Market Outlook 2015: what the wineries say

Some positives for premium regions but downward forces prevail

WGCSA market outlook survey of wineries 2014

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Executive Summary

A survey of major purchasers of South Australian winegrapes was undertaken in May-June 2014 to find out the market outlook for grapes in 2015 from the wineries' perspective, and to update information obtained in a similar survey conducted six months previously. The main findings of the survey were:

- Overall the outlook had deteriorated significantly, with the majority of wineries saying conditions were worse than 12 months ago.
- Grape purchases in 2014 were down by 9% on average – due partly to low yields in the premium regions but mainly attributed to reduced demand and increased competition. Wineries also noted that they could buy bulk wine more cheaply than they could buy and process grapes.
- There were numerous different reasons given for the deterioration in outlook; however the main ones were: continued oversupply, the AUD remaining high and the Chinese austerity measures.
- Although exchange rates were considered to be important, a more equivocal view was expressed this year regarding the role of exchange rates in improving the outlook. For example: many wineries buy in AUD anyway or forward sell currencies; the buyers of wine expect to share any benefit due to an improved exchange rate; other wineries (competitors) receive the same benefit; and the shift would have to be substantial and sustained to cause wine buyers to change their suppliers.
- The Producers' (WET) rebate was seen by some of the wineries as creating significant distortions in the market, affecting wineries' ability to compete and driving grape prices further down by sustaining oversupply. Distressed wine sales and stock write-downs were also seen as distorting the market.
- Although some growth trends in consumer demand were mentioned, wineries generally noted that such trends could not be relied upon to be sustained and growers should not consider them as planting signals. Conversely, the retailer's perspective was that the industry needed to become better at responding to market signals in order to succeed in future.
- In terms of demand for grapes in 2015, most wineries expected to reduce their intake again because of reduced demand and excess stock from relatively high vintages in 2013 and 2014. A surplus of top-end fruit was predicted due to the China slowdown and further declines in demand for C grade fruit. Overall, this was expected to lead to downward pressure on prices, which would be exacerbated if the 2014 vintage turns out to have been as big or nearly as big as 2013.
- Some moderating factors acting to maintain intake were the need to keep volumes up to reduce costs of production, and the need to maintain shelf space even if products are unprofitable. Wineries also consistently mentioned wanting to preserve relationships with growers and pay them sustainable prices if possible.
- Longer-term issues mentioned as barriers to recovery included: static or declining alcohol consumption in mature markets, competition from other products such as flavoured ciders – particularly with younger drinkers, the AUD likely to remain relatively high for the foreseeable future and the ongoing oversupply and market distortions.

Background

In 2013 a survey of wineries was carried out on behalf of WGCSA. The aim of the survey was to find out and collate qualitative information about near-term future grape demand in South Australia from the perspective of the purchasers (wineries) – including:

- Varieties increasing and decreasing in demand
- Regional variations in the above
- Quality/grade variations in the above
- Insights into buying strategies
- What wineries are looking for from growers
- Overall outlook on the industry over the next five years

16 of the top 20 grape purchasers of South Australian winegrapes were interviewed, as well as two bulk wine brokers. The results of the survey were presented at a series of regional workshops in November 2013.

In 2014, it was decided to repeat the research and present an update at a state conference for grapegrowers in June 2014. The same methodology was used but the survey was less detailed and more short-term in focus (ie relating to the outlook for 2015). All but one of the same wineries and bulk wine brokers were interviewed, plus an additional winery and a retailer.

Methodology

The survey involved a 20 – 30 minute interview conducted either by phone or in person. A semi-structured interview format was used. The information provided has been kept strictly confidential. Results are presented in aggregate form only and no individual respondent's answers can be identified.

Responses

Interview data was collected from 16 wineries accounting for an estimated 500,000 tonnes – over 90% of the total South Australian purchased fruit in 2014 (532,000t[1]). One major retailer and two bulk wine brokers were also interviewed and their views included.

Note: the findings presented in this report reflect the results of the research and the opinions expressed by the respondents. WGCSA does not endorse or vouch for the accuracy of the views expressed.

[1] PGIBSA (2014) South Australian Winegrape Crush Survey

Findings

How much fruit was purchased in the 2014 vintage?

12 out of the 16 wineries had purchased less fruit than in 2013. The drop in reported tonnage by the same group of purchasers was approximately 9%. The main reasons given were:

- Low yields (Barossa, McLaren Vale)
- Reduced demand – increased competition, lack of confidence
- Able to buy bulk wine cheaper than can make it
- Cutting supply of whites (no market for them)

The previously reported positive indications about intentions to increase intake over the next five years had generally evaporated.

How has the outlook for the industry changed in the past 12 months?

The majority of respondents (9/16) said that the outlook was worse or much worse, while another five said it had not improved (and wasn't good before). Only two had the view that the outlook was improving. These were both in premium regions where crops of in-demand fruit had been low for 2 – 3 years and they were expecting that growers would have a better crop in 2015 and receive higher prices.

A number of respondents indicated that they were surprised that the outlook had deteriorated – they had expected when interviewed last year that it would have improved by this time.

> ***"I didn't expect to be saying this when we spoke last year"***

What are the reasons for the change in outlook?

The reasons given by the respondents for the deterioration/lack of improvement in outlook were:

- Continued oversupply (no sign of any removals/exits from the industry)
- A big vintage in 2013 and 2014 not expected to be much smaller
- The AUD remaining over 90c (indications last year were that it would drop below 90c during 2014)
- Chinese austerity measures (these had a drastic effect of 30% - 40% drop in demand; however the overall impact of that depended on the extent to which each winery exported to China)
- Increasing effect of market distortions (distressed sales of wine and stock write-downs; also the effect of the producer's (WET) rebate)
- Ongoing slowdown in the UK (a 5% slowdown in the UK market represents more volume than a 30% drop in the Chinese market for Australian wine)
- Reduced consumer confidence (attributed to the May Federal Budget and to the increasing efforts of the anti-alcohol/health lobby)
- Difficulties for major wineries (it was seen that when the major players were struggling then everyone struggled and vice versa)
- Increased supermarket dominance – especially in the $10 - $15 range – restricting the market options for branded products

There were a few bright spots mentioned:

- Exchange rates are lower than they were (92c is much better than $1.02)
- Australia is still the number one supplier in the UK (off-trade)
- Bulk wine sales have improved
- Barossa Shiraz is in strong demand (and short supply)
- The growth in NZ Sauvignon Blanc is slowing
- The Canada market is very promising

"It's better than five years ago but it will be a long climb back"

How important are exchange rates?

This year the survey explored in more detail the perceived role of exchange rates in determining outlook. Last year there was a universal view that an improvement in the exchange rate, particularly with the USD, would be a major factor in turning around the industry's fortunes, but this factor was not explored in depth.

Respondents this year still believed that an improvement in the exchange rate would be helpful ("Any drop is good"); however, the picture was much more complex on closer examination. For example:

- Some wineries hedge or sell in AUD
- Some wineries are part of international companies
- It's a complex equation when you sell to multiple countries with different exchange rates
- It would have to drop below 80c US to make a real difference
- Sales are made periodically, not every day (so exchange rates could move steadily downward for a few months without actually improving sales – and then jump back up before the next round of negotiations)
- Wine buyers expect a share of any price reduction (this was a commonly expressed view – that even if the AUD rate does drop, buyers are aware of this and expect wineries to drop their prices)
- It takes more than a few cents in the short term for wine buyers to change their supplier – there is inertia in the system
- Competitors (other Australian wine companies) receive the same benefit
- It doesn't help on the domestic market

"There has to be a compelling reason for buyers to switch their supplier"

Therefore an improvement in the exchange rate was not seen as "the" answer or necessarily directly correlated with an improvement in outlook. However, no-one saw it as a negative.

The Producer's (WET) rebate, on the other hand, was regarded as a negative influence in the market by these major grape buyers. It was seen as enabling growers to become producers and undercut the wineries in the price they could offer – particularly for bulk wine. This in turn was seen as reducing wineries' ability to buy fruit and/or reducing prices for fruit in subsequent vintages – creating a vicious downward cycle that ultimately disadvantaged the growers. In general it was seen as a discouragement to export that led to overcrowding in a static domestic market, and as a disincentive to supply adjustment.

How are the wineries responding to the difficult conditions?

The main strategies identified in 2013 were still evident:

- Premiumising
- More red less white
- Innovation
- Focus on export markets

"We will end up with 90% red varieties and only 10% whites"

In addition, this time wineries mentioned:

- increasing efficiencies,
- changes in routes to market,
- increased marketing efforts,
- removing own vineyards and/or not renewing contracts, and
- reducing intake.

The wineries that were looking for more supply reported bringing wine on early and buying bulk wine to meet sales demand.

What varieties/brands are increasing or decreasing in demand?

Most buyers indicated that they were not seeing much change – Shiraz still being the main variety, then Cabernet Sauvignon. In terms of trends, some buyers mentioned a "bit of a buzz" around alternative varieties and the continued interest in lighter style reds, red blends and innovative products such as Sangria. Several people mentioned relatively strong demand for Tempranillo and Pinot Gris. However, there were no consistent trends identified and some respondents warned against even mentioning a possible growth product as consumer trends are short-lived and difficult to predict, whereas it takes up to five years to bring a new grape variety into production. On the other hand, the retailer argued that the wine industry has consistently failed to respond to consumer insights that are available, which has allowed the rise of imported products such as New Zealand Sauvignon Blanc and, more recently, Prosecco.

"The Moscato bubble has burst already"

Some wineries noted that organic wine was becoming popular and saw an opportunity to promote it particularly in the UK and Chinese markets; however, others argued that there were problems with this – eg different definitions in different markets – and also noted that it was not something you could charge extra for. A similarly ambivalent view was expressed for low alcohol wine, with some wineries finding it a worthwhile product to develop and others seeing problems with it.

"China have a growing obsession with clean food"

What will the demand for grapes be in 2015?

As stated above, most wineries were expecting to reduce their intake in 2015, because of reduced demand and excess stock from relatively high vintages in 2013 and 2014. (NB There was not full agreement on the size of the 2014 crop. Some wineries expressed the view that the 2014 vintage had been smaller and therefore had taken the pressure off inventory – but this was not the majority view.)

"We're back to balancing inventory"

A surplus of top-end fruit in 2015 was predicted, because of the slowdown in China and the excess inventories held by the major wineries. Further declines in demand for whites and C grade fruit were also mentioned. Overall, this was expected to lead to downward pressure on prices, the extent of which would be better known once the size of the 2014 crop was confirmed. It was also noted that ongoing uncertainty for wineries because of lack of commitment by their buyers meant a restricted ability to make forward commitments to growers and was likely to lead to more spot market and bulk wine purchases at the expense of grape contracts.

While the majority of buyers were looking to reduce their intake to some extent, there was a need to balance this with maintaining volumes to keep costs of production down. Another factor protecting intake to some extent was the need to maintain shelf space, even if a product was unprofitable, because if you lost it you might not get it back.

Wineries also consistently mentioned wanting to preserve relationships with growers for the longer term, and hoping that this would pay off when conditions improved, as well as wanting to pay sustainable prices to keep growers in business – "although it's hard when our competitors aren't".

What are the longer term issues affecting the prospects of recovery?

Some longer-term issues mentioned by the wineries were:

- The exchange rate with the USD is unlikely to improve significantly in the near future
- Alcohol consumption is static or in decline (in mature markets)
- The younger generations are looking for new tastes and are turning away from wine[2]
- Wine competes in a global market – and not just with other wines but products such as flavoured ciders and spirits
- Market distortions – especially the WET rebate – are preventing supply adjustment
- Lost ground in export markets will be hard to recover, even when conditions improve
- We still produce more than the market can handle. 1.5mt is the most we can sell but we can grow 1.8mt easily.

"There are only downward forces in the industry at the moment."

These factors were seen as barriers to recovery. It was suggested that recovery would not occur in the "foreseeable future" and that "while we continue to be in over-supply, no-one wins".

"It isn't good – and it isn't going to get better any time soon."

What suggestions do wineries have for growers?

A lot of emphasis was placed on this issue in the previous survey, but this year the question was not asked specifically. However, a few suggestions were made in general discussion or response to other questions. For example:

- Examine *all* vineyard activities for efficiencies – don't think there is no more room for improvement
- Remove unproductive parts of vineyards to lift overall profitability – even just a few rows that never yield as well
- Pull out whites and replant with Shiraz (Barossa and McLaren Vale)
- Look at alternative crops – eg almonds
- Actively market your grapes
- Be creative and proactive: grow the best you can to meet your winery's needs

"If you're growing the wrong product, you need to change."

It should be noted that these were suggestions made in passing – not as carefully

[2] In Spain, consumption is 17l/capita/annum among the 18-25s compared with 60l/capita for their grandparents.

considered, individualised advice.