The Australian wine industry enjoyed considerable success between 1991 and 2007. It more than tripled in production volumes from less than 400 million litres to 1.2 billion litres off the back of wine exports with the value of exports growing from AUD200 million to AUD3 billion. Since 2007, the industry faced the perfect storm of challenges, including the global financial crisis, a historically high Australian dollar, increasing competition, global and domestic oversupply, and retail consolidation. As a consequence, Australian wine producers have endured tough times in both the domestic and export markets, with the value of exports falling to AUD1.82 billion in 2014.

More recently, largely due to the improved trading conditions, there is renewed confidence and signs that the future of the Australian wine industry looks brighter.

In this issue of Ferrier Focus, we look at the current position of the Australian wine export market, the impact of the Free Trade Agreements (FTAs) and what still needs to be done, other barriers to the industry and the shape of the domestic market.

EXPORTS ON THE RISE

According to the Wine Australia Export Report December 2015, the value of Australian wine exports jumped 14 per cent to AUD2.1 billion in 2015 and exports grew in each of Australia’s top 15 export markets. Australia’s premium wines performed strongly in almost all of the major markets. However, exports still remain well below their peak of AUD3 billion in 2007.

A series of FTAs and a depreciating currency were significant factors in exports improving in 2015.

As outlined in our 2012 Ferrier Focus article titled, The Mining Boom Hangover, the recent reversal in the fortunes of the mining industry with lower commodity prices has driven down the Australian dollar providing opportunities for Australian wine exporters to increase both volumes and value.

Most impressive from the Export Report is the quarterly growth figures (October to December). Comparing the final quarter 2015 to the final quarter in 2014, the value of exports increased by 23 per cent to AUD$95 million. Of Australia’s top 35 markets (all in excess of AUD1 million), a total of 29 recorded growth during the quarter.

Bottled wine sales have been the key driver of the export turnaround. Bottled exports increased by 17 per cent to AUD1.6 billion, with an average value of AUD5.20 per litre.
Figure 1 illustrates that the average value of bottled wine has been increasing consistently since hitting a trough in mid-2010. The average is now approaching its historical high of AUD5.50 per litre recorded in 2003. Conversely, the average value of bulk exports is down by 1.8 per cent to AUD0.97 per litre on an annual basis. However, a gradual strengthening of the average value has been recorded in the past six months, driven by a sharp decline in sub AUD0.50 per litre exports, which indicates that a tightening of supply has occurred in the bulk wine market.

Source: Wine Australia

Australia's top five export markets by value according to the Wine Australia Export Report are:

1. **United States**, AUD443 million [↑ 4 per cent]
2. **United Kingdom**, AUD376 million [↑ 0.2 per cent] (Australia’s number one market by volume)
3. **China**, AUD370 million [↑ 66 per cent]
4. **Canada**, AUD193 million [↑ 7 per cent]
5. **Hong Kong**, AUD132 million [↑ 22 per cent]

**Impact of FTAs**

Tariffs are a key barrier confronting wine traded internationally, particularly in some emerging wine markets, such as throughout South East Asia and India, rather than in Australia’s traditional markets. The only way to overcome these tariff barriers is through negotiated FTAs and this is the mechanism by which Australian wine producers have recently been buoyed.

**China**

Under the landmark China–Australia FTA introduced in December 2015, the previous import tariff of 14 per cent for Australian bottled wine and 20 per cent for bulk wine will be phased out over four years. This provides a significant boost for Australian wine companies exporting to China, which is already the third biggest destination for Australian wine exports. The tariff is now 8.4 per cent and will be zero by 2019.

**Japan**

The Japan-Australia Economic Partnership Agreement, which came into effect in January 2015, immediately cut tariffs on bulk wine to zero and will reduce the tariff on bottled wine from 9.37 per cent to zero by 2021. In the first year of the agreement, Australian exports to Japan increased by 16 per cent in value to AUD46 million and 42 per cent in volume to 13 million litres.

**South Korea**

In 2015, Australian exports to South Korea surged by 38 per cent in value to AUD11.7 million and 39 per cent in volume to 1.8 million litres. This increase was due to the 2014 Korea-Australia FTA, which immediately removed a 15 per cent tariff on Australian wine.

**Thailand**

On 1 January 2005, the Thailand–Australia FTA came into effect which resulted in tariffs on imported wine reducing over a ten year period from 54 per cent to be totally eliminated by 1 January 2015. Since the tariff reductions were introduced, Australian exports have more than doubled from AUD7.6 million in 2004–05 to AUD16.4 million in 2014–15.

**Other trade agreement discussions**

The Trans Pacific Partnership is awaiting the US and Japan to sign before it will come into force (and the earliest likely time is anticipated to be in early 2017). This would deliver reduced tariffs over time with Malaysia, Vietnam and Mexico. Australia and the EU have also agreed to commence discussions (the earliest any potential agreement could come into force is anticipated to be 2018).

Discussions are also underway with India which imposes a tariff of 150 per cent of the landed price, so a wine imported at AUD10 becomes AUD25 even before various importer, distributor and retailer margins and other state taxes are applied (the earliest any potential agreement could come into effect is anticipated to be 2017).

**Other trade barriers**

Apart from tariffs, there are other technical trade barriers and arguably they represent more of a burden on wine exporters than tariffs. These barriers emerge from differences in the rules that various countries apply regarding wine production, wine labelling and wine composition. It would be ideal if an Australian winemaker could produce a bottle of wine in accordance with Australian law and then sell that wine in any of the 125 global markets with which we trade without having to change the blend or to modify the label, but that is certainly not the case at the moment. Nevertheless, progress has been made towards harmonising international standards.
DOMESTIC MARKET

While export markets account for 60 per cent of Australian wine sales, the domestic market remains vital, especially for smaller wine producers.

According to the Australian Bureau of Statistics — notwithstanding that Australians appear to be drinking less alcohol now than at any time in the past 50 years — consumption trends indicate that wine has not been impacted to the same extent as beer. Fifty years ago, Australians drank 20 times more beer than wine, whereas now both are consumed at around 40 per cent each of total alcohol consumption.

Wine sales overall in the domestic retail market are relatively flat in terms of volume but are up marginally in value.

Wine sales in the domestic retail market are relatively flat in terms of volume but are up marginally in value.

There are significant differences by category. For red wines, bottled sales are on the rise while cask sales are down. In comparison, white wine sales are down for both bottled and cask but the decline in cask sales is much steeper. Cask wine sales are on a long-term downward trend. Champagne sales have achieved double digit growth but sparkling sales are down.

The value of Australian made wine sold in the domestic market was up marginally but out-performed by imports. However, Australian made wine remains dominant, accounting for more than three-quarters of all wine sold in the domestic market.

While New Zealand Sauvignon Blanc is the market leader in the Australian domestic market, growth has slowed significantly. The traditional Australian varietals have been impacted to the same extent as beer. Fifty years ago, Australians drank 20 times more beer than wine, whereas now both are consumed at around 40 per cent each of total alcohol consumption.

2016 WINE INDUSTRY SNIPPETS

1. The 2016 vintage is generally looking strong with both yields and quality expected to be up in most regions.

2. The initial outlook for 2016 average grape prices shows some minor increases compared to 2015 averages with the impacts of the higher wine exports yet to be fully reflected by higher grape prices.

3. Profitability of growers remains depressed as they battle to secure a share of margin in the supply chain and there continues to be growers exiting the market.

4. Some recent data from the Australian Bureau of Statistics and the latest annual Australian and New Zealand Wine Industry Directory respectively reveal an industry still under pressure with a further downturn in both the land under vine and the number of wine producers, although not uniform across the country. We suggest this is healthy for an industry which has for some time been saturated.

5. A Senate Enquiry into the Australian grape and wine industry handed down its report in February 2016 recommending the WET Rebate be phased out over five years and replaced with a grant scheme available to smaller wineries. The recommendation has, not surprisingly, been met with disappointment from many smaller winemakers as the rebate allowed them to claim a refund on the amount of tax they pay, potentially up to AUD500,000 per annum, but has been subject to widespread allegations of rorting.

6. The Foundation for Alcohol Research and Education is lobbying the Federal Government in its pre-budget submission to reform the alcohol taxation system by replacing the WET with a volumetric tax rate that is based on the alcohol content of wine (i.e. the same basis as beer is taxed). The plan would raise the retail price of a bottle of wine costing between AUD15 and AUD20 by about AUD3.80. Not surprisingly, the Winemakers’ Federation of Australia oppose an increase in wine taxes.

7. No region seems to be immune from climate change. It has been reported that vines have been ripening between one and two days earlier each year in a trend some viticultural experts say could see some traditional varieties abandoned in warmer areas. Climatic factors such as bushfires, untimely rain events and drought are becoming more common. With the likelihood of reduced water allocations, water prices have been increasing significantly.

8. The UK is currently Australia’s second biggest export market by value (the biggest by volume), yet only a 0.2 per cent growth in 2015 is confirmation of a mature market, with China likely to soon take over the UK’s current number two position. According to Accolade Wines, unless the Australian wine category adapts and improves its average price point in the UK, sales will deteriorate as retailers are fixated on everyday low pricing.

9. Increasing trend towards Private Label or Buyer’s Own Brands. According to a December 2015 report from Canstar Blue, while not specific to wine but a trend likely to translate to wine, the number of Australians who tended to buy private label groceries over big name brands increased by 35 per cent of a household’s shopping basket will comprise Private Label or Buyer’s Own Brands. According to a December 2015 report from Canstar Blue, while not specific to wine but a trend likely to translate to wine, the number of Australians who tended to buy private label groceries over big name brands increased by one fifth in the space of six months, from 44 per cent to 65 per cent. It’s predicted that within five years, 35 per cent of a household’s shopping basket will comprise Private Label or Buyer’s Own Brands.

10. Takeovers and consolidations are still prevalent in the industry and prices being achieved for assets, particularly large-scale vineyards with water rights, are improving. Ferrier Hodgson recently sold the Littore Wine Group’s (one of Australia’s largest independent wine producers) Sunraysia vineyards and winery near Geelong.
of Shiraz, Chardonnay and Cabernet Sauvignon are on the rise. Shiraz recorded strong value growth in the last 12 months and is the second biggest category behind Sauvignon Blanc. Cabernet Sauvignon also recorded solid growth, while other varietals off smaller bases, including Pinot Noir, Pinot Grigio and Riesling, achieved record sales growth. The steady decline in Chardonnay sales in recent years was arrested in 2015 and sales were up marginally.

CONCLUSION

According to Wine Australia, the wine sector contributes AUD40.2 billion to the national economy and supports 173,000 full and part-time jobs, most of which are located in regional Australia. It’s vitally important the sector remains strong and prosperous. Through improved trading conditions and Government negotiated FTAs and other trade agreements, the sector is reversing the trend of testing times which it has endured for so long. Further reform and structural change is still needed to ride out any dip in trading conditions. The future looks brighter on the back of the renewed confidence, particularly in export markets.

HOW CAN FERRIER HODGSON HELP?

At Ferrier Hodgson, we have extensive experience reviewing and monitoring distressed wine businesses and are well placed to provide strategic and restructuring advice. We can also assist in ensuring wine companies have the appropriate sales and financial models, in order to improve profitability and cash flow. Please contact us to discuss your exposure to the sector or for a general overview of the state of the industry.

Ferrier Hodgson would like to thank Wine Australia (www.wineaustralia.com) for its contribution to the content of this article.

This publication is intended to provide a summary of the subject matter. It does not purport to be comprehensive or to render advice. No reader should act on the basis of any matter contained in this publication without first obtaining specific professional advice.