

# Wine Industry Insights

## Key Emerging Issues - September 2024

### 01 Navigating a changing world for Australia's wine sector

As spring approaches and the vines start to emerge from their winter slumber ahead of another growing season, it is timely to reflect on the state of play in the Australian wine sector.

It is no secret that wine consumption is undergoing a significant transformation, particularly in how and when wine is enjoyed.

Health and wellbeing concerns and emerging social settings are leading to less frequent consumption, which are also driving Australian consumers towards better quality wine and wine varietals such as white wine, sparkling and rose.

Red wine, traditionally celebrated for its rich flavours and complexity, has fallen victim to these shifting customer preferences as younger generations increasingly prefer lighter, more casual drinking experiences.

Global wine consumption has decreased by 4 percent over the past 10 years and in Australia it is on a similar trajectory. In fact, global wine consumption is estimated to be at its lowest volume recorded since 1996.

Most concerning for Australian winemakers is that consumption of wine in China is reportedly less than a third of what it was six years ago.

A supply and demand imbalance has emerged in wine across the globe. In Europe, governments are investing to battle the imbalance with vine pull schemes in France and various government subsidies in Spain and Italy.

There have also been factors outside of producers control which have naturally reduced vintage yields that have contributed to and masked the imbalance in domestic markets (i.e. bushfires in California, frost in France, El Nino in the southern hemisphere).



### The Commercial Wine Challenge

While the share of premium wine is growing stronger, albeit slowing due to cost-of-living pressures, the demise of the commercial wine segment is not imminent.

The challenge for producers operating in the commercial segment is profitability given the thin margins through the supply chain and the reliance on the retail channel for depletions.

### In the last year 2023-24

**90%** of Australia's exports were categorised in the commercial segment.

Since the tariffs on Australian wine imports into China were relaxed in March 2024, the short-term export boost in terms of value (to reach \$400m to mainland China), represents re-stocking of Australian wine in China after a long absence.



However, the volume supplied to mainland China is relatively small at from April to June 2024 so it has not yet made any significant impact on the current oversupply of bulk red wine.

**33 MILLION LITRES**

Exports to other global market participants have continued to decrease in 2023-24, with the total volume of exports to global consumers excluding mainland China declining by 5 percent to 587 million litres, which is the lowest volume exported to the rest of the world in a financial year since 2003-04.

As we see it, growers in the three predominant inland wine regions of Australia (responsible for around 75 percent of Australia's annual wine production), have no choice but to continue to adjust their grape crush levels to cope with the anticipated ongoing oversupply (particularly heavy red varieties Shiraz and Cabernet Sauvignon), and a reduced global demand for wine due to a variety of macroeconomic conditions.

By any measure, an oversupply of red wine in Australia will likely persist for at least the next two years based on the annualised initial uptick of the reopened China market. Even so, the reality remains the same – supply needs to adjust.

## 02 Consolidation and diversification – how the industry is reshaping itself

With the oversupply of red wine in Australia likely to persist, wine makers will need to continue to adjust supply and even take a deeper dive review into their operations and strategy.

We outlined this in our April 2024 wine industry insights paper, whereby if the industry is to remain resilient, profitable and sustainable into the future, significant industry restructure needs to occur, particularly in the commercial sector.

Our comments have also been echoed by the recent release of the One Grape and Wine Sector Plan (joint release by Wine Australia and Australian Grape & Wine).

The key question is what the new steady state for the Australian wine industry will be – particularly the commercial wine sector – and at what price levels on the retail shelf can Australia sustainably compete.

The industry will need to find a new normal which allows all key participants in the value chain to receive a reasonable return to keep them in the game for the long term.

This is driving consolidation amongst the larger wine industry participants (which we expect will start to play out globally as well) seeking scale, better utilisation of infrastructure and more efficient operations to maintain or improve margins, and be competitive in the commercial end of the market.

## Bigger Wine Operators Leading the Restructuring

Treasury Wine Estates' (TWE), Australia's largest wine company, has previously announced it will offload a number of commercial inland vineyards and their Karadoc winery.

This is in addition to its more recent announcement of putting prominent commercial wine brands – including Wolf Blass, Lindemans, Yellowglen, and others – up for sale.

These moves reflect TWE's strategy to continue their push to be the largest global premium wine producer.

The decision is also being driven by the challenging market conditions and the general decline in the commercial wine sector, which is due to a multitude of macroeconomic conditions influencing expenditure by consumers and sectoral challenges including the oversupply of commercial (mainly red) wine at a global level.

Whilst some market participants are restructuring their portfolio to limit their sales risk in the market or preserve cash, other participants are seeing opportunities in the market. One such example is the private equity investment into Accolade Wines who then announced the acquisition Pernod Ricard's businesses in Australia, New Zealand and Spain.

Accolade is clearly trying to create a more efficient and diversified company which, KPMG notes, can act as a hedge against turbulent economic conditions that are influencing consumer taste and demand between different sectors of the wine market.

Is Accolade's next move becoming a true powerhouse in the commercial sector and taking on the new owner of TWE's commercial portfolio given their impending exit of key commercial brands?



This comes as another prominent Australian wine industry player, Australian Vintage Limited (AVL) has also moved to consolidate its operations, albeit with a strategic sale of a 230 acre vineyard in the premium region of Barossa Valley (which follows a \$62.5 million sale and leaseback to Warakirri in December 2022), while it continues to face market challenges including its value on the ASX falling by more than 50 percent since the start of calendar year 2024.

These vineyards were snapped up by prominent Seppeltsfield owner Warren Randall as he bids to secure further Barossa fruit given for the 2025 vintage and beyond to supply the predicted increased demand, particularly from China, from 2025 onwards.

AVL have also highlighted their short-term strategic plan to generate free cash flow of 10 million to 20 million focused on improving top line and margin growth while driving operational efficiencies, grape sourcing reset, and better utilisation of inventory.

Costs are also looking to be slashed to maintain margins given the pricing pressure squeeze, reflective of changes that many market participants are currently experiencing as they seek to stabilise operations in light of difficult trading conditions.

The trend of bigger operators to either rapidly reduce their commercial wine exposure to refocus on the growing and more profitable premium opportunity, or, consolidate operations in an effort to reset the production cost base to deliver improved returns, underscores the industry's need to reshape operations and strategies to counter the lean few years still predicted ahead.



## 03 What does the future hold for Australia's wine sector?

Unsurprisingly, many players in Australia's wine sector are increasingly turning to government and industry leaders to address these issues.

The Minister of Agriculture, Fisheries and Forestry, Julie Collins, recently appointed Dr Craig Emerson to lead an independent impact analysis of the wine and grape sector's regulatory options concerning fair trading, competitive relationships, contracting practices and risk allocation.

However, it will be challenging for government to deliver a policy intervention that will imminently reset the market and provide value back into the supply chain.

As for industry leadership, as referred to in Section 2, Wine Australia and Australian Grape & Wine recently released a revised One Grape and Wine Sector Plan to 2050.

The report, which follows on from the release of the initial report in 2020, provides a coherent collective roadmap and delineates who has the imprimatur and the capacity to deliver certain activities.

Wine Australia and Australian Grape & Wine updated the report to reflect a revised strategy which considers and addresses recent global trends, challenges facing the industry, and short- and long-term projections in the wine industry.

**The report highlights six urgent sector priorities for the industry to address to ensure long-term sustainability, which include:**

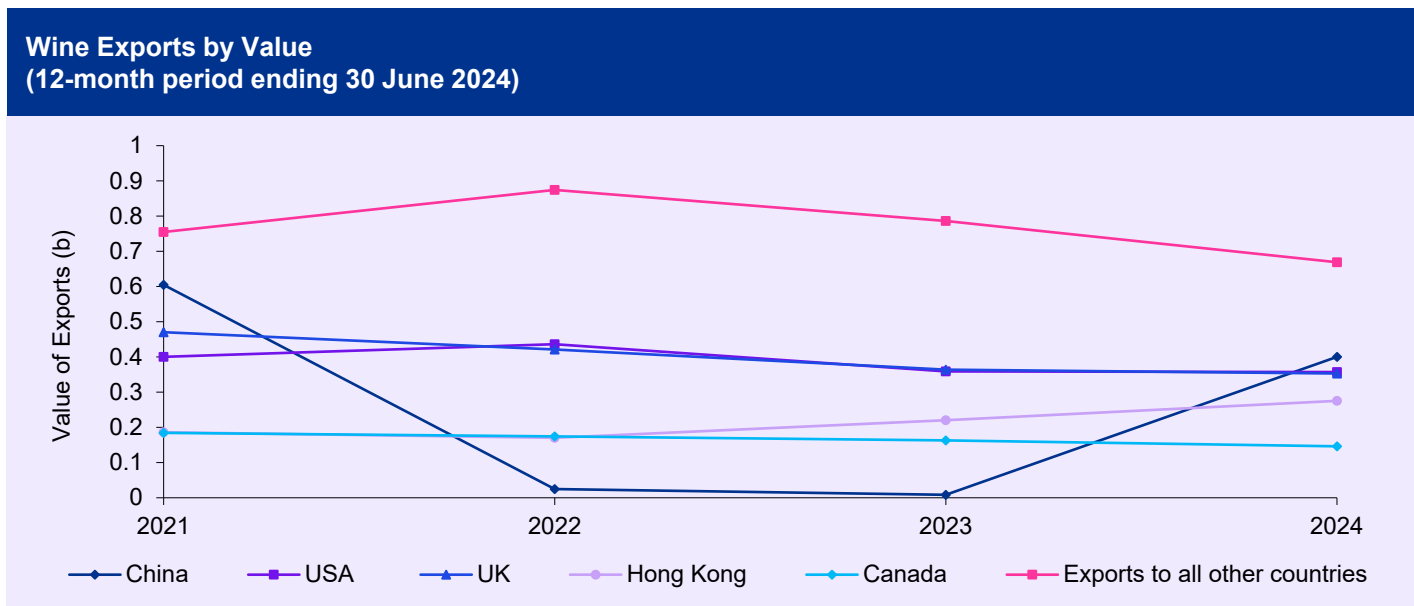
- > Balancing supply and demand;
- > Diversity in Australia's international markets;
- > Growth in Australia's domestic markets;
- > Embracing sustainability and aiming for continuous improvement in practices;
- > Defending wine's social licence; and
- > Ensuring a fit for purpose levy system.

KPMG notes one of the primary challenges faced given the market uncertainty is addressing and maintaining the wine industry as a profitable sector.

In that regard, the report also details a renewed focus on addressing profitability by undertaking actions that will help diversify and intensify the industry's international markets, enhance the perception and consumer appeal of Australia wine, and improve international market access.

Whilst trade lines between Australia and China re-opening in late March 2024 is a positive step forward for the industry with the restocking of Australian wine to China starting to take place – which will continue throughout FY25 – the continual decline of wine volumes exported annually to other key export markets, particularly major markets in the USA, UK, and Canada, remains a concern. Medium to long-term sustainable solutions need to be at the forefront of industry participants minds.

The decrease in the consumption of Australian wine from 2023 to 2024 by various key global consumers is shown in the table below (noting all other countries account for in excess of 80 export markets).



Source: Wine Australia

## Sustainability to Drive Prosperity

A key focus for the industry, as highlighted in the report, should be around sustainability and the efficient use of resources when considering the long-term health of the industry and its stakeholders.

The report places a strong focus on the importance of sustainable practices, highlighting the responsibility of Wine Australia and Australian Grape & Wine to develop climate-adaptive solutions for both viticulture and winemaking, take steps to reduce the industry’s carbon footprint, and promote sustainability responsibility within the industry.

In addition, KPMG notes the potential to extend growers’ incomes through biodiversity planning and initiatives, which is much more than the current focus on carbon credits across most of agriculture.

A high priority will also be placed on putting the sector’s ESG plans into action as reflected in Wine Australia’s ESG investment plan.

Wine Australia and Australian Grape & Wine also emphasised the role that growers and winemakers have when it comes to contributing to sustainability within the industry, highlighting that growers and winemakers can adopt sustainable and innovative vineyard practices to protect their vineyards and enhance their resilience against environmental and market-driven changes.

We’re reminded time and time again that the Australian wine industry is a resilient industry which has faced many business challenges in the past.

Every wine business will have different needs right now, however, the choices wine businesses make and the actions taken in the short- to medium-term, across the various issues raised in this insights paper will determine long-term success.

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