietnam	\$9.3m	Up to 54%
Peru	\$6.1m	9%
Mexico	\$0.8m	20%
- “ Parties:
  - “ Australia, US, New Zealand, Canada, Mexico, Chile, Peru, Japan, Singapore, Malaysia, Brunei Darussalam and Vietnam.



# Bulk Wine Inventories

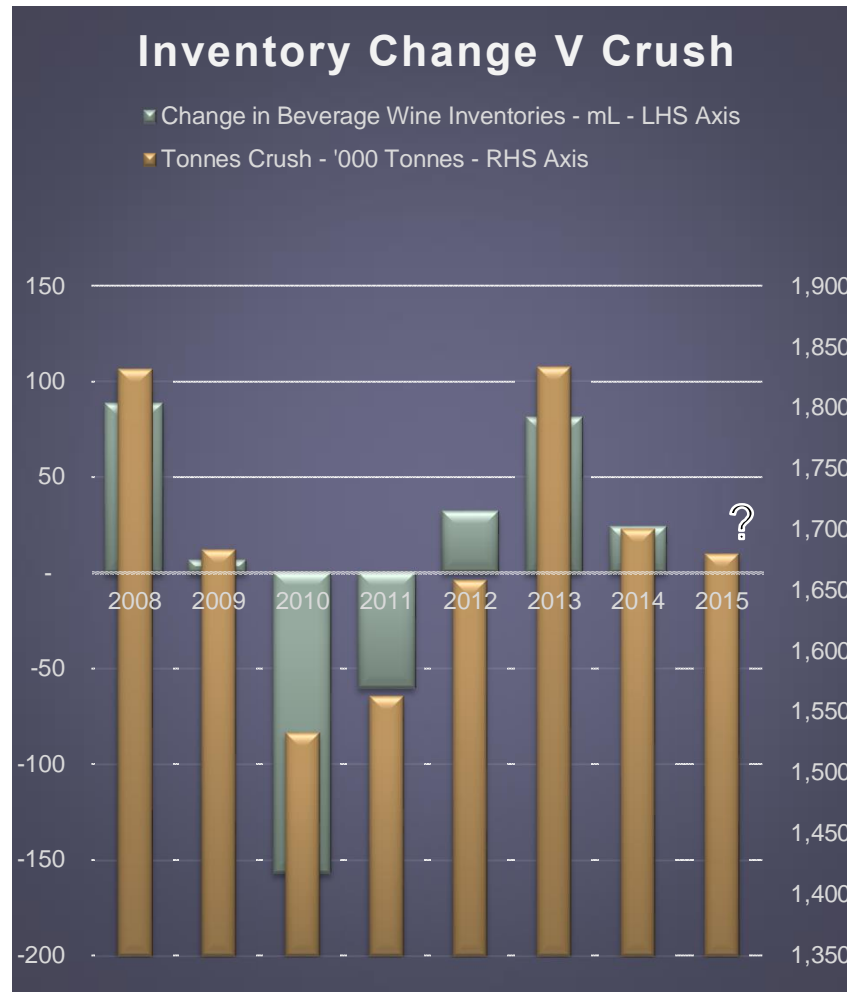
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Inventory Change v Crush

Top 4 Varieties

Stock to Sales Ratio

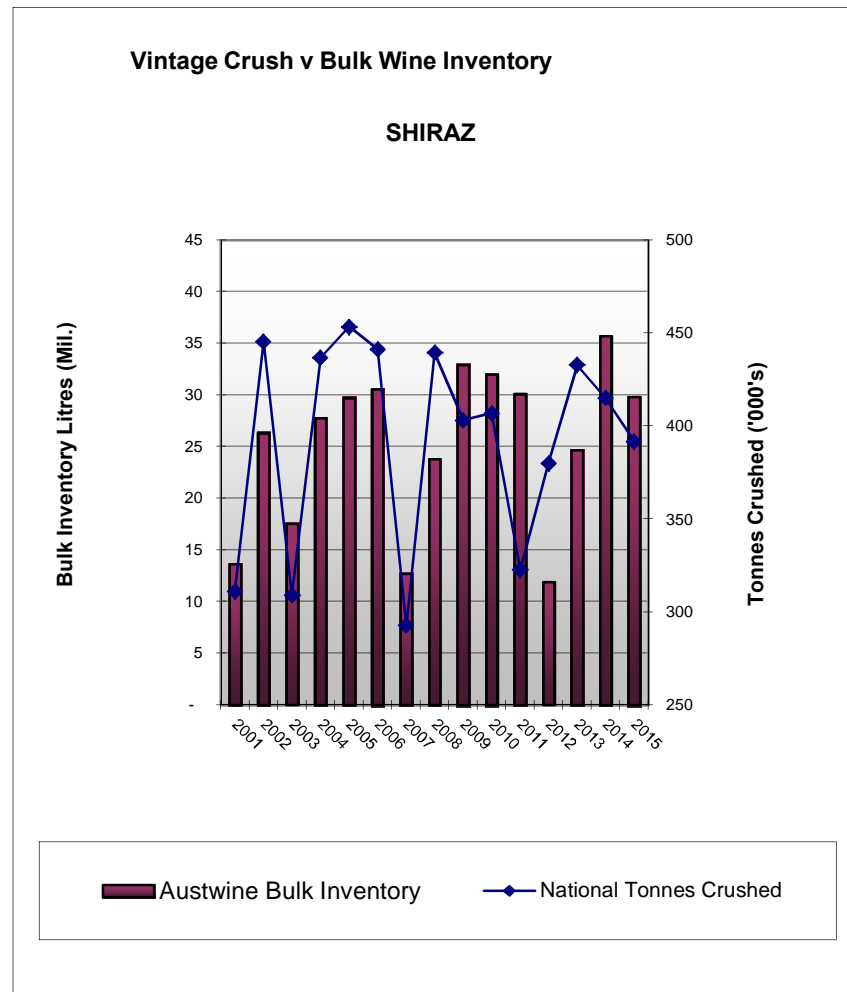
# Inventory Change v Crush



- Historically, for most of the past decade, an average Australian wine grape crush has been ~1.65mT.
- It can be seen from the graph opposite that:
  - Vintages above ~1.65mT were generally considered too big, since they led to inventory **increases**.
  - Vintages below ~1.65mT were generally considered too small, since they led to inventory **decreases**.
- Following the Paradigm Shift in Fundamentals detailed above, which is likely to stimulate demand for Australian wine, is an average crop of 1.65mT enough?
- Time to stop advocating vineyard removals?

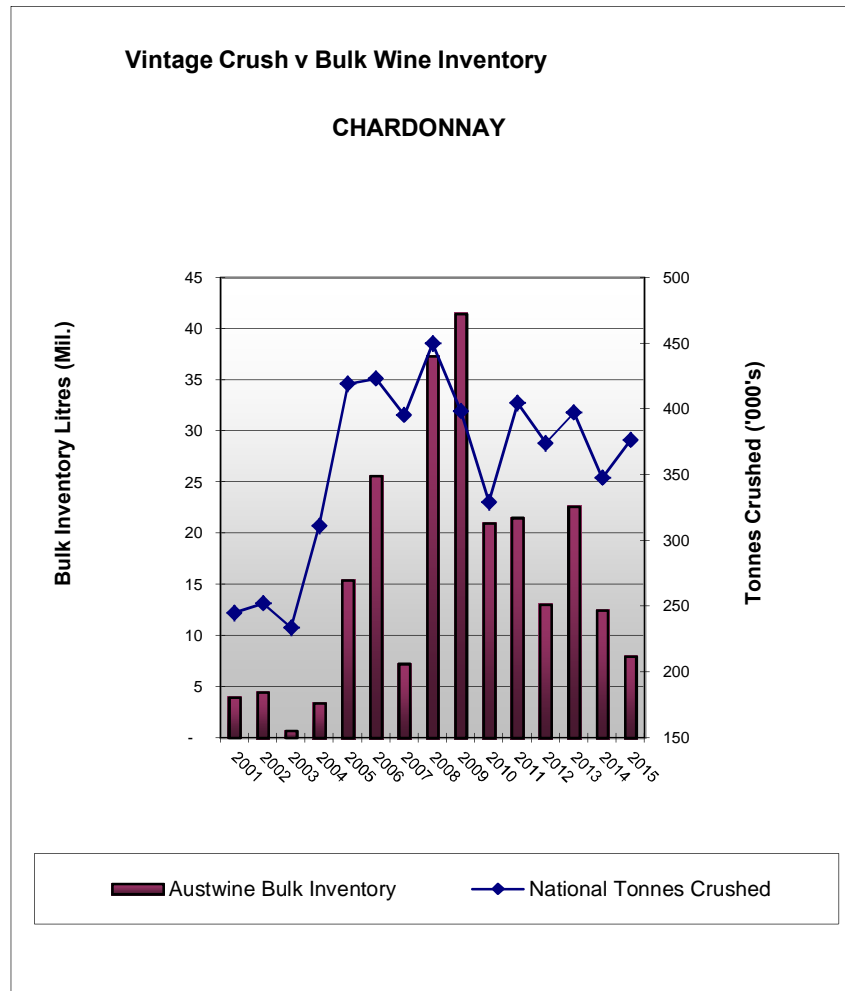


# Top 4 Varieties - Shiraz



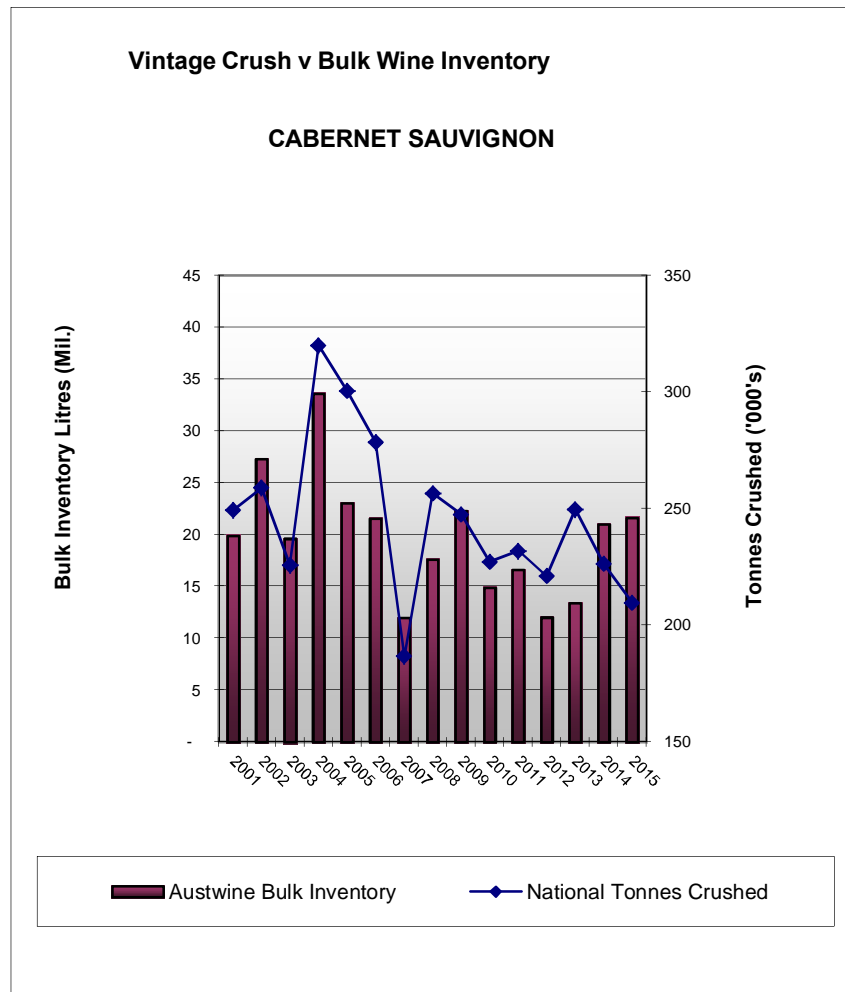
- " Shiraz is the largest red variety grown in Australia, with annual production usually between 400-450,000t.
- " Except in drought years, such as 2001, 2003 & 2007, where berry shrivel can lead to significant yield reduction.
- " 2011 was short due to crop losses arising from rot due to heavy rain during vintage.
- " Inventories listed on Austwine's book have been building since 2011: wineries tended to take Shiraz preferentially since as a red wine it enjoys a longer selling window (of up to 18 months) and is a classic Australian variety.
- " Inventories peaked in 2014 due to behaviour described in previous point, with 2015 intake down due to rising inventory levels.
- " Currently, there is pretty good supply of Shiraz bulk wine from most areas, with a deep market existing of lots of buyers also.
- " ***If current very strong El Niño conditions persist and lead to drought conditions, (see below), then the possibility exists for a much lower 2016 Shiraz crop.***
- " ***If history is any guide this could be in the order of 25-30% lower in 2016, than otherwise would be the case.***

# Top 4 Varieties - Chardonnay



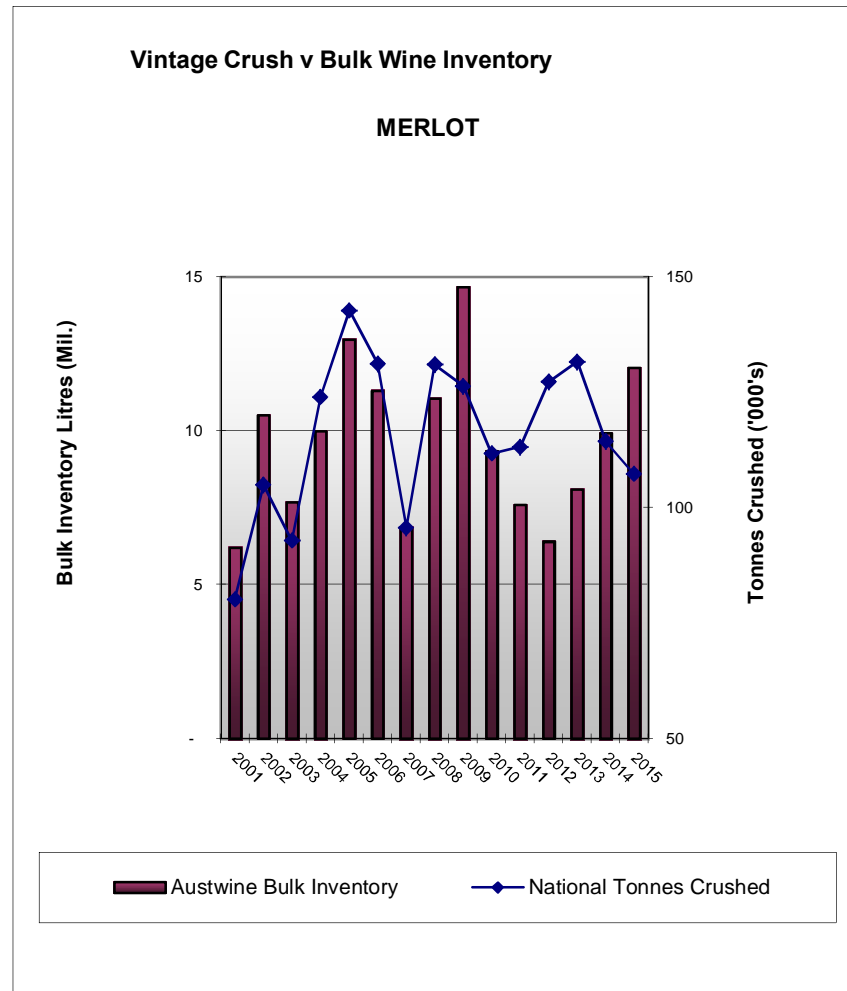
- " Chardonnay is the largest white variety grown in Australia, usually between 350-400,000t per annum.
- " Tonnes crushed have been gradually falling for the best part of a decade, as supply exceeded demand in most years leading to low prices.
- " Bulk inventories ballooned in 2008 and 2009, leading to smaller subsequent crush sizes in 2009 and 2010. Inventories then fell accordingly.
- " An average crush 2013 led to significantly much higher inventories as a result of high grape prices and a high A\$. Grape prices in 2014 were generally lower as wineries avoided Chardonnay, which usually has a short 6-9 month selling window.
- " Quite a significant fall in inventory listed on Austwine's inventory book has occurred from 2013, as a result of lower wine prices stimulating new demand.
- " Low Chardonnay inventory tends to lead to increased demand for blenders such as Colombard, Semillon and other Dry Whites.
- " ***Chardonnay inventory levels have not been at current levels since the 2007 drought.***

# Top 4 Varieties - Cabernet Sauvignon



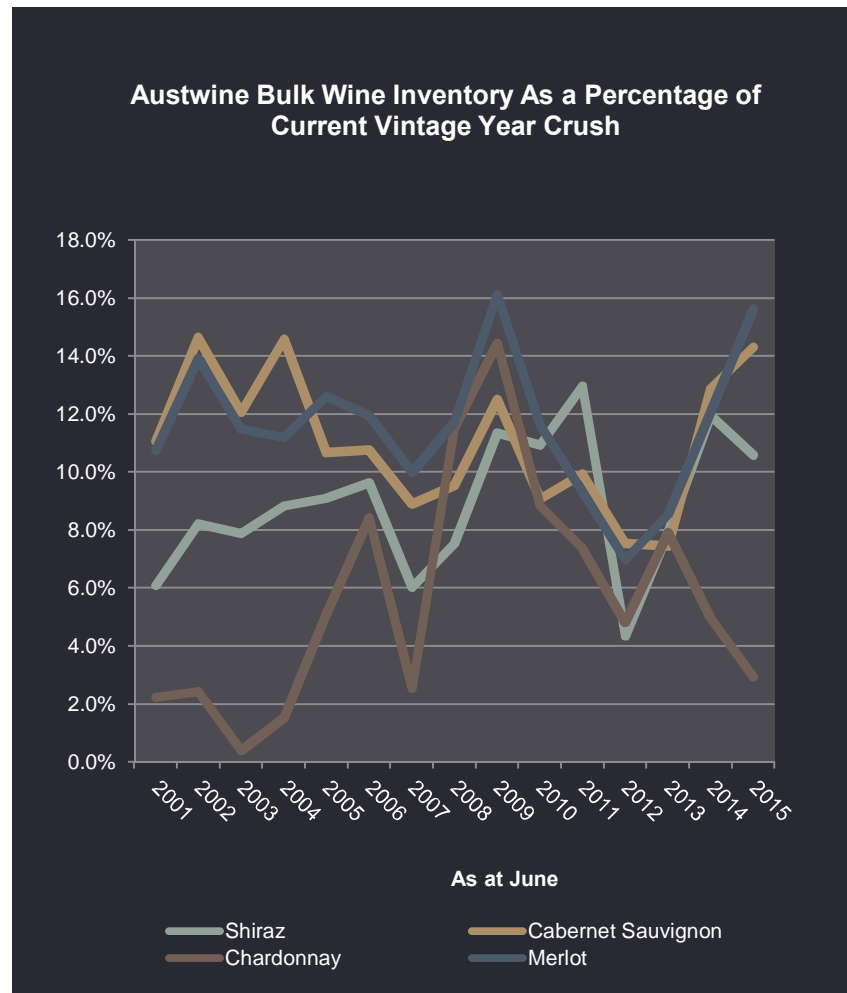
- " Cabernet Sauvignon is the 2<sup>nd</sup> most planted red variety in Australia.
- " Production has fallen by about 1/3 to 200,000t, from its peak in 2004.
- " Production tends not to be as volatile as Shiraz in response to drought or rain, but extreme drought events, such as 2007, can cause production of Cabernet Sauvignon to drop significantly also.
- " Currently, there is reasonable supply of bulk Cabernet Sauvignon, depending on region. SEA is relatively scarce.
- " Australian Cabernet Sauvignon has generally not been able to effectively compete in export markets with Cabernet Sauvignon from other New World countries, especially Chile.
- " Inventory listed on Austwine's book is up since the large 2013 crop and are currently steady.
- " ***If current very strong El Niño conditions persist a smaller crop in 2016 would shrink current bulk inventories.***

# Top 4 Varieties - Merlot



- " Merlot is the No. 3 red variety in Australia, with current production just above 100,000t.
- " Poor fundamentals: Production has been falling for 3 years, but inventory listed on Austwine book continues to rise.
- " Merlot is pretty unloved at the moment.
- " Merlot is in a similar situation as Chardonnay was until 2-3 years ago.
- " Much Merlot will end up as Dry Red or blending wine.
- " Australian Merlot can display generous ripe characters, that consumers expect from Australia.
- " ***A good opportunity for new markets to be established using current abundant supply of Australian Merlot.***

# Top 4 Varieties - Summary



“ This chart summarises the previous 4 charts.

“ ***Over the past 2-3 years, inventory of Shiraz, Cabernet & Merlot listed on Austwine’s book are up.***

“ ***Over the past 2-3 years, inventory of Chardonnay listed on Austwine’s book is down.***



# Stock To Sales Ratio

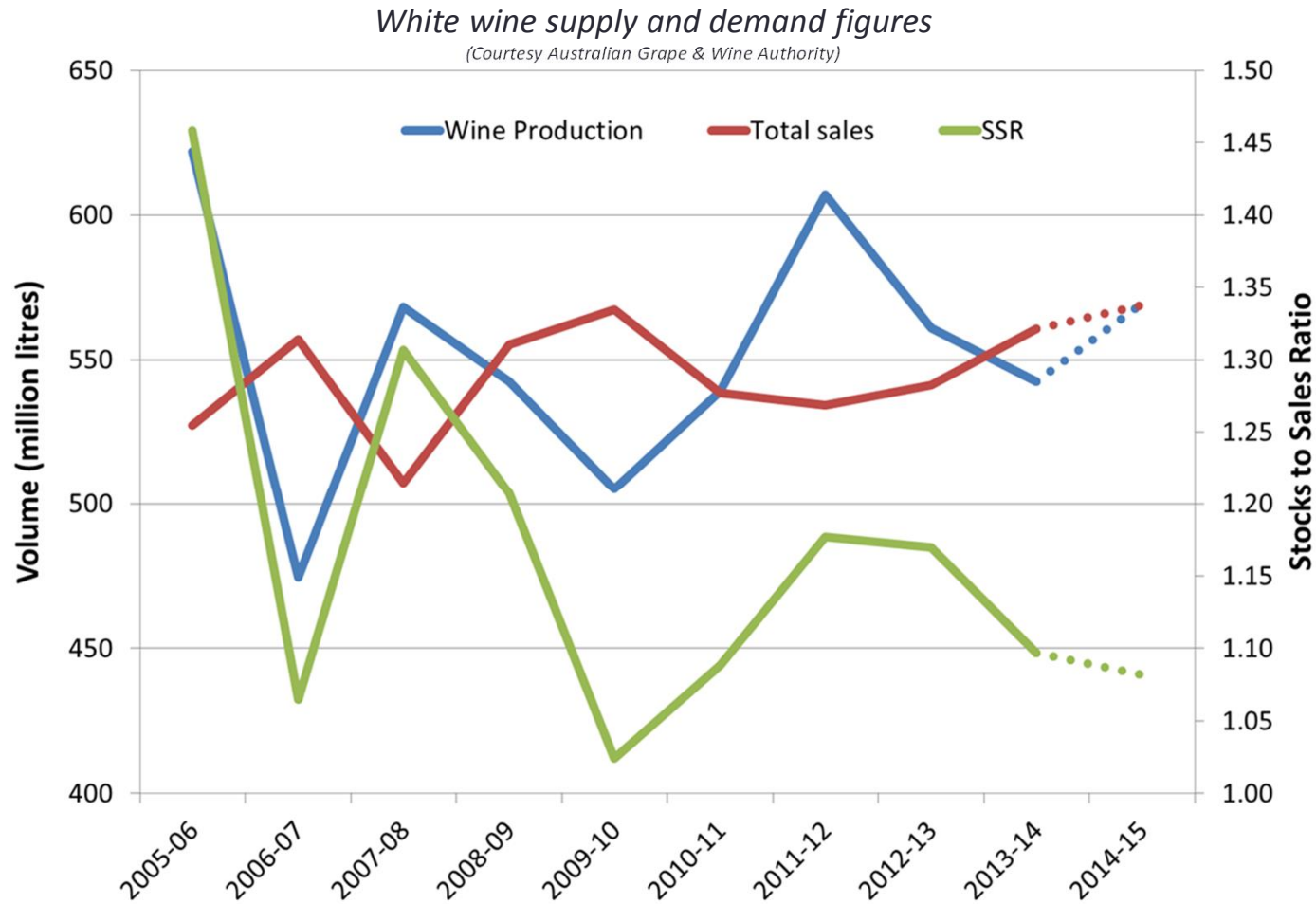
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An overview of Total Industry Inventory

Graphs courtesy Australian Grape & Wine Authority

# Overview . All white varieties

## Wine stock to sales ratio is declining

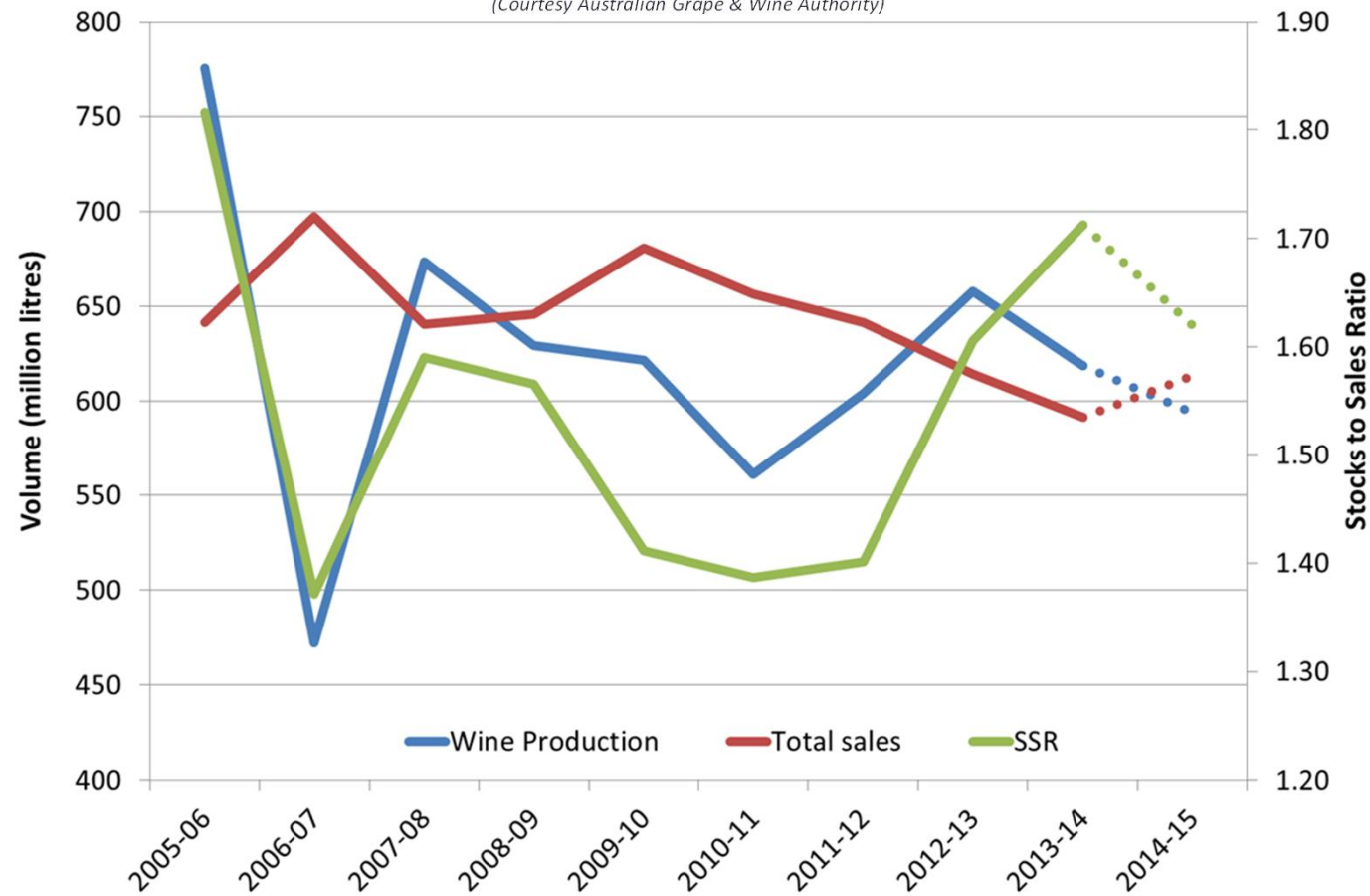


# Overview . All red varieties

## Wine stock to sales is increasing

Red wine supply and demand figures

(Courtesy Australian Grape & Wine Authority)







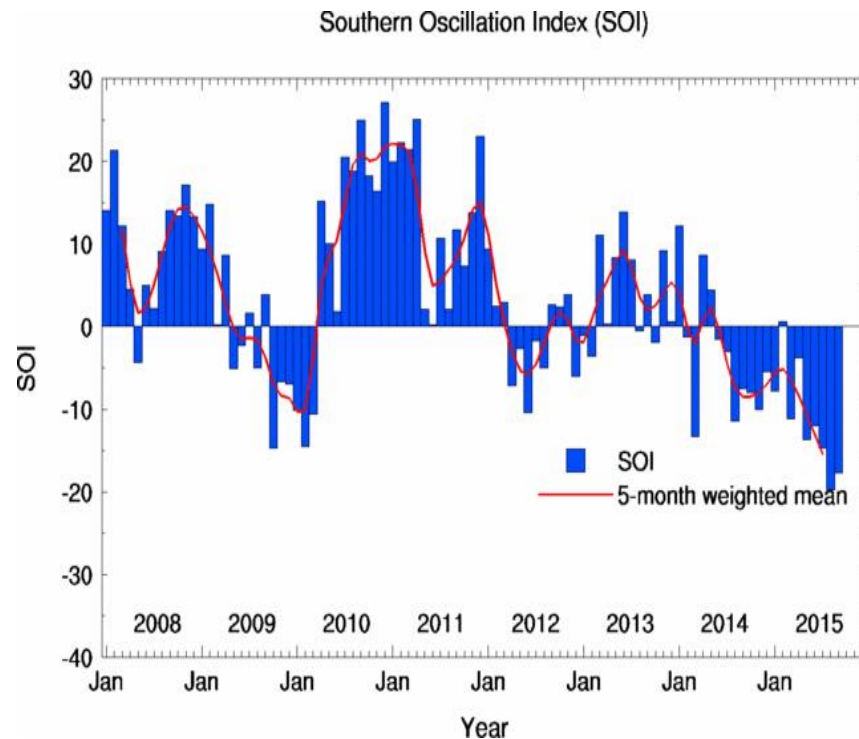
# Water

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El Niño

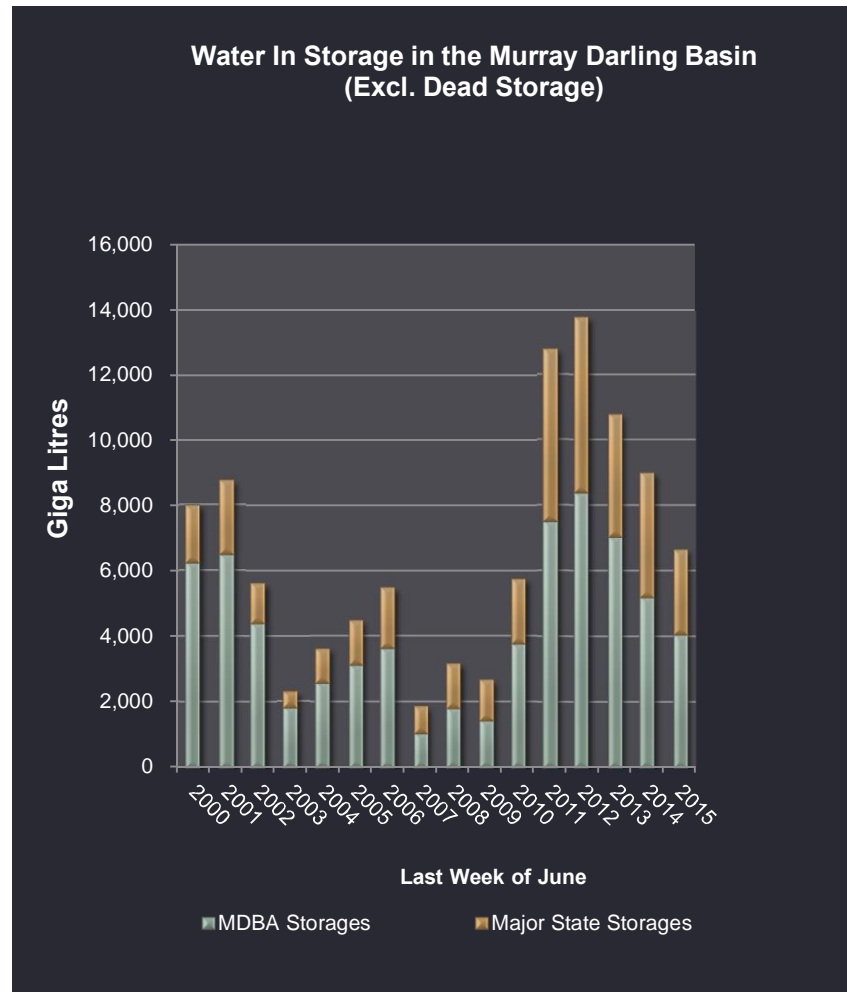
Water in Storage

# A word about Water . El Niño



- “ The chart opposite plots the Southern Oscillation Index, which can predict likely weather conditions in South Eastern Australia.
- “ Sustained *negative* values of the SOI of below 8 often indicate El Niño episodes, which usually means less rain in South East Australia.
- “ Current values are in the vicinity of -20.
- “ ***This indicates a very strong El Niño pattern, leading to very dry and potential very hot conditions in South Eastern Australia.***

# A word about Water . Water in Storage



- “ The chart opposite shows that water scarcity is emerging in Murray Darling Basin, with a hot dry summer predicted due to El Niño effect.
- “ There is probably enough water for grapes, but the price of temporary water has doubled since last year, and is still rising.
- “ Some growers with permanent water are better off leasing water and abandoning/mothballing their vineyards.
- “ Current temporary water price is \$200+ per megalitre.
- “ At 5mL/Ha and 20t/Ha for SE Australian wine =
  - “ ***\$50 per tonne or 7 cents per litre or 60 cents per case, just for water.***



# Grape Grower Sentiment

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Not much enthusiasm out there ã .

# Grape Grower Sentiment

- “ Most regions (except perhaps Barossa, Tasmania & McLaren Vale) have experienced very poor profitability during the last couple of years, on top of declining grape prices for ***many of the past 15 years.***
- “ Generally, due to recent low grape prices, there is very little enthusiasm about growing grapes in most regions.
- “ Many growers are reaching financial exhaustion.
- “ Larger growers are hanging in there taking losses or switching crops.

# Grape Grower Sentiment

- “ Smaller growers continue to exit grape growing and vineyards are not being farmed for 2016 (possibly up to 5% of vineyard area that are not farmed or crop use changed).
- “ Vineyards that do remain in production in unprofitable areas will tend to have fewer inputs, including water, tending to lead to lower crop levels.
- “ It is still very early in the growing season:
  - “ Frost,
  - “ Fruit set, and
  - “ Disease pressure from more limited spraying inputs.
- “ All these risks are yet to be played out.
- “ Otherwise, apart from the expected very dry conditions, so far the growing season has been generally quite ideal!



# Vintage 2016 Outlook

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A summary, and more.

# Outlook for Vintage 2016

- “ Fundamental No. 1            Exchange Rates
  - “ Significant improvements in competitiveness as the A\$ is the lowest against ALL the currencies in its top 5 markets against peaks during the past 5 years:
    - “ US\$                    Down 40% in 4 years
    - “ UK                     Down 35% in 2 years
    - “ Yuan                  Down 35% in 4 years
    - “ C\$                     Down 10% in 1 year
    - “ ”                        Down 30% in 3 years
  
- “ Fundamental No. 2            Free Trade Agreements & TTP
  - “ Significant improvements in competitiveness through reduced tariffs in emerging markets of China (currently 3<sup>rd</sup> largest market for Australian wine), Japan & South Korea, together with further tariff reductions under the TTP, especially the Number 4 market for Australian wine, Canada.
  
- “ The vast improvement in the fundamentals of exchange rates, FTAs & TTP during the past year will work its way through the industry and participants will adjust to what is perhaps a new paradigm.
  
- “ Could this finally signal the end of the current 15 year bear market for Australian wine?



# Outlook for Vintage 2016, contq

## “ Bulk Wine Inventory

### “ Red:

- “ Reasonably abundant inventories of Bulk Red Wine, Shiraz, Cabernet Sauvignon & Merlot and Dry Red.
- “ Increasing overall red stock to sales ratio.

### “ White:

- “ Quite tight inventories of Bulk White Wine, with Chardonnay reasonably scarce, leading to increasing scarcity of blenders such as Colombard, Semillon.
- “ Very tight inventories of other whites, such as Sauvignon Blanc and Pinot Gris.
- “ Decreasing overall white stock to sales ratio.

# Outlook for Vintage 2016, contq

## “ Water

- “ El Niño pattern very strong, leading to increased likelihood of very dry conditions.
- “ Temporary water is currently trading at \$200/mL. This is \$50/t, 7c per litre or 60c per case, a significant impost.

## “ Grower Sentiment

- “ Generally poor, arising from low grape prices (some regions excepted) leading to reduced grower inputs, vineyard mothballing, abandonment or crop change, leading to smaller crops.
- “ Quite good growing conditions so far this growing season (but very early).
- “ Dry conditions could also see constrained crop levels. Historically, Shiraz seems to be the most susceptible to drought conditions.

## “ Market sentiment

- “ Split somewhere between manic and depressive, depending on how close the business is to the final wine consumer and their current inventory position:
  - “ Those closest to the consumer or those lightest in inventory are quite enthusiastic (perhaps manic).
  - “ Those furthest from the consumer or still heavy with inventory are quite despondent (perhaps depressive).



The End

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