



TAYLOR WOODINGS



INDUSTRY FOCUS

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Has the Government Given the Wine Industry a Chance to Breathe...?

Key facts

- Serious rationalisation necessary
- Exports and internal markets in decline
- End of GFC provides little relief
- But Government does not adopt recommended move to Volumetric System

More information

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The recently released Henry Tax review had many winegrowers anxiously waiting to hear if rumoured tax changes would become a reality. In particular whether Australia's wine equalisation tax would be replaced with a "volumetric" system based on alcohol content. Such a change would result in a significant reduction in income for small producers and potentially force the closure of several small wineries.

But when Kevin Rudd and Wayne Swan announced the accepted recommendations of the review, Wine tax arrangements remained unchanged. The Henry review recommended moving to a volumetric tax system but the government expressly ruled this out at this stage. But with a federal budget and election looming, it remains to be seen whether this will be only a temporary reprieve for the industry.

Several factors must certainly have been weighing on the governments mind. The governments decision had to juggle tax simplification with the reality of a Wine Industry reality with a less than rosy future. Supply and reduced demand has left the Australian wine industry suffering from a significant grape glut. Many growers and wineries will now be forced to consider if they have a future given almost certain losses and continuing uncertainty surrounding the sustainability of the industry.

After peaking in October 2007, exports of Australian wine declined sharply by eight million cases in volume and 21% in dollar value compared to 2009. Domestic sales of Australian wine have fallen significantly due to cheaper imports and the increasing popularity of New Zealand Sauvignon Blanc.



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The result is a current surplus of more than 100 million cases of wine. A wine surplus likely to double over the next two years if production continues to outstrip demand by the current 40 million cases per annum.

‘At least 20 per cent of bearing vines in Australia are surplus to requirements, with few long-term prospects. On cost of production alone, at least 17 per cent of vineyard capacity is uneconomic.’¹

Taylor Woodings has worked with several wine industry participants, seeing first hand the issues they are facing and how they may be addressed. We discuss these below.

Grape oversupply

During the 1990’s significant investment was made planting new vines and expanding the industry on the back of tax incentives, rising grape prices, tree changers, managed investment scheme raisings and expanding exports due to the fascination of Australian wine with US and the UK customers. Aided by a relatively low Australian dollar and the industry’s own estimate of a ‘blue sky’ future. This situation is now reversed, replaced with a significant surplus of wine estimated currently at 987 million litres. Some of the reasons for the industry’s reversal include:

- Significant over plantings, due to increases in investment
- Higher Australian dollar, reducing price advantage
- Reduced domestic demand for Australian wine and increase in imported wine

The massive grape surplus has resulted in a significant reduction in the price of grapes and bottled wine. Fosters, Australia’s largest producer, has indicated growers are likely to receive as little as \$150 a tonne for Chardonnay for the 2010 vintage, approximately half the cost of production and a fraction of the \$900 they received in the good years.

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Uncompetitive Australian Dollar

In the boom years of the 1990’s the Australian dollar was trading in the US60 cent and UK33 pence range, whereas now it’s trading in the 90 cent and 60 pence range.

The dollar is at a 25 year high as a result of the resources boom and Australia’s interest rate differential. Not surprisingly this is having a significant effect on price competitiveness of Australian exporters and growth in wine imports.

Australian wine “branded” cheap

During the 1990’s boom, Australian wine popularity grew, and more producers wanted a piece of the action. Exports to the UK and US market grew significantly resulting in these markets being awash with relatively cheap, yet good quality, Australian wine. As a result, despite having a number of wonderful premium wines, Australia’s reputation overseas has become one of a cheap wine producer.

Accordingly, when the Australian dollar rose and Australian wine was no longer cheap, consumers turned to cheaper Chilean and Argentinean wine which are produced at a significant cost advantage to Australian wine.

¹ Winemakers Federation of Australia



Retail concentration

Over the last few years the two major supermarket chains, Coles and Woolworths have moved from customer to competitor entering the liquor retail market in a big way through LiquorLand, Dan Murphy, Woolworths Liquor, BWS 1st Choice and Vintage Cellars. This has been at the expense of the local liquor store and has had the result of forcing the retail price of wine down.

With supply greater than demand, a number of other cheap bulk suppliers have emerged such as Cellarmasters, Wine Selectors, The Wine Liquidation Centre, Clean Skin Groups and GraysOnline.

The growth in these supply chains has pushed retail prices down and provided outlets for wineries willing to sell wine at less than the cost of production, just to maintain some form of cashflow.

The oversupply has also enabled supermarkets to transform from customer to competitor through the distribution of low cost 'home brand' wine.

Reduced property prices

The difficulties facing the industry, coupled with a flood of properties on the market, have led to price reductions of at least 30% for vineyards across the country. In many areas (in particular the Riverland) vineyards are now worth no more than base land value (in some instances less) as there is a cost of between \$2,000 to \$4,000 a hectare to remove vines. The reduction in land value could expose owners to issues with their financiers and for those lucky enough to still have equity significantly reduce their ability to borrow further.

The challenges

Due to the combination of the factors detailed above many operators will face the following challenges in the short to medium term.

Increases in input costs:

- Water: Drought, rising infrastructure costs, government buybacks
- Fertiliser: Rising demand from China and India driving up global prices
- Labour: Rising visa restrictions and relative health of employment market
- Continued downward pressure on prices
- Increased competition in local and foreign markets
- Reduction in winery throughputs resulting in an increase in fixed costs per unit
- Difficulty in raising finance and increased pressure from financiers wishing to exit the industry

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Conclusion

Taylor Woodings understands the Australian wine Industry's many unique challenges. Intensive capital, vagaries of climate and large holdings of stock demand an approach that is both technically and operationally appropriate. Our experience extends beyond the spreadsheet to include an intimate knowledge of day-to-day operations at the cellar door. And ultimately the difference between a strong and marginal operation.

Despite the challenges there are opportunities for Australian wine given our quality and relative proximity to the growing Asian markets. The immediate future will be difficult however, as with many industries, rationalisation will bring significant benefits to those operators who are able to continue

Specifically Taylor Woodings can assist with the following:

Viability Assessment	Does your business plan and cost structure fit with the market segment you are targeting? We can benchmark your business against industry norms.
Financial Modelling	Taylor Woodings can assist with budgeting, financial modelling of the business operations and cashflow and debt amortisation models for financiers.
Product Costing Reviews	We can review your production costs to ensure your product pricing is correct.
Recapitalisation and Debt Restructuring	We can assess your current financing structure, make recommendations, and assist with capital requirements.
Workout Plans	Should your business be suffering financial stress we can carry out an operational review and provide restructuring advice.
Sale and or Equity investment	Taylor Woodings can assist with capital raising and/or sale of your business.
Restructure and or Exit Strategies	Taylor Woodings are specialists in corporate restructuring and accordingly can assist with a voluntary administration or winding up of the business if this is required.

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