

2009 post-vintage bulk wine review



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Australian Wine Business presents an exclusive analysis of the 2009 vintage and the resultant likely outcomes for the bulk wine market.

2009 vintage overview

1.706 million tonnes is the latest estimate¹ of the 2009 Australian winegrape crush, down 125,000 tonnes or 7% from 2008 (1.831 million tonnes), but up 76,000 tonnes (4%) on a mid-vintage estimate² of 1.63 million tonnes.

For most of the summer, generally benign ripening conditions prevailed across South-Eastern Australia until a significant heatwave occurred during the last week of January and first week of February. This culminated in extreme weather conditions and wildfires on 7 February 2009³. But despite the widespread wine press coverage suggesting otherwise, the impact of these fires on the national winegrape crush was in actual fact, fairly immaterial.

Of significant impact was the two-week heatwave immediately preceding 7 February, which reduced the size of the Australian winegrape crop. Table 1 presents selected weather data in major grapegrowing locations, with extreme observations marked in red:

- Anecdotaly, the impact of the two-week heatwave included:
 - fewer grapes left unpicked than otherwise would have been, particularly in the warm inland regions⁴ such as Renmark, Mildura and Griffith, as winemakers considered topping-up their intakes due to losses from the heatwave. Other winemakers chose to allow nature to reduce their planned intakes and it has been reported⁵ that up to 30,000 tonnes of winegrapes were left unharvested in the Murray Darling and Swan Hill regions during 2009
 - greater losses of grapes in the cool climates regions than the warmer inland regions. This was probably due to a higher proportion of fruit exposed to direct sunlight in the cooler climate regions, leading to greater sunburn damage during the days of intense heat. Furthermore, the irrigation infrastructure in cooler climate regions was generally less able to deliver sufficient water to vines at the critical times
 - much less adverse impact on the flavour on the surviving grapes than last year's heatwave, since this year's extended heatwave occurred two months earlier, and grape berries were less mature and so slightly less vulnerable to flavour damage.

Table 1.

2009 Vintage Weather	Mt Barker, WA	Nuriootpa, SA	Padthaway, SA	Renmark, SA	Mildura, Vic	Griffith, NSW	Cessnock, NSW
Rainfall: Jan – Apr 09 (mm)	91	81	83	36	46	50	409
No of Days > 35°C: Jan-Feb 09	5	15	10	27	24	27	17
Mean January Temp (°C)	26.5	32.1	30.3	35.6	35.3	36.0	32.1
Hottest February Day (Date, °C)	2 Feb, 38.5	7 Feb, 43.9	7 Feb, 42.9	7 Feb, 48.2	7 Feb, 46.7	7 Feb, 45.2	7 Feb, 40.6

I have now had the opportunity to taste quite a number of wines from the 2009 harvest, particularly from the warm inland regions, and have been left generally well impressed with wine quality.

Crush v bulk inventory: Crush down, bulk wine inventory up. Why?

With the 2009 crush down 7% on 2008, it would be reasonable to expect that bulk inventory would also be down. But from the data presented in Figure 1, which plots Austwine's bulk wine inventory as a percentage of current vintage crush, it can be seen that inventory across each of the four major varieties actually increased. Why is this so?

Some potential reasons could include the strong growth in imported wine volumes now penetrating the Australian domestic market displacing local wines (in particular, see the discussion that follows on NZ Sauvignon Blanc). There has also been a reduction in wine export volumes, from a record 798 million litres for the year-ending June 2007, to 750 million litres for the year-ending June 2009.⁶

The good news is that 2008 was the only year during the last dozen years where Australia recorded negative growth in wine

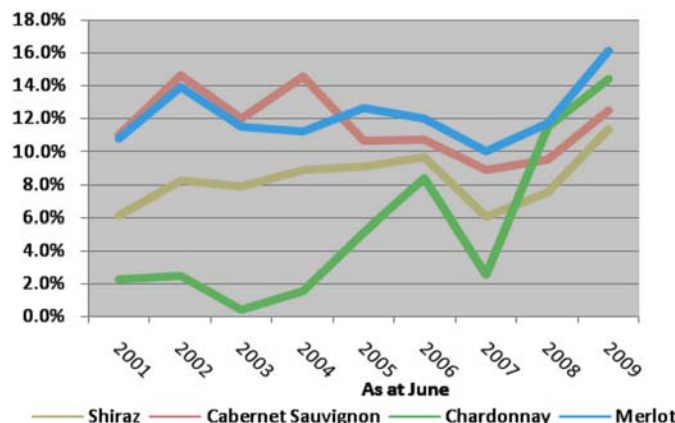


Fig. 1. Austwine bulk wine inventory as a percentage of current vintage crush.

bulk wine

export volumes. Volume growth resumed in 2009, albeit at lower FOB prices. Worryingly, however, the year-ending June 2009, was the second consecutive year of negative value growth for Australian wine exports during the last 15 years. But this may have something to do with the increased level of bulk shipments for major brand owners bottling closer to destination markets (see discussion to follow on the composition of bulk shipments).

Henry Tax Review

In addition to the factors detailed above, my general sense is the increase in bulk wine inventory in the face of a 7% smaller crush this year may have something to do with generally negative market sentiment and uncertainty associated with the Henry Tax Review⁷. Currently, wine attracts a wholesale tax that is calculated on its value, although more than 90% of wineries are small enough to be exempt. There is speculation the tax may be changed to be calculated on the volume of alcohol, or that small wineries will no longer be exempt, or both, or that the current rate of tax (29%) might be increased.

Of course, nobody knows what the Review will recommend when it reports in December this year, or what the Government may choose to implement at any time after that. The possibility of measures that may significantly increase the tax burden on the wine industry and hence dampen domestic wine demand, has created uncertainty. So wineries appear to have fewer compelling reasons to hold bulk wine inventories in reserve.

Finally, but not insignificantly, wineries may also expect grapes to be equally cheap and abundant in 2010. This may go some way to explaining why our bulk listings across all four major varieties are increasing in sympathy with each other. Wineries are choosing to list any surpluses on the bulk market, and relying on spot bulk purchases to top-up, if and when required, rather than holding onto stock.

So does this mean there is plenty of bulk wine around for both domestic and export buyers? Yes, but there is a trap in the data, particularly for export buyers! Here it is: We have an abundance of bulk inventory from cooler climates, which certainly eclipses the current market opportunity. Such wines are generally in parcels too small to export as bulk, except perhaps a container or two at a time. Furthermore, with asking prices at over twice the average export price, they are generally too expensive for bulk export in any volume (Table 2). Therefore, these wines will probably find themselves in a long queue of excellent blend enhancers available to domestic buyers.

Table 2.

Bulk wine inventory profile ⁸ vs average bulk export FOB price ⁹	Cooler climate regions	Warm inland regions	All data
Average parcel size (litres – Austwine data)	41,000	280,000	100,000
Average asking price (A\$/litre – Austwine data)	2.93	1.37	2.52
Average bulk export FOB price (A\$/litre – AWBC data)			1.12

The inventory position of each of the four major varieties: Shiraz, Cabernet Sauvignon, Merlot and Chardonnay.

National tonnes of Shiraz crushed fell 8%, but bulk inventory rose 38%, the highest rise in inventory of the four major varieties (Figure 2). It can be seen that inventory has been rising over the past two years after the 2007 drought, despite tonnes crushed trending downwards during the past five years. For the four or five years prior to 2009, the supply position of

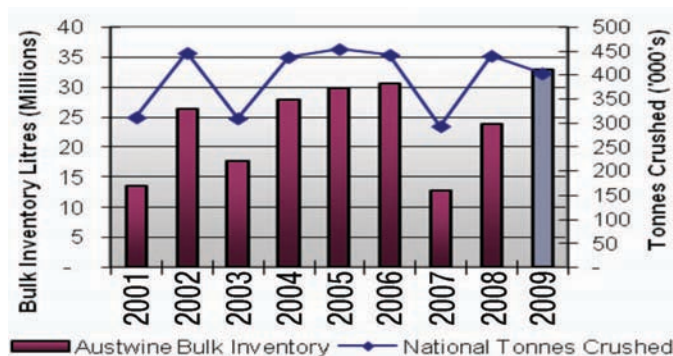


Fig. 2. Vintage crush vs bulk wine inventory: Shiraz

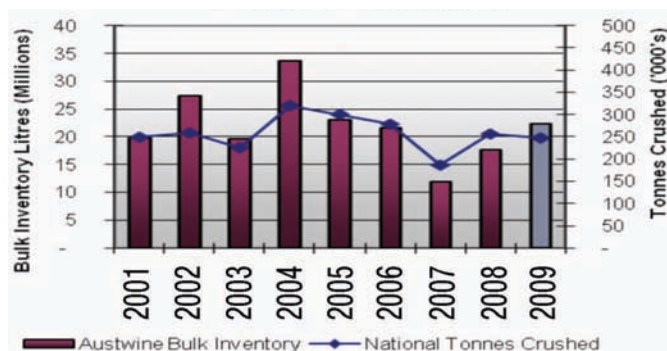


Fig. 3. Vintage crush vs bulk wine inventory: Cabernet Sauvignon

Shiraz was shorter than Cabernet Sauvignon, but this year market sentiment indicates this situation may be reversed. Spot domestic prices (typically, ex-works, single immediate shipment, not bottle ready, with 30-day payment) for current vintage commercial quality warm inland Shiraz range from \$0.85-\$1.10 per litre.

National tonnes of Cabernet Sauvignon crushed fell 4%, but bulk inventory rose 26% (Figure 3). The trend is similar to Shiraz, although less pronounced. Cabernet Sauvignon inventory has been rising during the past two years despite tonnes crushed trending downwards over the past six years. Industry inventories of this variety are probably the shortest of the three major red varieties, and sellers are typically requesting a small premium in the asking price for Cabernet Sauvignon – somewhere in the order of 10 cents per litre above Shiraz and Merlot. Whether this can be achieved is yet to be seen, as inventory levels can be viewed as rebuilding to the more usual levels of the past several years. Spot domestic prices¹⁰ for current vintage commercial quality warm inland Cabernet Sauvignon range from \$0.95-\$1.15 per litre.

National tonnes of Merlot crushed also fell 4%, but bulk inventory rose 33% (Figure 4). The national crush of Merlot has

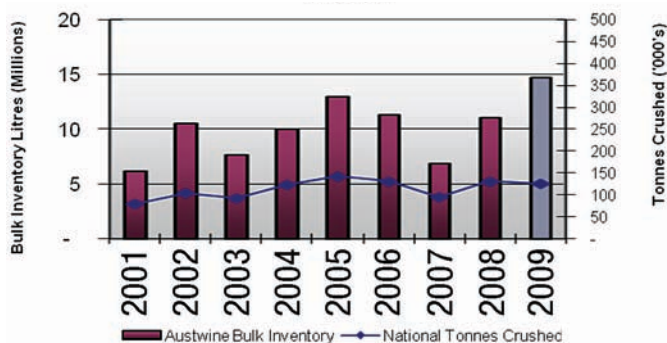


Fig. 4. Vintage crush vs bulk wine inventory: Merlot

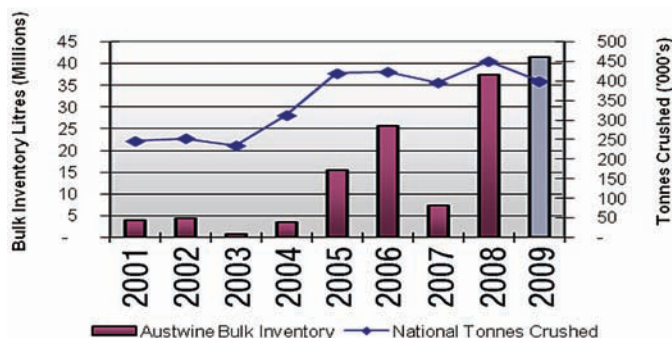


Fig. 5. Vintage crush vs bulk wine inventory: Chardonnay

been pretty static over the past five years, at between 120,000 to 140,000 tonnes, and bulk wine inventories appear to have been rebuilding over the last couple of years following the 2007 drought. Spot domestic prices¹¹ for current vintage commercial quality warm inland Merlot range from \$0.85-\$1.10 per litre.

National tonnes of Chardonnay crushed fell 11%, the greatest fall of the four major varieties, but bulk inventory rose 11% (Figure 5). Although this year's inventory increase is relatively modest compared with the three main red varieties, inventories have been building for several years and Chardonnay is now quite long. This is reflected in the spot domestic prices¹² for current vintage commercial quality warm inland Chardonnay which range from \$0.60-\$0.80 per litre.

Impact of imports of New Zealand Sauvignon Blanc on Chardonnay

In the 12 months to April 2009, total wine imports¹³ into Australia were 62 million litres or nearly 15% of total Australian domestic wine sales of around 431 million litres¹⁴. About 35 million litres, or over half the current volume imported, originates from New Zealand. Astonishingly, this is more than all Australian wine imports just two years ago, which then stood at 34 million litres¹⁵. The rapid growth of New Zealand (Sauvignon Blanc) is illustrated in Figure 6, with total imports from New Zealand shown separately for the last four years.

Total wine imports have almost tripled from 22 million litres four years ago to 62 million litres now. That is an extra 40 million litres. Or, looking at it another way, that is equal to an extra 55,000 tonnes of local grapes, perhaps mostly represented by Chardonnay, (as well as local Semillon, Sauvignon Blanc and Riesling) that has been displaced in the domestic marketplace. At an average yield of 11 tonnes per hectare¹⁶, that's about 5000ha of vineyard now looking for a home, an area almost half the size of all of Western Australia's vineyards.

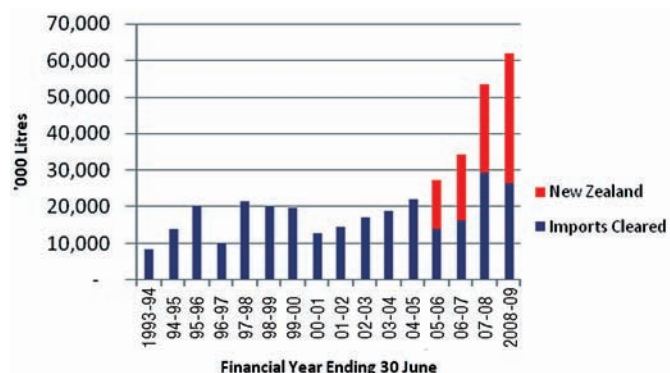


Fig. 6. Australian wine imports showing New Zealand's share of all imports in the last four years.

So the rapid growth in imports of recent years may partly explain the rapid increase in Chardonnay inventory during the past four years, despite Chardonnay production remaining relatively static in the 400,000-450,000 tonne range during that time (excepting the drought-constrained 2007 vintage).

Composition of bulk wine shipments

For the year to 30 June 2009, Australian wine exports were 750 million litres, up 41 million litres for the year, but down from the peak of 798 million litres a year earlier.

Bulk wine exports increased by 100 million litres to 255 million litres for the year, and now represent one-third of all export volumes. This looks like a very big share that bulk shipments have achieved in a very short time but, again, there is a trap in the data! Here it is: There is an increasing trend amongst some major brand owners to increase shipment of wine in bulk for bottling closer to their markets, particularly for their commercial brands.¹⁷ The main reason would appear to relate to cutting transport costs (and also perhaps to minimise carbon emissions, hence boosting environmental credentials). AWBC export approval figures do not separate such shipments, so we do not know how much of the bulk wine is for such major brands, (Lindemans and Banrock Station may well be examples). But it is probably a significant part, given the market presence of such brands.

Apart from anecdotal evidence and company announcements, a basic analysis of bulk versus bottled shipments to Australia's two largest markets, UK and USA may provide some clues as to the quantum of this phenomenon¹⁸. In Table 3 it can be seen that bottled shipments to the UK have fallen by 38 million litres, accompanied by an almost identical

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increase in bulk shipments to the UK of 37 million litres, which may be suggestive of bulk-for-branded shipment substitution of a similar quantum. Contrast the bottled shipments to the USA, which have fallen by a modest 5 million litres. This fall is completely eclipsed by growth in bulk shipments to the USA of 54 million litres. So the data for the USA is less suggestive of bulk-for-branded shipment substitution.

Table 3.

Australian wine exports UK & USA bulk & bottled As at 30 June 2009	Volume		Change	
	This year	Last year	%	Million Litres
	Million Litres	Million Litres		
UK Bottled	157	195	-20%	-38
UK Bulk	101	64	58%	37
UK Total volume change				-1
USA Bottled	159	165	-3%	-5
USA Bulk	75	15	397%	60
USA Total volume change				54

Water availability

Water availability is ever-present in the minds of Australian winegrape-growers and no discussion about Australian bulk wine is really complete without a discussion on water. Consider Figure 7, which provides an historical summary of water availability in the major storages in the Murray Darling Basin during the last week of June each year. The low water availability arising from the 2007 drought can be clearly seen – less than half the available water resource than 2003, which was the previous worst drought year of recent times. The larger than expected 2008 crop (1.83 million tonnes) was grown with low water availability, as was the slightly smaller, but still large 2009 crop (1.71MT). Without heatwave losses and grapes unpicked, 2009 could have well equalled 2008.

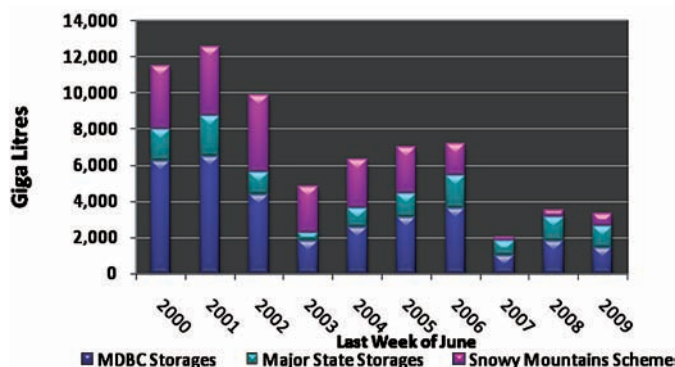


Fig. 7. Water storage in the Murray Darling basin (excludes dead storage)

Table 4. Gross Value of Irrigated Agricultural Production and water consumption, by commodity—Murray-Darling Basin—2005–06

	GVIAP(a)	Proportion of total GVIAP	Water consumption	Proportion of total water consumption
	\$m	%	GL	%
Dairy farming	938	21	1287	17
Other livestock	132	3	1284	17
Rice	274	6	1252	16
Cereals (excl. rice)	92	2	782	10
Cotton	797	17	1574	20
Grapes	722	16	515	7
Fruit (excl. grapes)	898	20	413	5
Vegetables	530	12	152	2
Other agricultural commodities(b)	193	4	460	6
Total agricultural commodities(c)	4576	100	7720	100

(a) In current price terms. (b) Includes other broadacre crops and nurseries. (c) Components may not add to total due to rounding.

Does this mean that water scarcity is no longer an issue for Australia? After all, a significant winegrape crop was produced in both 2008 and 2009 during times of critical water scarcity.

In the short term, I believe water scarcity adds considerable risk to winegrape-growing in Australia. Witness the extreme reaction that our industry experienced during the 2007 drought: Extreme water scarcity, immature water markets, and extreme anxiety about grape supply arising from drought conditions more severe than anything experienced before. With the great benefit of hindsight, this led to a premature and rapid escalation in water prices, leading to much higher bulk wine prices as the cost of water contributed as much as A\$0.30 to the cost of a litre of wine. The (then perceived) scarcity of bulk wine led industry participants to view (once again) bulk wine inventory as an asset, rather than a liability, on their balance sheets. A lot of players increased their bulk wine prices disproportionately and told their precious customers to go away, which they did. Now that markets have been lost as a result of these actions, customers are being asked to return. Such volatility is bad for business and it is certainly conceivable that it could occur again, although less likely due to the drought experience the Australian wine industry now has.

In the medium to long term, I believe Australia's water crisis will be solved: it has to be. But it will mean major changes to the way we harvest, manage and use our water. One of those changes may be to the crops we grow in this country, and this will have a major social impact on many rural communities.

Crops with low Gross Value of Irrigated Agricultural Production per Mega-Litre of water used (GVIAP/ML) are less likely to be grown. We can see this occurring already: limited rice and other irrigated cereals have been grown in the past three years because these crops consume 26% of water, but contribute just 8% of GVIAP in the Murray Darling Basin (Table 4).¹⁹

Those crops with high GVIAP/ML (such as fruit and vegetables using 7% of water, but contributing 32% of GVIAP) are more likely to be grown, albeit in more water-efficient ways. In other words, the market will prevail in allocating scarce water resources to those crops with the highest value end use.

Happily for the Australian wine industry, grapes have a relatively high GVIAP/ML, using 7% of Murray Darling Basin water, but contributing 16% of GVIAP. Using this analysis, winegrapes are likely to continue to be grown in times of extreme water scarcity.

Where are we in the cycle? Domestic bulk wine price versus vineyard area non yet bearing

Figure 8 displays weighted average domestic bulk wine prices for all Austwine domestic sales²⁰ since 2000, plotted against percentage of vineyard area not yet bearing.

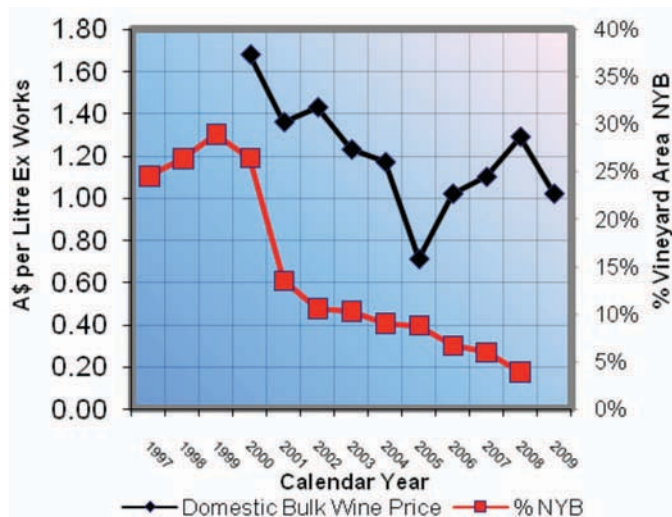


Fig. 8. Domestic bulk wine price vs percentage of vineyard area not yet bearing.

The graphic shows domestic bulk wine price has been trending lower since 2000, except for the period 2006-2008 as a result of the short 2007 vintage.

It can also be seen that the percentage of vineyard area not yet bearing has been falling since 1999, as a result of the late 1990s planting boom, which peaked in 1998 with 16,000 hectares planted in just a single year.

The two indicators clearly move in sympathy. Vineyard area not yet bearing falls as the pricing signal to plant (profitable grape sales - for which bulk wine pricing is a crude proxy) fades. The good news is the percentage vineyard area not yet bearing is less than 5%, the lowest value in over a decade. This means the wine industry cycle is somewhere near the bottom. But the critical question is: When and from where will the stimulus come from to turn the cycle around?

Based on the disproportionate increase of bulk wine that has come on to the market (crush down, bulk wine inventory up - see previous discussion), together with the large number of vineyard and winery assets that are currently for sale, it seems many industry players cannot foresee any significant stimulus any time soon. That must be a clear indicator that we are near the bottom of the cycle, assuming we have faith in the long-term competitiveness of our industry to the extent that any significant stimulus will once again create profitable opportunities.

If we do not have faith in the long-term prospects of our industry, then the only other view is the Australian wine industry is on a slow and painful slide into the abyss of long-term decline. For our industry, which has been here since the first days of European settlement, this is a view to which I do not subscribe.

Summary

The 2009 vintage and its associated outcomes in the bulk wine market can be summarised as follows:

- a good-sized vintage of 1.706 million tonnes, constrained slightly in volume, but not quality, by a two-week heatwave spanning the end of January and beginning of February
- crush down, inventory up: Shiraz, Cabernet Sauvignon, Merlot and Chardonnay bulk inventories are all moving up as wineries reduce their bulk inventory holdings in light of uncertainties in the market
- bulk wine inventories have a disproportionate volume of higher cost, cooler climate wines
- imports into Australia are growing rapidly, and now represent nearly 15% of total Australian domestic wine sales by volume

- bulk wine shipments are increasing rapidly due to major companies choosing to bottle their brands nearer to export markets, in particular in the UK
- water availability remains critically low, but good winegrape crops can still be grown despite high water scarcity
- we are somewhere near the bottom of the wine industry cycle, with no obvious source of stimulus for an upturn evident at this time.

Jim Moularadellis is Chief Enthusiasm Officer (CEO) of Austwine, Australia's Bulk Wine Specialists. He 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. For the past two years Austwine has been in the top 25 Fast Movers for South Australia, an index of South Australia's Fastest Growing companies. Established in 1993, 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:

- 1 Winemakers Federation of Australia, 2009 WFA Vintage Report, June 2009.
- 2 AWBC: Australian Harvest Update, February 2009.
- 3 7 February 2009 is now referred to as Black Saturday. The Black Saturday bushfires were a series of bushfires that ignited or were burning across the Australian State of Victoria on and around Saturday 7 February 2009 during extreme bushfire-weather conditions, resulting in Australia's highest ever loss of life from a bushfire. A total of 173 people are confirmed to have died in the fires with around 500 injured. As many as 400 individual fires were recorded on 7 February by both the Victorian Country Fire Authority and the Department of Sustainability and Environment.
- 4 "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 climate(s)" is defined as all other regions.
- 5 MVW News & Views, March - May 2009: Murray Valley Winegrowers Inc.
- 6 AWBC: Wine Export Approval Report, June 2009
- 7 On 13 May 2008 the Australian Government announced a review of Australia's tax system. The review will look at the current tax system and make recommendations for change. The review is being chaired by Dr Ken Henry (Secretary to the Treasury). The Review Panel is due to deliver its final report to the Federal Treasurer in December 2009.
- 8 Austwine Bulk Wine Database, 10 July 2009, all volumes for all vintages, regions and varieties, with and without asking price.
- 9 AWBC: Wine Export Approval Report, June 2009
- 10 Typically, ex works, single immediate shipment, not bottle ready, with 30 day payment.
- 11 Typically, ex works, single immediate shipment, not bottle ready, with 30 day payment.
- 12 Typically, ex works, single immediate shipment, not bottle ready, with 30 day payment.
- 13 Australian Bureau of Statistics: Sales of Australian Wine and Brandy by Winemakers, April 2009, Cat No. 8504.0.
- 14 Australian Bureau of Statistics: Sales of Australian Wine and Brandy by Winemakers, May 2009, Cat No. 8504.0.
- 15 Total Imports for the 12 months ended June 2007: 34.275 million litres.
- 16 11.1 tonnes per hectare: Australian Bureau of Statistics: Australian Wine & Grape Industry, 2008, Cat No. 1329.0.
- 17 "It makes more sense to bottle in the UK," said Neil Barker, Fosters Commercial Director UK and Ireland. "There is a cost benefit, but the environment is something consumers are more aware of." "Constellation goes for Greener Bulk Bottling" 12 July 2009. http://findarticles.com/p/articles/mi_hb5245/is_7798_230/ai_n29339663/ Tony Christensen, Constellation Europe President, says: "Construction of the [bottling facilities in Bristol, UK] facility, which will be able to fill around 120 million bottles per year, will start immediately, and the distribution and bottling facility should be operational during 2009." "Constellation's Bristol Bottling Site to be World Class". 28 April 2007 http://www.britishbottlers.com/news.php?article_id=115
- 18 AWBC: Wine Export Approval Report, June 2009
- 19 Australian Bureau of Statistics, 2008: Water and the Murray-Darling Basin - A Statistical Profile, 2000-01 to 2005-06. ABS Cat No 4610.0.55.007.
- 20 Austwine bulk wine database. Data includes all domestic bulk wine sales: All contract types (long term contracts, pre-harvest orders, sale-by-sample and distressed sales), all vintages, regions, all varieties.