



Industry growth at the crossroads



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AUSTRALIAN WINE is considered to be an exceptional value for money in the United States - as our full fruit, 'sunlight' flavours compare very well with old world and US wines.

Price is always going to affect sales, but the feeling in the industry to date appears to be that Australian wine sales may prove quite resilient in the US market. It should also be remembered that other wine exporting countries are in the same boat as Australia - currency wise.

There was a reduction of the national crop after this year's vintage - the first time in many years - as the decline in plantings since 1998, and poor seasonal conditions, hit home. Chardonnay went into short supply - and virtually all varieties into balance. Although cabernet sauvignon was still in declining over-supply in most areas, it was in short supply in others - including some premium areas such as Coonawarra and Wrattenbully.

The question of over supply of particular varieties is now a matter of timing and the availability of particular varieties in specific regions. Grape contracts are now being written as wineries move to secure future supplies in light of a looming grape shortage.

The outlook for grape prices at vintage 2004 is to hold firm or slightly increase overall. Australia cannot continue to experience compound export growth of about 20 per cent annually, on the one hand, and an annual rate of vineyard planting, which does not significantly exceed the underlying rate of vineyard renewal, on the other.

The current rate of vineyard planting does little more than account for the removal of old, non-productive vineyards of non-preferred varieties and their replacement with new, required varieties. These indices are going in opposite directions - and at some stage something will have to give. Given that, the necessary start-up period for vineyard development, the grape supply demand equation at vintage 2005 and beyond is going to be interesting indeed.

The domestic market is also growing, albeit at a much lesser rate. The challenge for the plethora of brands this year in

Australian wine exports have continued to grow at the spectacular rates of recent years with volumes increasing at an annual rate of 19 per cent to the end of September this year. The value of exports has risen 14pc, reflecting a relative decline in value of 4.4pc over the increase in 2002. The reduction in litre returns reflects the fact that new, lower price category wines are driving growth. However, Australian producers are not giving up price in existing categories to buy volume - at this stage.

Australia has been to obtain meaningful distribution and shelf space. There are literally a handful of truly national distributors, with significant sales forces in each state and territory, making it extremely hard for Australia's 1400 or so winery labels to gain meaningful distribution.

As the grape shortage unfolds, expect many of these winery operations to go back to being purely grapegrowers. This explains the recent media stories about 300 or 400 wineries being expected to close-up shop in the next few years. Many of these small winery operations have had to hand sell all their products through cellar door, by mail order and to selected wine shops and restaurants. This is hard work indeed - which is normally totally dependent upon owners.

Despite the continuing growth of Australia wine exports, certain trends - evident in 2002 - have continued and new features have emerged

The turbulence and shakeout of the past two years in the middle part of town continues, with the virtual demise of small to medium wine producers from the listed wine sector. Many of these small to medium listed wine companies - which were floated in the mid to late 1990s - have now well and truly come and gone.

The catalogue is impressive. It includes the Lion Nathan wine group, which now controls medium sized producers Petaluma, Tatchilla and Hillstowe - with Tatchilla and Hillstowe recently proceeding to close their successful, regional, cellar door sales' operations. Hillstowe is being reduced to a purely export label only.

Moet Hennessey - which owns Cape Mantelle and Cloudy Bay - now has Mountadam - and has recently taken over an Australian distributor. The private German company, Hess, has just purchased a controlling interest in Peter Lehmann Wines leaving Grant Burge as the largest Barossa Valley producer privately owned.

The runner-up for Peter Lehmann Wines, Allied Domecq, says that it may now look to start its own Australian winery from the ground up because of the dearth of middle size Australian wineries available.

The reality of the large four producers controlling some 80pc of the market is that there is a large gap between those companies, the next tier and the plethora of small wineries. McWilliams Wines, Yalumba and McGuigan Simeon are, of course, notable exceptions.

Many of the small medium wine producers which have now been acquired grew out of small companies because of the unique and sustained boom of the 1990s. This boom made it possible to grow a wine business in a capital intensive industry, with limited capital - a situation that never existed before in the 200 year



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history of the wine industry in Australia.

Investors readily subscribed for public floats - and taxpayers invested in tax effective vineyard investment. Apart from the Cockatoo Ridge float of a wine brand in 2002, no wine company float has occurred in recent years. Tax driven vineyard investment has dried up since the refusal by the large wine companies from 1998 to enter into new fruit purchase agreements.

At this point, the unique set of circumstances which existed have disappeared altogether notwithstanding the fact that demand for Australian wine overseas has continued to grow at unprecedented levels. The wine industry is no longer the flavour of the month with the investment community, or taxpayers, looking for tax effective investment. We are unlikely to see many wine industry floats while even the largest companies struggle to increase profits and projected earnings, and are under share price pressure.

Consequently, small to medium wine enterprises are likely to find it difficult to access capital - and difficult to grow significantly during this decade.

Competitive pressure is also likely to suppress profits, reducing the amount of earnings available for reinvestment.

It is likely that small to medium wine enterprises will turn increasingly to private investors to take long term positions in wine companies. Small to medium wine enterprises are unlikely to be attractive to venture capitalists because of the lack of a public float option as an exit strategy.

Mergers between unlisted small and small to medium wine companies are a possibility to gain economies of scale, as opposed to access to capital.

The outlook is therefore for an ever increasing gulf between the likely performance of large and mid-tier wine companies, which can be expected to grow, and the performance of small wine enterprises, which will struggle for growth because of lack of access to capital.

The Australian dollar has now appreciated against the US dollar to six-year highs (exceeding US0.70 cents) as against the currency in our major wine market. The question for next year is will this affect volumes - and litre returns - or has Australian wine been sitting comfortably within existing price categories in the US - and, therefore, be able to withstand some price increase.

The owners of small to medium wine enterprises will need to be set lesser growth objectives and work hard on improving quality - and net litre returns - rather than substantially increasing volumes.

As against this, the industry has never been better placed in terms of access to knowledgeable and experienced personnel in winemaking, sales and marketing. University courses abound and the result is that a significant crop of wine professionals in the industry have an educated background in wine marketing - as well as some practical experience.

This investment by government, the industry and educational institutions will stand the industry in excellent stead as Australian wineries have access to a wide range of marketing professionals, with world's best knowledge, for decades to come. Most of these people are young, with less than 10 years experience. Watch out when they hit 15 to 20 years experience of marketing Australian wine in a worldwide market place.

They will be a formidable force indeed.

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