The 'New World' Wine Revolution:

Redefining market opportunities, competitiveness factors and Australia's potential

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As an overseas observer of your industry, I have always been deeply impressed by the industry's commitment to quality and what has been required to achieve that quality. I don't believe any other wine-producing country in the so called 'Old' or 'New World' is thinking strategically like this, setting their objectives and planning for the substantial capital resources required to achieve them.

In the context of the theme: 'Can the Australian wine industry meet the export goal with a world surplus of wine and an Australian shortage', I will briefly review world wine production and exports where the major 'New World' players, Australia, the US and Chile rank in the world. Then I will focus attention on Chile and California as producers and as export competitors to Australia. Each for their own different reasons will be major competition as you work towards your export goal.

So, what is all this talk about the 'New World' wine revolution? We are referring to a very fundamental shift that had started in the early/middle 1980s where wine consumption trends in key world markets began to move away from regional wines (that are produced in what we call the 'Old World' and are difficult for consumers to understand) to varietal wines (that are produced in the 'New World' and have been easier to understand).

In large part this shift has come about because of technical developments that have produced more approachable, consumer-friendly wines than many of the 'Old World' regional wines. Often these innovations originated in Australia or other parts of the 'New World' but they are now impacting on the way 'Old World' wines taste.

World wine production

The European Union producers, predominantly France, Italy and Spain account for 62% of world wine production, while the US is only 6%, Australia 2% and Chile 1%.

Although world wine production has dropped from its peak in recent years, consumption has declined by 20% and the world surplus still averages about 5.5 billion litres per year and is growing as a percentage of total production. Consumption has fallen sharply in most major wine-producing countries over the past three decades.

Of the total wine produced in the world, only 18% is exported. The EU countries lead the way with France and Italy equal, accounting for about 50% of the total. The US has grown to 3% and Chile and Australia are equal with a 2% share of world exports. Because of the small share the 'New World' producers have, less than 10%, it may be that Australia's real competition is not in fact other 'New World' competitors but rather France, Italy and Spain. But this issue will need to be addressed at a later date in detail.

Some of Australia's competitors receive billions of dollars in support from their governments. Even under the new provisions of GATT, which will reduce subsidies, EU producers are projected to receive US$1.5 billion by the year 2000 in the form of direct export refunds, product intervention, aid for the use of must and in acreage reduction programs. However, in the US the scant government support through the Market Promotion Program is currently under attack in Congress. The Australian Government needs to understand these issues and the support that the Australian wine industry will require to achieve the industry's year 2010 objectives.

All cases quoted are in standard nine litres. Dollar figures are US dollars. Plantings are in hectares. Statistical resources are OIV and the individual wine industry institutions in each country.

'New World' exporters 1990

How did the US, Chile and Australia compare on the international market in 1990? (Seeing California accounts for over 95% of US wine exports, when we talk about US exports we are referring to California wine exports.)

In value California exported 150% more than Chile and 43% more than Australia in 1990. California also led the way with volume, with almost three times as much wine sold as Australia and more than twice as much as Chile. However, on a per litre basis, Australia was establishing a better image by exporting better quality wine at a higher price—over US$2 a litre—while Chile was gaining a reputation with a lower price image that they have since exploited so successfully in major world wine markets.

By 1994 the situation had changed dramatically. Australia leads the way in value, now 50% ahead of California and 100% ahead of Chile, with a gain of over 200% since 1990 and almost US$300 million in export sales. The Chilean revenues increased by almost 200% to over US$100 million, with a per litre price not much below California. Chilean volume is almost level with Australia and both have increased substantially since 1990, while the US has grown only marginally.

Australia is much more reliant on its major market, the UK, when compared to the importance of the largest market for both California and for Chile. Interestingly, California sells to their largest market at a lower price than Chile sells to their largest market.

USA 1994 major markets

Between 1990 and 1994 California exports only increased from 100 to 130 million litres. In 1994 export revenues to their five major markets accounted for 67% of the value and 63% of the volume. Canada grew by 11%, the UK continues to be important from a small, growing base and Asia grew by 19%. Interestingly, table wine exports increased by 14% in volume for the first six months of 1995 with the UK running ahead into first place at 1.7 million cases, up 54% over 1994.

The challenge for California will be to keep the commitment to the export market during the current period of strong domestic market growth and wine shortages. For Californian exports to achieve their potential in the next five years the international market needs assurance from producers that they are serious this time about building a viable export business. With a total domestic wine market of almost 200 million cases annually there has been a history of start and stop in Californian wine exports based on how the US market was performing.

In 1994 total US federal government support to wine exports was US$8.5 million. Since 1986, wine exports have increased over five-fold and the percentage of funding to exports has fallen from 12% to 3% in 1994.

Chilean export markets

Between 1990 and 1994 Chilean exports increased from 43 to 108 million litres. To fully understand this growth Chile only exported 16 million litres of wine in 1985. Last year exports were made up of 7.5 million cases of bottled wine, 38 million litres of bulk and 244 thousand cases of sparkling wine. In terms of value, wine exports have increased from US$11 million to US$142 million since 1985. Last year the average per litre price dropped to US$1.33. The US market continues to represent 20% of volume as Chile effectively positions itself in the fast growing, lower-priced fighting varietal market. The UK market is set to grow quickly from the current small base as quality improves and Chile begins to fill the vacuum created by increased prices from other producing countries and hit the key £3.99 price point.

Generally, Chile's strength has been in producing good tasting, inexpensive wines from the four classic varieties and in part this explained why they have been able to restrict the importance of their top five export markets to only 55% of value and volume.

In the last two years Chilean quality has jumped dramatically and will continue to improve in the next ten years and increase pressure in key export markets. While government export promotional budgets are not yet significant and the official export office, ProChile, usually manages any activity, the government actively supports production of value-added export products and encourages rural development. The start-up of a new Chilean Wine Bureau in the UK indicates a change in the previously modest efforts to promote wine exports.

Australian 1994 export markets

Between 1990 and 1994 Australian exports increased from 37 to 114 million litres. With 1994 export revenues growing by 6%, volume down 13% and pressure on supply, Australia is entering a new era in wine exports. The short term priority is no longer bulk to Sweden and New Zealand, but to defend existing shelf space, in the UK particularly, against other challengers while new plantings come into production in the next few years, when Australia will be prepared to fuel export growth. Carefully select the markets where you increase prices during this period of transition and carefully select the markets where you hold prices. In some markets, such as the UK, once it has gone shelf space will cost twice as much to buy back, and Australia will need it in a few years when its new plantings come on stream. Also, with over 80% of revenue and volume selling to Australia's top five markets, there are other major opportunity markets to develop—Germany, the Netherlands, the Far East and the USA, to name a few.

Chilean wine industry strengths

In evaluating the relative competitiveness factors, Australia may want to look at developments in Chile. Having recently returned from my seventh visit to Chile since August 1993, I continue to be amazed at the pace with which the Chileans are adapting their wine industry and building their international market. Everywhere I go I see new vineyard plantings, conversion to new trellis systems, new winery buildings and upgrading of existing facilities and equipment. All this activity has resulted in dramatic improvement in the quality of wines from the 1994 and 1995 harvests, most of which is still not on the market. By way of background, wine production started in Chile over 200 years ago and peaked in the 1930s when consumption reached 80 litres per capita. The Chilean wine industry then slipped into decline due to a shift away from wine to other beverages.

Consumption is still declining, now at 30 litres per capita, and with a current population of 13 million, the domestic market is limited to consumption of lower quality table wine, generally sold in 1 litre Tetra bricks. There is a small growing domestic market for 'export' quality wines, as they are called, but Chile cannot rely on domestic market growth to absorb substantial quantities of varietal wines. Although the country has had a turbulent political history, a democratically elected government has been in power since 1989 and they are not likely to want to change this current stability.

Chile is blessed with a Mediterranean climate ideal for wine grapegrowing, with considerable diversity in site and climate that is only just beginning to be understood now.

There is virtually unlimited land available at low cost for vineyard development. It has an abundant supply of water from the Andes snow melt, plentiful cheap labour, no mildew or phylloxera, rapid improvements in viti- and vinicultural techniques, a looming excess of the classic varieties due to recent plantings with a limited domestic market and a buoyant financial community willing to support industry development.

Also, Chile is currently negotiating to join Canada, the USA and Mexico in NAFTA. Much to the concern of Californian producers this could result in a reduction of US duties for Chilean wine and will open the potentially large Mexican market.

Perhaps most fundamental to their strength and potential challenge to Australia in wine exports is the high level of US-educated management expertise available in Chile which has built their economy and other agribusiness exports; for example in the fresh fruit industry Chile is world leader with over 10% of the international market and annual revenues approaching US$1 billion. And interestingly, the current head of OIV is Alejandro Hernandez, former Professor of Santiago's Catholic University Enology School and a local winery owner.

Chilean wine industry weaknesses

The basis for the growth of Chilean exports since 1985 has been sales of inexpensive varietal wines. In the US these wines have presented a real challenge to California fighting varietals at lower price points. There is a risk that despite recent quality improvements Chile may be locked into their bargain price image for the next few years. Although, they are quickly developing entries in the sub-premium categories and the image of Chilean wine will improve with time. Most new plantings are limited to the four classic varieties— Cabernet Sauvignon, Chardonnay, Sauvignon Blanc and Merlot and they have no variety that they can call their own, like Australia can Shiraz, or South Africa Pinotage or California Zinfandel. Although the infrastructure is being developed and much is being done to improve it through importing the expertise, the wine industry still lacks the necessary depth of experience.

Chile has only 30 wineries, of which four (Concha y Toro, Santa Rita, Santa Carolina and San Pedro) control over 80% of the domestic and export business. Mechanisation is arriving quickly but low labour costs (US$1 to US$2 an hour) may socially slow its acceptance. The historically famous Cabernet vineyards in Maipo are already in the southern suburbs of Santiago, a fast growing city of 5 million, and in the future may be absorbed by urban growth.

Concha y Toro

Because of Chile's mandatory pension scheme, whereby all employees have to contribute to their retirement plan, the pent-up demand of the Chilean investment community has resulted in many local companies being over-valued. Based on their performance in the six months to June 1995 Concha y Toro, Chile's largest winery and one of the country's four publicly traded wine companies, had an estimated market value of US$238 m and a price earnings multiple of 46.5.

Since 1993 the buoyancy of Chile's stock market has served to keep international investment focus on Chile with a series of international offerings of Chilean companies. American Depository Receipt Listings (ADRs) are an investment vehicle that allows overseas public companies to trade in the US and investors to buy overseas stock.

In October, 1994 Concha y Toro went to Wall Street with a US$53 million Initial Public Offering and 63% was sold to US investors, most of them institutional. The stock opened at US$19.25 a share and currently trades at US$17.25. The company plans to use the money to pay down debt, fund vineyard acquisitions and cover operational costs. A few eyebrows were raised in California by a Chilean winery so effectively tapping into the US equity market!

Chilean plantings 1994

Chile has 53,000 ha of winegrapes. Of these 26,000 ha are planted to the classic varieties. With current exports at just over 100 million litres and a declining export market, production of the classic varieties alone will shortly approach double the 1994 export sales. Chile will continue to have a plentiful supply of classic varieties at low costs to continue to develop their world market at competitive prices as their quality continues to improve. Current bulk prices FOB Chile are between 75 and 85 cents (US) per litre for Chardonnay, Cabernet and Merlot and 45 cents (US) for Sauvignon Blanc.

California wine industry strengths

To change the focus to California and the competitive threat that it represents to Australia internationally, let us look at its relative strengths and weaknesses. Some of the strengths are that large areas of land are still available at costs that may be higher than Australia's or Chile's, but are still lower than Europe's. Weather conditions are good, with considerable diversity of location and climate. Significant resources are committed to research at various institutions and the industry has a highly developed infrastructure.

Mechanisation is rapidly being incorporated throughout the industry and is supplemented with plentiful, experienced and inexpensive labour resources. There is considerable varietal diversity throughout California. The blending of regional wines to produce better quality, lower priced wines for the mid-priced market opportunity is only now being understood. The wine and grape industry is of strategic importance to the state. Generally, federal and state taxes are low: federal excise tax is US$2.54 per case and state taxes vary from a low of 50 cents a case (California) to a high of US$6 (Florida).

California wine industry weaknesses

The major weaknesses of California as an exporter is the huge and growing domestic market that currently absorbs all production and takes away from the strategic significance of developing an international market for most companies.

Exporters have to believe that it is going to grow into a meaningful business long term because with today's grape shortage most of California export volume is sold at a break-even based on the competitive international environment. The potential limitations on water availability for future agribusiness development is a serious threat to all Californian agriculture, vineyards particularly. The current replanting costs of phylloxera are estimated to be over US$1 billion. And although taxes are currently low and they are certain to increase in the future, government regulations are increasing costs in the industry in various ways.

California plantings 1994

Total wine grape plantings are 138,000 ha in California. The growth in the last ten years has been in Chardonnay and Cabernet Sauvignon, and recently to a lesser extent Merlot. In 1994, the total crush of wine grapes was 2.2 million tonnes, down 5% from the 1993 tonnage. The latest crop estimate for 1995 was revised down to 2.2 million tonnes, flat with the 1994 harvest. With continued double digit growth for varietals in the US and future shortages of grape supply, a major opportunity exists for Australia and other overseas varietal producers to fill this vacuum at all price points. Bulk prices for California appellation Cabernet Sauvignon start at US$1.70 per litre with Chardonnay a little higher. Because of demand Merlot is unavailable on the bulk market today.

Californian Cabernet Sauvignon

Total tonnage of Californian Cabernet Sauvignon crushed has increased from 65,000 in 1984 to 172,000 tonnes in 1994. Grower returns moved from US$550 to US$825 per tonne over the same period. New bearing acreage has increased only by 3% in 1995 and the current Cabernet crop is projected to be between 160,000 and 190,000 tonnes for a small 3% increase over 1994. Some industry projections are for a shortfall in the California appellation Cabernet of up to 5,000 tonnes by 1997 and closer to 15,000 tonnes in the regional appellations (i.e. Napa, Sonoma, etc.).

Californian Chardonnay

Total Californian Chardonnay tonnage crushed increased from 70,000 in 1984 to 306,000 tonnes in 1994. Grower returns decreased from US$1,000 to US$825 per tonne over the same period. In 1995 new bearing acreage increased 6% and the crop is projected at between 300,000 and 350,000 tonnes. Industry estimates are that the Chardonnay shortage for the California appellation may be up to 30,000 tonnes by 1997 and larger in the regional appellations.

Californian Merlot

Total Californian Merlot tonnage crushed increased from 8,000 in 1984 up to 54,000 tonnes last year. Grower returns increased from US$600 to US$1,100 per tonne over the same period. In 1995 bearing acreage increased by 20% and the crop is projected at between 58,000 and 73,000 tonnes.

Australian wine industry strengths

Let's look at the relative industry and export strengths and weaknesses of Australia compared to California and Chile. Australia has political and economic stability. Australia still has lower cost land available, relative to California and parts of Europe. Australian industry infrastructure is highly developed and has some strong research institutions to support technical developments.

Most would agree that Australia has a proven leadership position in many aspects of world viti- and vinicultural developments, hence the host of Australian flying winemakers and technicians now working in most wine-producing countries of the world. Australia has a broad selection of varieties to satisfy all demands and something nearly unique, the Shiraz grape, that produces a style unique to Australia.

Australia pioneered the concept of regional blending to produce better quality wines very effectively and you should not be drawn into limiting yourselves by reverting to regional appellations to satisfy overseas buyers. You have new areas that can be drawn on for this in the future. With your export success Australia has very effectively developed entries into all price categories of the international wine market, from Jacob's Creek to Grange and all categories in between, and is recognised as a leader in world class wine production.

Australian wine industry weaknesses

Some Australian limitations are similar to California's: water, for one, and this will become a political issue, to prove the economic viability of grapes over other crops. Australia's relatively high labour costs place pressure on margins, but on the positive side this has forced the industry to mechanise more rapidly than others in the world. A similar problem to California is the current shortage of winegrapes; that will be relieved in both cases in the next three to four years. Government support has been an issue, as it has in the US, and their support must be developed if the year 2010 goals are to be achieved. Phylloxera may prove to be a costly problem for the industry.

Concentration of Australia's exports in only a few markets will prove a weakness long-term and it is important to build new wine markets during the early stages of development.

Australian plantings 1994/95

Australia's current plantings total 42,000 ha, 20% less than Chile, one third of California's plantings. However, Australia has 35,000 ha planted to the classic varieties (Chardonnay, Cabernet, Shiraz, Merlot, Semillon, etc.) whereas Chile has only 25,000. I understand that the year 2010 goal projects total Australian plantings to grow by 3,000 ha per year to over 78,000.

US beverage consumption, 1994

I would now like to look at the US wine market. To put US wine consumption into perspective with other beverages consumed, the wine industry has some competition in what I call the 'share of tummy'.

1994 beverage consumption, litres per capita, consists of wine at around 6.8 litres, beer at 3, coffee, tea, milk and soft drinks at a whopping 180 litres per year. It is interesting to note that US consumers have their preference in the chiller box. Most of these beverages are consumed chilled, with the exception of coffee and red wines. Most of the tea is iced.

USA wine trends

Consumption of wine turned the corner in 1994, increasing 2% to 193 million cases, making the US the fifth largest wine market in the world after France, Italy, Spain and Germany. National per capita consumption still remains very low, but with a population of 260 million the potential is enormous. Total domestic wine shipments increased to 163 million cases and excluding coolers grew by 3%. Imports increased to 30 million cases, their highest level since 1989. The wine cooler category declined at double-digit rates in 1994, down 27%, just as it did in 1993. Champagne and sparkling wine consumption continued to decline in 1994, dropping to 13 million cases, while import sparklers increased to 4 million cases. Dessert and fortified wines dropped last year to 11 million cases. Shipments of all types of California wine increased to 151 million cases, an increase of 4 million cases over the previous year to 80% of total wine consumed in the United States. This alone represents some 55, 000 to 60,000 more tonnes of California grapes used.

Total table wine, the tax classification for still wine 14% or under, increased in 1994 to 157 million cases. Imports grew to 25 million cases with Australia up 13% to 1.4 million cases, and Chile up to 24% to 2.2 million cases.

Domestic table wine increased 5% to 133 million cases. Varietals from all sources are driving the market and many major California wineries posted double-digit gains in 1994 and this is where the real opportunity exists for Australia.

Value of USA wine imports, 1985–1994

When we look at the FIS value of US wine imports by major producing country, Australia ranks second after France with a value of US$4.02 per litre. This indicates a solid premium positioning in the US market when compared to Chile or Italy, which places Australia well for further growth in the premium US wine market.

California table wine shipments

When evaluating the potential for Australian wines in the US, it is important to understand the market and grape supply trends of the California wine industry and that 80% of all wine sold in the US is from California. In 1994 total California table wine shipments increased to a record 117 million cases. Shipments of premium varietals, US$3 and above (750 mL bottle at retail), increased by 7% to 48 million cases. Since the early 1980s varietal sales growth has continued at an annual compound growth rate of 15%. Last year even California jug wines (all sizes above the standard 750 mL bottle) increased to 69 million cases, with reds increasing 10% while whites stopped their ten year decline. Volume increase for jug wines is due to the dramatic growth of the 5 litre cask size. For example, supermarket sales of White Grenache increased by 54% last year in this new package. The surge of the cask package has put pressure on margins but may be the beginning of expanding the wine consuming base as happened in the Australian market twenty years ago.

California table wine revenues, 1980–1994

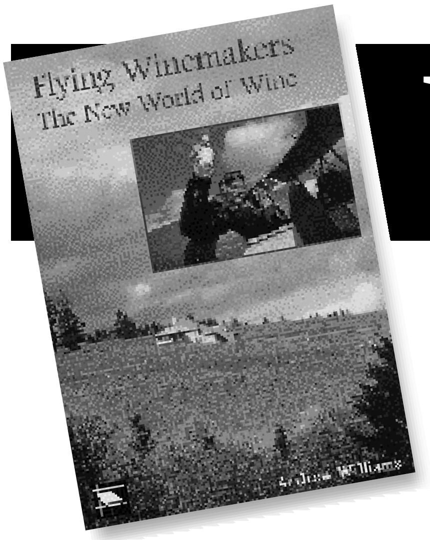
In 1994 winery revenues for all California table wines exceeded US$2.6 billion. Since 1987 premium wine revenues have exceeded jug wines and last year increased to 67% of total.

Shipments of premium California wine increased by 5 million cases to a total volume of 48 million cases in 1994. Looking at how the California premium market is segmented by retail price, the popular premium sub-category grew to 35 million cases, the super premiums to 10 million and the ultras to 3 million. Premium California table wines represented one third of all US table wines. Varietals are now part of mainstream wine consumption in the US and this indicates a major opportunity for growth in the future for suppliers from all countries, including Australia.

California varietal shipments 1994

In 1994 Chardonnay continued to be the favourite wine of US consumers, increasing 20% to 18 million cases and representing 38% of all premium California varietal sales. Cabernet Sauvignon shipments increased by 16% to 9 million cases. Merlot is still on fire, increasing over 40% to 3 million cases sold.

Red Zinfandel and Pinot Noir also turned in impressive performances, growing by 23% and 40% respectively in 1994. As is the case with Californian grape supply for Chardonnay, Cabernet Sauvignon and Merlot, in the short term sales projections will exceed increases in production and shortages



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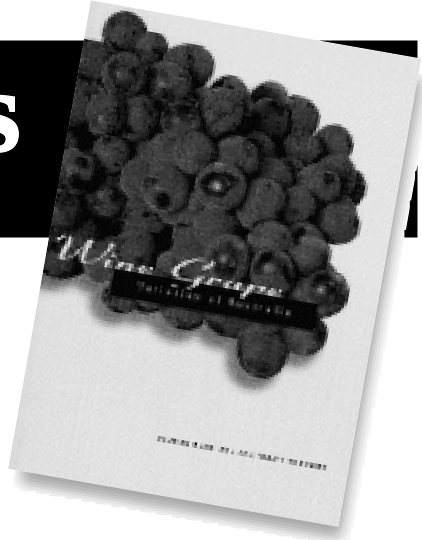

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Flying Winemakers: The New World of Wine
Andrew Williams
The wine industry is becoming more internationalized as ideas and customs move freely across national borders. 'Flying winemakers' now carry the latest and best in winemaking practice around the world. Andrew Williams argues that the flying winemaker phenomenon has not only changed the *way* wines are made but has influenced the *style* of wine being made. His lively prose profiles some of the more visible 'flying winemakers', such as Kym Milne, Richard Smart, Peter Bright, Tony Laithwaite, John Worontschak, Gaetane Carron and Hugh Ryman.
66 pages, colour plates, paperback $19.95 + $3.00 postage

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George Kerridge and Allan Antcliff
Thousands of vines have been imported into Australia since the first in 1788. Many of these varieties were misidentified. *Wine Grape Varieties of Australia* describes 88 of the most important winegrape varieties, with photos of leaves, growing shoots, canes and fruit for vine identification, alongside an ampelographic description of each variety and its current world status. Cultivars which have been 'fingerprinted' by DNA profiles are identified by a DNA logo. Based on the pioneering work of Allan Antcliff, brought up to date by George Kerridge. Published in association with CSIRO.
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Ed. Phil Nicholas, Peter Magarey & Malcolm Wachtel
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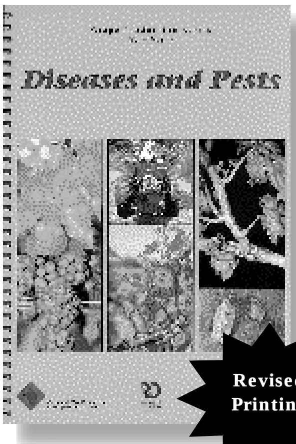

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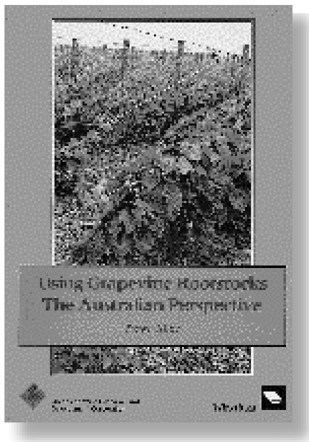

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will result. California prices will increase and the growth will slow down.

Clearly a major opportunity exists for Australian suppliers to fill this vacuum at all price points as branded entries because, as opposed to the UK, the US is very strongly a branded wine market and this bodes well for developing the difference that is Australia.

The Chardonnay train is going to be tough to slow down in the US because, since 1988, sales of California Chardonnay alone have increased by over 300% from 4.2 million cases to 18 million cases in 1994.

In summary with respect to Australia's market opportunity in the USA, because of the current California shortage my advice would be to not waste any time in moving in now at all the premium price points. And, because of the pressure to hit critical price points in the UK and your current difficulty in doing so, you may find the US can absorb some of the slack from that very price-sensitive market. Remember, in the US, there may be a lower per capita consumption than in the UK, but there is not their exorbitant tax structure on wine and US consumers are generally able and willing to pay more for wine than UK consumers.

Australia's potential year 2010

I believe that Australia can achieve the potential outlined in the WFA strategy, effectively put into place over the last 15 years, by fundamentally continuing as an efficient low-cost producer of better quality wines than its competitors. Australia has the climate and the soils, the technical skills and the industry infrastructure. Australia does need the ongoing support of the Government to assist in making the industry an attractive and viable, long-term investment for overseas sources of capital to develop the industry.

Australia already produces a full range of products, from standard to premium to ultra premium, broader in quality and image than its major competitors. Australia is still relatively competitive on cost and it is critically important that cost remains in balance. However, there will always be lower cost producers than Australia arriving on the scene; Australia must expect these to capture an increasing share at the lower price points, but as Australia develops its business at higher prices it can always dip to lower price points if inventories dictate that it must.

And, yes, there may be a host of Australian winemakers showing Europeans and others in obscure parts of the world how to correct generations of inflexibility in how wine is made, and, yes, they are beginning to produce wines in the so-called 'Australian' or 'New World' style with upfront fruit, but don't forget that none of them will ever make a drop of Australian wine, and *that is what branding Australia as a quality wine producer is all about* and *that is what Australia has to sell most aggressively*.

And finally, none of your competitors in the world has yet done this much homework and planned this far ahead. Australia's planning alone sends a very strong message to those in the world financial community from whom support is needed to develop the wine industry, and it says a lot about Australia's current infrastructure and strength.

Remain Australian. That's what the wine world loves it for being and, after all, is the reason why Australia's wines taste the way they do. Never be complacent, stay ahead of the technical curve, refine and redefine the formulas and I believe that Australia can achieve it's year 2010 objectives.

But for those of you who have not yet done so, please, take a look at what is happening in Chile! You'll find it interesting and perhaps less threatening after a visit. ❑