DRAFT DISCUSSION PAPER

FOR PUBLIC CONSULTATION

The Over-supply of Cool Climate Wine Grapes

Prepared by the Cool Climate Study Steering Committee

of the South Australian Wine Industry Council

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SOUTH AUSTRALIA
WINE
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KEY MESSAGES

1. The Australian wine industry is over-supplied with cool climate wine grapes. In 2007, anticipated over-supply of cool climate grapes in South Australia will be 42,000 tonnes but by 2011 this is expected to have increased to 100,000 tonnes, from about 10,000 ha of vineyards.

2. If the cost of grape production in a cool climate region is greater than $450-$500 per tonne, the vineyard faces high financial risk and is probably unprofitable and unsustainable.

3. In the past, the industry made optimistic projections about future grape needs but those were based on expectations about wine prices per litre, which have proven incorrect.

4. The current over-supply and low price scenario will not end soon and individual wine grape producers must carefully consider their long-term viability.

5. Some growers, who cannot sell their grapes to wineries, may consider making their own wine (branded or bulk) to utilise grapes. If the grower does not have winemaking experience, connections with winemakers and capital for this step, the probability of success is remote. It also crowds the wine market with more brands.

6. Wine grape producers need close relationships with winemakers who have established brands associated with the grower's own region.

7. Cool climate grapes destined for popular premium wines must be produced at low cost, regardless of region.

8. Demand for grapes for premium wines may not be as restricted as for popular premium wines and some regions have certain varieties that will remain successful.

9. More premium wines must be sold if the capacity of South Australia's cool climate regions is to be maintained.

10. Wine grape producers should be aware of their rights under the *Wine Grapes Industry Act 1991.*

EXECUTIVE SUMMARY

At the December 2005 Supply / Demand meeting held by the South Australian Wine Industry Association, considerable concern was expressed that cool climate wine grape producers were in distress. The meeting called for preparation of a report similar to the study conducted on the warm climate Riverland, *A Report on the Impact of Current Grape-Pricing Trends on the Riverland Region*[1], to address the situation in cool climate regions. The South Australian Wine Industry Council (SAWIC) endorsed preparation of a study that would examine the economic situation of wine grape producers in the Coonawarra, Adelaide Hills, Clare Valley, Langhorne Creek, Barossa Valley and McLaren Vale Regions. Appendix 1 provides further details of the scope of the study as presented to the SAWIC on 10 July 2006.

The wine industry has always experienced cycles of growth followed by periods of over-supply and the rebalancing of supply and demand. In fact, a University of Adelaide study has identified 5 instances of boom, over-supply, decline and recovery since the 1850s with the most recent in the 1960s. The cycles are caused primarily by changes in demand and trade that have periodically made grape growing and winemaking uneconomic in particular regions (Osmond and Anderson, 1998).

Australia and some other parts of the world, particularly in the Old World, are experiencing the rebalancing part of such a cycle. In Australia's case, the over-supply is as large as 25% of annual vintage volume once grapes sold at unsustainably low prices have been taken into account. The balance between supply and demand is not expected to be restored until 2010 (AWBC, 2005). Even then, assuming the status quo is maintained, it is likely significant parts of the crush will be supplied at less than long-term cost of production.

In this environment of global over-supply, Australian wineries also continue to face difficult times. A relatively strong Australian dollar, continued consolidation of retail outlets and the increasing number of wine participants and wine brands put pressure on wineries to reduce wine prices or increase marketing support to achieve sales (Deloitte, 2006).

[1] PIRSA (2005): "*A Report on the Impact of Current Grape-Pricing Trends on the Riverland Region*". http://www.pir.sa.gov.au/byteserve/wine/riverland_wine_price_impact_assessment.pdf

This report assesses the current over-supply of cool climate wine grapes to assist industry participants in making informed decisions about their future. It shows that cool regions differ from warm climate regions in several respects – principally that they are relatively low yield and high cost regions and produce some of the highest quality grapes. As such, these regions are critical to the future of the Australian wine industry if it is to continue to distinguish itself from other, rapidly emerging New World producers of wine.

The study shows the over-supply problem in cool climate regions cannot be considered in isolation. The reasons for this include that regional blending has been a critical element in the success of the Australian industry, being one of the primary means of creating value-for-money, quality wines. The study also emphasises that the over-supply of cool climate grapes must be understood as the inability to sell wine, and therefore use grapes, at prices that provide a viable, sustainable return to cool climate producers. Another feature of over-supply is that excess cool climate grapes are displacing warm climate grapes and being used in lower price wines, but at prices unsustainable to cool climate producers. The critical point is that rebalancing supply and demand will not occur until profitable, sustainable uses are found for cool climate grapes or, alternatively, a lower proportion of Australian wine production is from cool climate regions.

The report considers the recent growth phase that has created the over-supply and identifies developments along the supply chain that are increasingly separating winemakers from wine grape producers. In particular, the significant number of new entrants with little industry experience or industry intelligence is making the transmission of market signals more problematic. This may have been a factor in new wine grape producers entering the industry, especially in the latter part of the growth phase.

The key to solving over-supply is growth in demand, especially export demand. However, the long-term solution must involve export growth at prices that will accommodate cool climate grape production costs. History suggests little change in wine grape tonnage should be expected. In previous rebalancing phases, tonnage fell only marginally and most of the adjustment was by means of large and prolonged declines in grape prices.

The current process of rebalancing may also be exacerbated because of excess wine stocks. Both those elements suggest rebalancing will be delayed beyond 2010, the point at which stocks are expected to return to desired levels and export growth will have been sufficient to ensure all grapes being produced will be crushed.

This report acknowledges the significant pressures faced by wine grape producers and winemakers in this period of over-supply rebalancing. Investigations made in preparing this report revealed the impact this is having on weakening communication channels and relations between some wine grape producers and winemakers. This may be adding to the burden of adjustment in cool climate regions.

This report provides a series of recommendations endorsed by the SAWIC. Each is aimed at finding long-term solutions to the over-supply problem. They encompass:

- A coordinated initiative that will promote demand growth, which is the best means of rebalancing supply and demand for cool climate wine grapes;
- One critical means of enhancing information flows along the wine industry supply chain is to improve understanding of the link between the cost of grapes and the prices of bottled wine. This study has looked at wine grape production and identifies the need to take into account typical costs of activities further along the supply chain;
- There is a clearly identified need to improve decision making by wine grape producers and suggestions are made about how that may be encouraged;
- The South Australian wine industry must recognise the importance of a close partnership between winemakers and the increasingly diverse group of wine grape producers, and be proactive in maintaining good industry relations. An important step by industry will be establishment of a voluntary code of conduct.
- There is an opportunity to investigate innovative new enterprise models for wine grape producers, processors and winemakers. Organisations may improve efficiency by reducing the costs of coordination, increasing the scale of operation and enhancing the flow of information. There have been a number of models established within the wine industry and the lessons of their success and failure are useful in guiding future developments.

RECOMMENDATIONS

As a result of this study, the SAWIC makes the following recommendations to the South Australian Government and the South Australian wine industry.

RECOMMENDATION 1: That a marketing strategy be developed with a regional branding framework to promote higher value, premium wines from cool climate regions. This should be linked to tourism.

This study shows there is a need to accommodate the high cost, high quality grapes from cool climate regions. The current branding of the Australian wine category does not extend to the sub category level of States and regions. The South Australian Government has already allocated funding to the South Australian Wine Industry Association to develop a regional branding framework to strengthen a brand franchise for South Australian wine, and stage 1 results are due in December 2006.

In addition, the South Australian tourism industry benefits greatly from the presence and international profile of the wine industry, one of this State's premier attractions. The over-supply might jeopardise this in the future if the rebalancing process involves losing vineyards from premium quality regions. A marketing campaign emphasising the quality of South Australian wine regions will ameliorate that risk.

RECOMMENDATION 2: That further analysis be undertaken of the relationship between the costs of wine grapes and the prices of bottled wine.

This report focuses considerable attention on relations among winemakers and wine grape producers. One means of improving those relations is to clarify the costs involved in moving from grape production to sold wine. A greater understanding of these costs would help wine grape producers to understand the prices offered by winemakers and enable winemakers to communicate the reasons behind shifts in the prices paid for grapes.

RECOMMENDATION 3: That a simplified toolkit and training program be prepared to assist decision-making in the wine industry.

In preparing this report, the template of grape production costs, which PIRSA makes available to the wine industry, has been reviewed (PIRSA, 1999).[2] That template or

[2] The template was prepared along with a report "Seasons of Change: A guide to successful vineyard investment in a changing world", 1999.

tool is comprehensive and has been well received by some members of the industry. However, the tool is complicated because it aims to assist in decisions to start up new vineyards as well to assist existing wine grape producers in decision-making and assessing business sustainability.

The SAWIC is aware of different proposals within industry to develop a simplified toolkit and training program. It supports these initiatives but emphasises the need for a coordinated approach from industry.

RECOMMENDATION 4: That steps be taken to improve industry relations, particularly between winemakers and wine grape producers.

The Winemakers' Federation of Australia and Wine Grape Growers Australia are jointly developing a voluntary code of conduct and the SAWIC supports that development. Some members of the industry believe the code should be mandatory. The Council is supportive of a voluntary code of conduct implementation timetable being developed with specified deliverables and the Commonwealth establishing a watching brief on its uptake.

RECOMMENDATION 5: That assistance be provided to promote the uptake of alternative enterprise models in the South Australian wine industry.

This report describes some changes to the wine industry supply chain that are making the transmission of market signals from consumers, through winemakers to wine grape producers more complicated. In conjunction with recommendation 4, consideration should be given to the promotion of innovative thinking and action regarding new and better enterprise models. Some exemplars already exist in the wine industry and these successes should be highlighted. However, caution must be taken because there have also been failures. There is an opportunity to investigate the different models and consider the advantages and disadvantages of each. The SAWIC seeks to develop materials to assist the industry in identifying the successful models and the potential to adapt them to individual circumstances.

Section 1: INTRODUCTION

1.1 Background and purpose

This study of over-supply of cool climate grapes is linked to other work of the South Australian Wine Industry Council (SAWIC). The work conducted in the Riverland in 2005 provided detailed analysis of the warm climate grape-growing region. The SAWIC submission to the Primary Industries Ministerial Council meeting in November 2006 makes recommendations to the Commonwealth regarding the over-supply of wine grapes (SAWIC, 2006).[3] All these works deal with the current over-supply situation and are focused on 3 key themes:

- Industry reform and restructuring;
- Market development; and,
- Building better industry relationships

This study confirms the relevance of those themes to the cool climate regions.

The primary purpose has been to focus on cool climate regions and collect information that will alert industry to the nature and scale of its problems. This has involved summarising the work of others to develop a general understanding of the problem and then collecting information from six of the cool climate regions in South Australia to show their distinguishing characteristics and what role they will play in the rebalancing process.

[3] SA Wine Industry Council (2006): "Responding to the Current Over-supply of Australian Wine Grapes. A paper to the Primary Industries Ministerial Council."

1.2 Outline of the report

The structure of this report is as follows.

Section 1.3 provides background information on the wine market, including the current international wine industry and its impact on the Australian wine industry.

Section 1.4 describes the dimensions of the over-supply problem in South Australia, particularly as it affects cool climate regions.
Section 2 describes the cool climate regions and the roles they play in the Australian wine industry.

Section 3 provides insight into the recent spectacular growth in wine grape production that preceded over-supply, firstly by placing the boom in historical perspective, and secondly by describing changes in the grape growing industry that have emerged during the growth years.

Section 4 describes the rebalancing process. It discusses predictions about the duration of that process and examines possible means by which it can occur. It also reports information obtained from wine grape producers regarding the manner in which rebalancing is proceeding in cool climate regions.

1.3 Wine market context

1.3.1 Global wine market

Australia's role in the global wine marketplace means it cannot expect to be immune from pressures being experienced throughout the world.

Over-production has been a factor in the world wine market for more than three decades. This was primarily a feature of Old World (France, Italy, Spain) production and comprised lower quality wines, but with the expansion of planting into the New World (Australia, United States, Chile, South Africa, Argentina), surpluses have become a feature of most wine producing countries, and with improvements in technology, the surplus is often of a better quality than formerly.

There has been a decline in Old World wine production since the peak in 1982. This mainly reflects supply control measures implemented in the European Union. As well as reducing wine output, the measures have shifted production towards more marketable varieties of wine grapes. The decline has been partly offset by increases in wine production in the New World countries. However, Italy, Spain and France still dominate in terms of area under vine and overall wine produced.

World consumption of wine is relatively stable and the medium-term prospects for world demand for wine are for a small, steady increase in total demand. This disguises the long running contrast between rapid growth in consumption in Australia's main export markets and falling consumption in traditional wine consuming countries. The United States and United Kingdom are expected to account for much of the increase in consumption, followed by Canada, The Netherlands, Ireland and Sweden. The importance of demand conditions in France, Italy and Spain, where total wine consumption is expected to decline, is in the size of their consumption and production. Between them they account for almost 30% of world consumption and 50% of world production, and the importance lies in the impact that any changes in those countries have on their net export potential. (ABARE, 2006).

The other important aspect of the global market, shown in Figure 1.1, is the structure related to price and volume. The volume of wine sold has a strongly negative correlation with price, with lower priced wines selling in much greater volumes. The price/volume structure of the global market highlights the relatively small opportunity

for high priced wines (above $15) and the much larger opportunity below that price. The cost of production however does not change as dramatically, again making it more difficult for smaller wineries to compete.

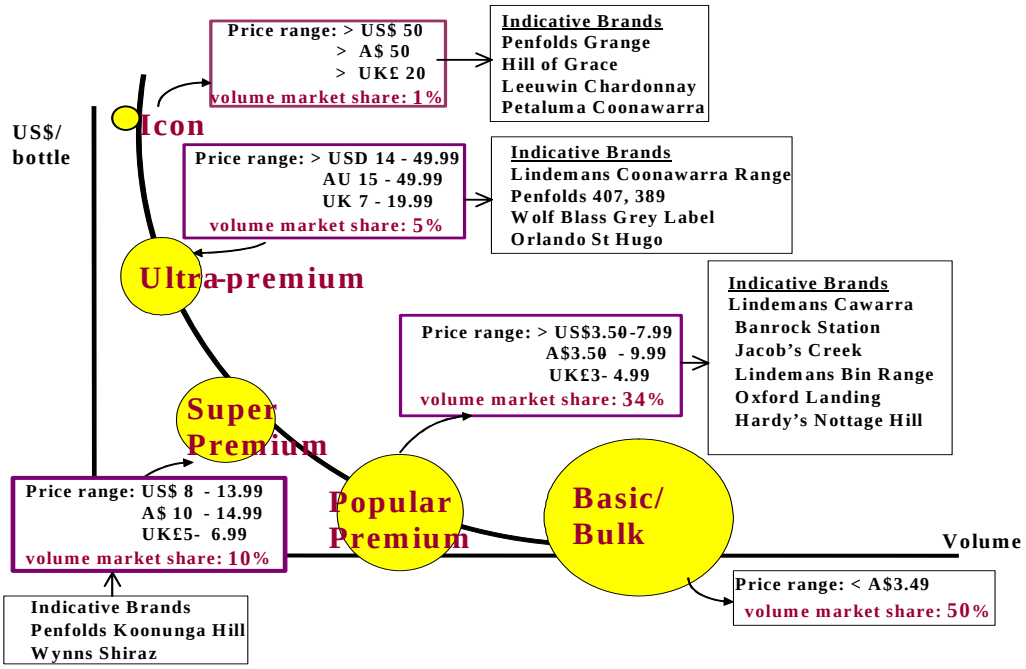

Figure 1.1: Global Price Points and their Share of Volume
Source: Adapted from Lockshin, Rabobank

Wine businesses grow in order to spread their overheads and use their size to gain efficiencies in the purchase of inputs including grapes, bottles and electricity. Margins are thinner from wines priced under $10, but larger companies need these wines to create the scale necessary to make higher margins on higher priced wines and to cater to the needs of the large retail chains. All these pressures push wine producers to reduce costs wherever they can, including prices paid to wine grape producers.

In addition to surplus wine production, Australian wineries are facing extreme margin pressure due to strong domestic and global competition, unfavourable exchange rates, and greater retail consolidation leading to restricted channels to market. The 2006 Deloitte benchmarking survey showed that, among wineries of all sizes, income was being reduced by higher general and administration costs, interest expenses, higher selling costs and inventory write-downs.

1.3.2 Australian wine industry

The Australian wine industry has experienced rapid growth since the early 1990s, driven by a dramatic increase in exports. During this period, Australia has quickly gained a solid reputation as a producer of high quality, consistent and affordable wines supported by innovations in grape growing, winemaking, sales and marketing.

Australia is now the world's 4th largest wine exporter behind France, Italy and Spain with approximately 60% of production exported. This level of international exposure, while providing increased sales, makes the industry increasingly vulnerable to global trends and fluctuations in exchange rates. Market access and quality maintenance are keys to the survival and growth of the Australian industry. The very important small boutique players throughout Australia need this as much as the export dominated global companies.

Surplus production is an issue for Australia and adversely impacts on all sectors of the industry. Storage capacity is limited and stock in hand is capital intensive and needs to be cleared for ensuing vintages. This lowers prices for domestic markets, in a relatively flat market, and does not substantially grow the number of consumers.

The Australian market place has seen a dramatic increase in the range and volume of cleanskin (unlabelled) wines, wines in super and ultra premium brackets being reduced in price, including to lower price brackets, and the unsustainable use of wines from cool climate regions for popular premium and bulk categories. This is placing significant cost pressures on Australian wineries, with mergers and takeovers and large write-downs in stock reflecting the difficult situation.

In 2005-06, Australian export volumes grew 12% to a record 738 million litres while value grew 2% to A$2.801 billion. However, average price per litre declined 9% to A$3.80, representing the fifth consecutive year the average price for Australian wine exports has declined.

Competitive pressure is pushing down wine prices globally for all wines below the luxury price points. South Australia is exposed to all wine price points within the global wine industry, but particularly in the popular premium segment. While this market segment has been the key factor in Australia's success as a wine exporter and continues to grow, the average price per litre continues to drop.

1.4 The extent of over-supply

Figure 1.2 shows there is a significant excess of supply over preferred intake of wine grapes in South Australia. It shows that, after a sequence of years of strong growth, a large gap now exists between actual and preferred usage of South Australian grapes.

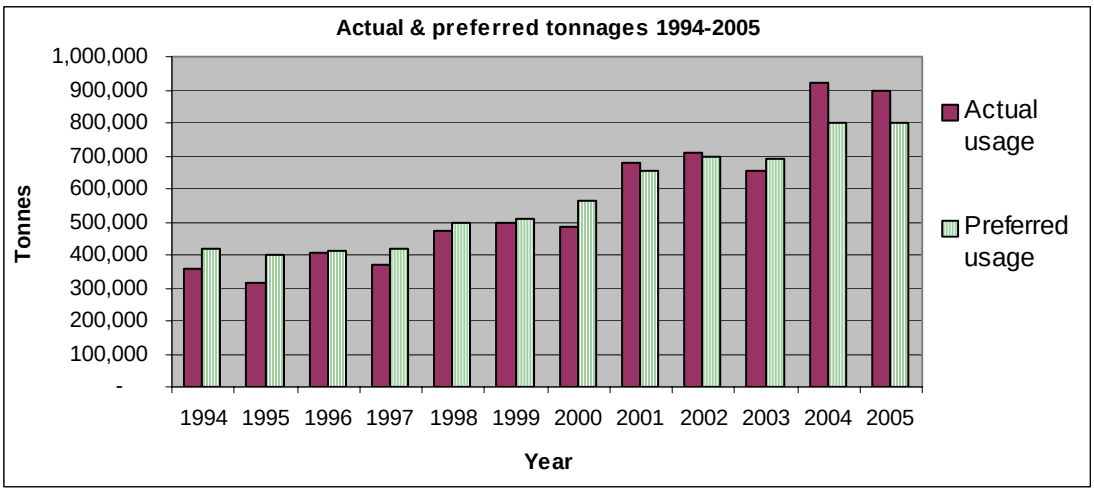

Figure 1.2: Actual crush and preferred intake of South Australian wine grapes, 1994-2005
Source: Phylloxera and Grape Industry Board of South Australia

	2007 (tonnes)	2011 (tonnes)
Estimated Supply	466,000	500,000
Winery Demand	355,000	400,000
Committed Intake	424,000	341,000
Surplus Expected	**42,000**	**100,000**
Spot Market Demand	0	59,000

Table 1.1: Supply vs demand: South Australian cool climate wine grapes
Source: Phylloxera and Grape Industry Board of South Australia, 2006

Table 1.1 compares estimated supply and demand for cool climate regions and forecasts an increase in the expected surplus from 2007 to 2011. It is worth noting that in 2007 winery demand is forecast to be 111,000 tonnes below the estimated supply, however the committed intake of wineries will leave an expected surplus of only 42,000 tonnes. This identifies 70,000 tonnes committed to wineries beyond their demand requirements.

To analyse the situation regarding cool climate grapes requires a disaggregation of the data in Figure 1.2. Table 1.2 shows actual total crush versus total preferred intake by variety of grapes, an over-supply of 12% overall.

Variety	Total crushed	Total preferred	% of demand supplied
Cabernet Sauvignon	168,074	137,897	122%
Grenache	22,692	17,633	129%
Merlot	58,157	53,447	109%
Petit Verdot	17,453	13,654	128%
Pinot Noir	18,548	16,874	110%
Ruby Cabernet	14,029	4,569	307%
Shiraz	254,980	229202	111%
Others	17,703	12,996	136%
Total red	**571,636**	**486,272**	**118%**
Chardonnay	163,888	152,363	108%
Chenin Blanc	6,115	5,821	105%
Colombard	36,030	36,831	98%
Muscat Gordo Blanco	22,637	23,462	96%
Riesling	28,739	27,387	105%
Sauvignon Blanc	17,057	18,743	91%
Semillon	30,244	27,284	111%
Others	21,819	23,727	92%
Total white	**326,529**	**315,618**	**103%**
GRAND TOTAL	**898,165**	**801,890**	**112%**

Table 1.2: Actual crushed and preferred intake of South Australian wine grapes by variety, 2005, tonnes

Source: Phylloxera and Grape Industry Board of South Australia

The imbalance is worse for reds than for whites. In the white varieties, by volume Chardonnay stands out as the most unbalanced, while in reds Cabernet Sauvignon, Ruby Cabernet and Grenache are particularly over-supplied.

More insight can be gained from Table 1.3, which shows the expected imbalance (i.e. difference between supply and demand) in 2006 and 2008, according to the three most common grape varieties across the cool and warm climate regions.

Table 1.3 shows:

- A major imbalance exists within the Adelaide Hills with supply being twice demand and the imbalance expected to grow in major red varieties;
- The Barossa and Clare valleys show very large and growing imbalances in major red varieties;
- The Coonawarra is particularly over-supplied with Cabernet Sauvignon.

	2006			2008		
Region	Estimated supply	Estimated demand	% Difference	Estimated supply	Estimated demand	% Difference
Shiraz						
Adelaide Hills	2,610	1,299	50%	2,655	1,119	58%
Barossa Valley	39,195	30,546	22%	42,579	35,246	17%
Clare Valley	13,712	10,004	27%	14,352	11,727	18%
Coonawarra	9,558	9,283	3%	10,503	10,333	2%
Langhorne Creek	19,130	24,470	-28%	20,360	27,518	-35%
McLaren Vale	28,305	26,226	7%	28,962	29,091	0%
Other cool climate regions	52,422	35,114	33%	53,658	34,449	36%
Cool climate total	**164,932**	**136,942**	**17%**	**173,069**	**149,483**	**14%**
Riverland	106,260	112,618	-6%	108,948	118,184	-8%
Grand total	**271,192**	**249,560**	**8%**	**282,017**	**267,667**	**5%**
Cabernet Sauvignon						
Adelaide Hills	2,817	1,495	47%	2,826	1,133	60%
Barossa Valley	11,176	7,942	29%	11,232	6,850	39%
Clare Valley	9,728	6,744	31%	9,792	6,124	37%
Coonawarra	28,701	18,933	34%	29,808	20,342	32%
Langhorne Creek	20,240	22,535	-11%	20,540	24,686	-20%
McLaren Vale	11,502	8,829	23%	11,592	8,057	30%
Other cool climate reg'	26,717	27,980	-5%	29,162	28,804	1%
Cool climate total	**110,881**	**94,458**	**15%**	**114,952**	**95,996**	**16%**
Riverland	70,160	55,193	21%	70,200	70,833	-1%
Grand total	**181,041**	**149,651**	**17%**	**185,152**	**166,829**	**10%**
Chardonnay						
Adelaide Hills	7,350	7,577	-3%	8,470	7,095	16%
Barossa Valley	5,540	7,342	-33%	6,470	6,939	-7%
Clare Valley	2,832	2,624	7%	3,112	2,662	14%
Coonawarra	3,980	2,574	35%	4,210	2,741	35%
Langhorne Creek	7,015	7,863	-12%	6,900	9,367	-36%
McLaren Vale	6,460	10,161	-57%	7,310	12,267	-68%
Cool climate total	**33,177**	**38,141**	**-15%**	**36,472**	**41,071**	**-13%**
Riverland	102,425	106,716	-4%	110,100	118,553	-8%
Grand total	**135,602**	**144,857**	**-7%**	**146,572**	**159,624**	**-9%**

Table 1.3: Estimated supply and demand of South Australian wine grapes by variety, 2006 and 2008
Source: Phylloxera and Grape Industry Board of South Australia.

Tables 1.2 and 1.3 might understate the full extent of the over-supply problem. The movement of grapes among regions within South Australia and in other States makes the notion of regional balance difficult to measure and an unreliable guide for future supply decisions. In addition, some grapes are being purchased currently at prices below cost and that is causing significant financial distress in cool climate regions.

Section 2: THE ROLE OF COOL CLIMATE REGIONS

2.1 Characteristics of cool climate regions

This study recognises that there are differences between cool climate regions (many are detailed below), thus it is somewhat artificial to speak of cool climate regions as a single entity. Some winemakers make finer distinctions between regions than a simple warm vs cool climate split.[4] Nonetheless, discussions with the industry have revealed ways in which cool climate regions differ systematically from warm. Understanding these differences is important in clarifying the adjustment process now underway. The cool climate regions also differ among themselves, and that provides some indication of how each region might be affected by the adjustment process.

As part of this study, a series of workshops was held to collect cool climate cost data to compare with the warm climate data from the PIRSA 2005 Riverland report previously cited. The purpose of this data collection was to provide an indication of costs within and between regions, not a comprehensive analysis of the cost of production for each region. Other data was provided by experienced industry participants on a confidential basis. [See Appendix 2 for cool climate cost data.]

In comparing the cost data collected in the cool and warm regions, a number of important points are clear:

- Costs per hectare vary surprisingly little between warm and cool climate regions and among cool climate regions;
- Only large warm climate vineyards have significantly lower costs per hectare;
- The Adelaide Hills and parts of the Barossa Valley and Coonawarra have significantly higher costs per hectare than warm regions;
- There is a considerable cost range within some regions, especially the Barossa;
- Data collected during the workshops align well with the independent data.

[4] Some consider as many as 5 different climatic regions; others make distinctions based on regions that give a distinctive characteristic to all varieties or to some, or regions that can supply many varieties (that amounts to warm climate, some specific cool climate regions and others).

Some distinguishing characteristics of the various regions that affect the costs of grape production include:

- Langhorne Creek uses mainly mechanical harvesting and is economising by changing fungicide and herbicide application methods and by varying the pruning regime;
- Coonawarra production systems vary considerably with a significant number of trellis systems and management techniques. Large variations in pruning costs were also reported;
- McLaren Vale has significant costs associated with trellis systems, including multi-tiered trellising;
- Clare has lower pest and disease risks in most seasons. Water, hand pruning and harvesting in older vineyards are significant costs;
- In the Barossa, there are considerable differences between new and old vineyards and a range of microclimates. Water costs vary substantially. Prices paid for grapes varied from $85 to $2700 per tonne;
- Adelaide Hills vineyards with higher rainfall and disease pressure require more fungicide and herbicide sprays. Canopy management requirements are also higher and some vineyards require cane pruning.

Cool climate regions are also characterised by lower yields per hectare than warm regions, leading to a higher production cost per tonne.

From the data collected, the following points emerge:

- Langhorne Creek is the lowest cost cool climate region;
- Coonawarra and Clare rank next, followed by the Barossa and McLaren Vale
- Adelaide Hills is the highest cost region;
- The variations relate largely to the different labour requirements in each region and those in turn relate to disease pressure, canopy management activities, type of pruning and method of harvesting;
- Variations are further explained by differences in pest management and water costs.

Given these data, which show that cool climate regions are high cost, low yield regions, why would grapes be grown there? The answer is simply that winemakers indicate the quality of grapes produced is generally higher.

The cost data also give an indication of which regions are most vulnerable to the downturn in prices, that is, those with high costs per tonne and greatest over-supply. That would imply the following:

- The Adelaide Hills is a highly vulnerable cool climate region with the highest costs and large over-supply in certain red varieties;
- The Barossa and the Coonawarra have a great variety of growing conditions and have large over-supply in some varieties;
- Clare has over-supply in all three major grape varieties and is also a relatively low yield region;
- Langhorne Creek appears to be least vulnerable with low costs and little over-supply, but is most vulnerable with respect to water supplies.

However, it is important to stress the limitations on those conclusions; the vulnerability of a region must consider other factors outside the cost data:

- Grapes are bought and sold between regions;
- Vulnerability depends on a range of financial factors, including costs relative to prices and the wine grape producers' financial situations;
- Vulnerability also depends on wine grape producers' access to alternative sources of income;
- The issue of regional vulnerability depends on the composition of the regional economy (how important is the wine industry in the mix) and on the alternatives to wine industry production that are available.

No matter how the cool climate regions rank against each other, the data collected establish that cool climate grapes are relatively high cost grapes, and that raises the issue of the relationship between cool climate and warm climate regions.

2.2 The relationship between cool and warm climate regions

Analysis of the over-supply of wine grapes in Australia centres on an understanding of vineyard costs. The over-supply of wine grapes arises because sales of wine lag behind production of wine. That lag exists even though some grapes remain unprocessed or unpicked, and some are now being sold at below cost. The results are an expanded stock of unsold wine and falling wine prices, which are problems for winemakers, and declining grape prices across nearly all varieties, an obvious problem for wine grape producers.

Australia is a relatively small producer in global terms, and the amount of Australian wine that can currently be supplied at a profit to world markets is insufficient to absorb all the grapes harvested, meaning there is an over-supply of wine grapes *at viable prices*.[5]

The question arises of whether this is primarily a problem of cool climate regions, where the imbalance between the preferred uptake of grapes and the likely supply is greatest. This situation is sometimes defined as the "80:20/60:40" split (see for example Australian Wine and Brandy Corporation, 2005, p 23) meaning that, while the warm climate regions grow only 60% of Australian grapes, they make up 80% of Australian wine sales. Conversely, the cool climate regions are said to produce 40% of grapes but sell only 20% of wine. It implies that, in the absence of cool climate grape supply, there would be no over-supply of Australian grapes.

The 80:20/60:40 split is actually stating that 80% of Australian wine sales are made at prices which, once winemaking costs are taken into account, imply prices paid for grapes that only warm climate regions can supply profitably.[6]

That conception clarifies the point being made here: that the cool climate regions produce much of the nation's high quality, high cost grapes. If warm and cool climate grapes were indistinguishable in quality, the 80:20/60:40 split would be resolved and there would be declines in the quantity of cool climate grapes sold. However, the problem for warm climate regions is the superior quality of cool climate grapes. This

[5] As stated recently by one wine industry executive, "For too long there has been a belief that all supply matches all demand … (when) it is very clear that the economics of production … prove that this is not the case." (David Woods, CEO, Hardy Wine Company, *Wine Australia Magazine*, **5**, April-May 2006).
[6] Mr Woods commented further in the article previously cited: "15-20% of wine sold globally can profitably afford to come from what we loosely define as our "cool climate" regions, but … 40% of our production from the last two vintages has been cool climate" (ibid).

means that, given little or no difference in price to the wineries, cool climate grapes can, and currently are, displacing warm climate grapes on the basis of quality. In other words, the current over-supply is resolving itself in cool climate grapes being supplied at a loss to wineries which, if there were no over-supply, would use warm climate grapes.

That is causing difficulties for warm climate growers and is unsustainable for cool climate producers. While there is a limit to the transfer of grapes between cool and warm climate regions, determined predominantly by the transport costs and partly by possible restrictions due to phytosanitary regulations, the movement of grapes from cool to warm climate regions is a fundamental feature of the adjustment process.

There is one, somewhat ironic, point to make. Although losses are being made in both warm and cool regions, winemakers can now afford, and will choose, better quality grapes so that during the over-supply period, it is likely wine quality is being improved. That is a point taken up again in Section 4.

2.3 Wine prices and the costs of wine grapes: the problem of viable supply

The over-supply must be understood with reference to the prices paid for Australian wine and the costs of producing Australian wine grapes. Figure 2.1 from the AWBC shows the prices paid for exported Australian wine and what is happening to these wine prices.

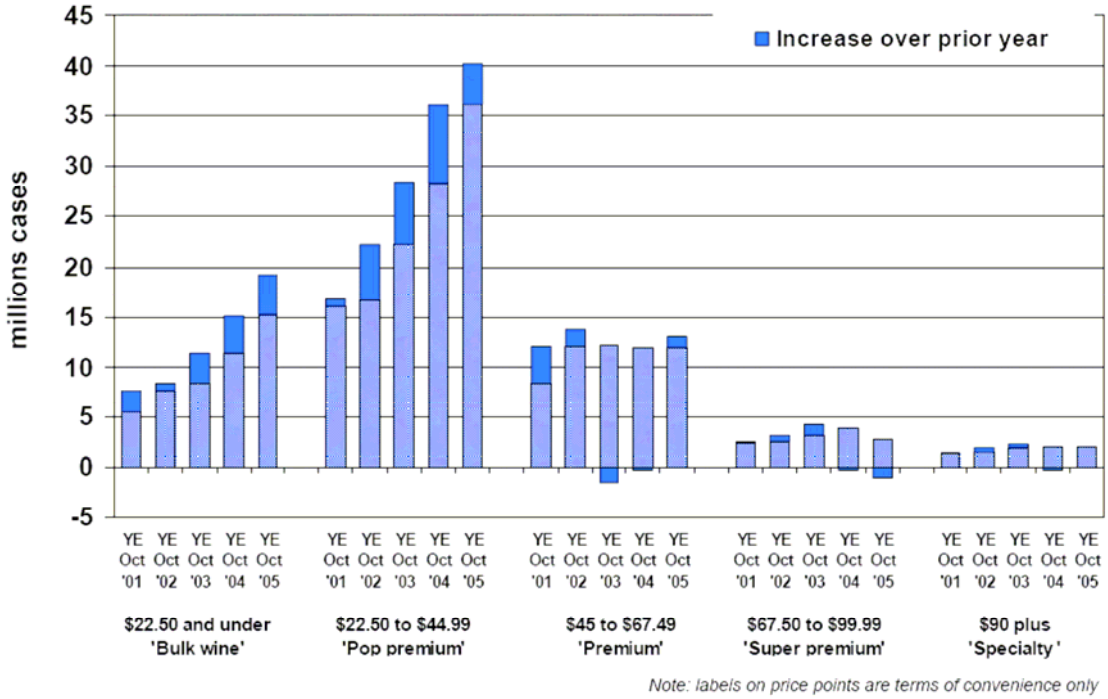

Figure 2.1: Prices and volumes of Australian exported wine, 2001-2005
Source: Australian Wine and Brandy Corporation

Two points emerge:

- Most Australian export wine, measured by volume, is sold at either bulk or so-called popular premium prices.
- Growth in export demand is almost entirely within these low price categories, thus the proportion sold at the low price points continues to rise.

More wine is being sold but only at lower prices. There are two possible reasons for this. First, consumer demand is changing with a growing portion of consumers only willing to drink Australian wine at lower prices; second, the need to reduce surplus stocks is forcing winemakers to sell wine at lower prices. It is likely that the declining prices are a result of a combination of those two factors.

The price declines on export markets also raise the question of the relationship between wine prices and grape costs – what prices can wineries offer for grapes at different price points. A comprehensive answer to that question is beyond the scope of this report, which has focused primarily on grape production. The need for further work in that area is acknowledged in the recommendations. However, information that has emerged in preparing this report is summarised in Table 2.3 below.

Information source	UK retail price per bottle	Implied cost of grapes per tonne
SA Centre for Economic Studies	£3(A$7.50)	$300
	£4(A$10)	$500
	£5(A$12.50)	$700
Industry authorities	£2(A$5.00)	$300
	£3(A$7.50)	$400

Table 2.3: Preliminary data on the relation of wine prices to grape costs

Based on this data, the vast majority of Australian wine grapes cannot be profitably supplied to make wine for sale at current export market prices. The problem is especially acute for high cost, cool climate growers but also impacts on warm climate regions.

Rebalancing the wine grape sector requires viable markets for wine made from cool climate grapes or a reduction in the volume of cool climate supply. Otherwise cool climate grapes will continue to displace warm climate grapes and spread the losses throughout the sector. To solve the over-supply problem for cool climate wine grape producers, export growth at higher than average price points is needed.

Section 3: CHARACTERISING THE GROWTH PHASE

Before considering the process that will rebalance the supply of wine grapes, it is useful to analyse the recent growth surge that created the over-supply. Two approaches have been considered in this study: the first to provide an historical perspective by comparing the recent growth to previous booms in grape production; and the second is to collect information about how the industry has changed during the recent boom.

3.1 An historical perspective on the 5th Australian wine grape boom

A University of Adelaide study of the Australian wine industry since 1850[7] makes the point that oscillations in the international wine industry have been documented for 3000 years. The rollercoaster ride of booms, over-supply, declines and recoveries is not new and, as with all previous downturns, this one will end.

The central characteristics of the recent boom are as follows:

- It is the fifth since 1850[8];
- It is the longest and strongest (that point was made during the acceleration and 4 years *before the end* of the boom);
- Wine sales growth has been overwhelmingly in export markets;
- While there has been some government assistance, it has had only a marginal impact;
- The drivers have been global: the emphasis on quality and brand, combining Australia's clean, green image, a value-for-money product and the global reach of wine companies.

The importance of exports in the recent growth phase is clear from Table 3.1 which shows that the recent phase is not the first in which exports have played a significant role but is the first to have raised exports to the central role.

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[7] Osmond, R and Anderson, K (1998) "Trends and Cycles in the Australian Wine Industry, 1850 to 2000" Centre for International Studies, University of Adelaide.

[8] The previous booms and their primary characteristics are:

1. mid 1850s: domestic demand arising from Gold Rush wealth; exports limited by duties and transport costs, boom short lived but critical to establishment of the industry
2. mid 1880s: domestic and export demand; exports dominated by generic bulk wine, mainly dry reds
3. 1918-c1930: large increase in plantings, export boom, government assistance via export subsidy for fortified wine
4. 1960s: entirely domestic demand with Australian consumption increasing 3 times.

Time period	Exports as % of sales
1900-1910	16%
1930	> 20%
1980	< 0%
1985	2-3%
1993	33%
2005	60%

Table 3.1: Export Intensity of the Australian wine industry, exports as a % of total sales.

Various sources.

The historical perspective alerts us also to the possible shape of the adjustment phase. While there is no apparent regularity in the length of the downturns, each has had a serious effect on wine grape producers' income. The adjustment occurs not by means of declines in the volume of grape production but by declines in the price of grapes. As the authors put it, "each of the booms in vineyard area … has been followed by a long plateau and a large decline in grape prices …" (emphasis added).

It must be recognised that, because wine grapes are a derived demand, factors affecting the demand for Australian wines affect the demand for wine grapes by Australian winemakers. This downturn in grape prices must also be acknowledged as a reflection of the downward pressure on wine prices being experienced by winemakers.

The difficulties now being experienced by wine grape producers are the reverse side of the growth phase when the shortage of grapes saw historically high prices paid. The University of Adelaide report noted that wine grape producers had "enjoyed a rising share of the benefits … (but) should international prices of Australian wines fall, winemakers will inevitably pass the decline back to wine grape producers."

3.2 How the industry has changed during the recent boom

One trend evident during the growth phase was that more of the crush is coming from independent wine grape producers or those who are not also winemakers. However, many of these have been linked closely to wineries by contracts and sales over many vintages. There are many types of independent grape producers, including:

- Large investors who have established large vineyards, sometimes using Managed Investment Scheme arrangements;
- Syndicates of small investors;
- Small producers who neither live at the vineyard nor derive a substantial portion of their income from wine grapes;
- Traditional, long-term producers, operating often family-owned vineyards;
- Recent entrants and recent re-entrants, some of whom have alternative and viable uses for the land put to vines.

It is important to recognise, as Table 3.4 shows, that many independent wine grape producers are small and some do not derive the majority of their income from grape growing.

Table 3.2 shows the proportion of the South Australian crush supplied by wineries' own vineyards and that supplied by independent wine grape producers.

The table shows:

- More of the recent growth in red wine grape supply has come from independent wine grape producers (Table 1.1 shows the over-supply problem is worse for red than for white varieties);
- Within the red and white classifications, the imbalance is also most acute for Cabernet Sauvignon and Chardonnay and these are the varieties for which recent growth has been mostly the result of supply by independent wine grape producers.

	1998			2005			2005 from 1998
	Independent grower	Total	Independent Grower share	Independent grower	Total	Independent Grower share	% Change
Shiraz	65,758	96,462	68%	203,984	254,980	80%	15%
Cabernet Sauvignon	40,873	68,342	60%	122,694	168,074	73%	18%
Total red varieties	153,284	230,601	66%	445,876	571,636	78%	15%
Chardonnay	50,081	72,649	69%	132,749	163,888	81%	15%
Colombard	11,661	12,892	90%	33,868	36,030	94%	4%
Total white varieties	179,579	240,712	75%	257,958	326,529	79%	6%
Grand total	**394,605**	**556,854**	**71%**	**700,569**	**898,165**	**78%**	**9%**

Table 3.2: Independent Wine Grape Producers Share of Total Supply, by variety 1998 and 2005.
Source: Phylloxera and Grape Industry Board of South Australia

These data are consistent with the view that the recent growth has been predominantly the result of plantings, not by wineries but by independent wine grape producers. This may indicate that some of the worst problems of over-supply have been caused by the surge in independent wine grape producers' share. This is not to say that the growth has not involved wineries because many plantings were made based on contracts offered by winemakers to prospective wine grape producers.

Table 3.3 provides further evidence to suggest over-supply might be associated with plantings by independent wine grape producers. It shows data on grape supply growth by region and the role of independent wine grape producers in that growth.

The growth in supply since 1998 tends to vary directly with the proportion supplied by independent wine grape producers: the greater the increase, the higher the proportion independently supplied. Regions such as the Coonawarra, McLaren Vale and Clare, where most grapes are supplied from wineries' own vineyards, have grown relatively slowly. In regions such as the Adelaide Hills and Langhorne Creek, where growth has been strongest, independent growers tend to make up a larger part of the whole. In the case of Langhorne Creek, the proportion of grapes grown by independents has also grown quickly (that is also true of the Coonawarra but there it has come from a very low base, the lowest of all the regions considered).

Region	Growth in supply 1998-2005	Growth in supply independent growers 1998-2005	Total supply from independent growers 2005
Adelaide Hills	181%	24%	88%
Barossa Valley	59%	41%	80%
Clare	54%	26%	55%
Coonawarra	11%	105%	41%
Langhorne Creek	270%	97%	68%
McLaren Vale	28%	64%	71%
Total cool climate	**66%**		**69%**
Total Riverland	**106%**		**90%**

Table 3.3: Growth in Supply and Change in Independent Wine Grape Producers Share of Total Supply, by region 1998 and 2005.

Note: Figure for supply imbalance for each individual region is estimated production/preferred; figure for cool climate and Riverland are supply/demand.

In summary, the limited evidence that exists suggests much of the growth that preceded the current over-supply is the result of decisions by independent vineyard owners. The varieties that have grown fastest and the regions that have grown fastest tend to have the largest number of independent wine grape producers. However, the picture is complicated and the data in tables 3.2 and 3.3 are only partial indicators of that trend.[9]

The general point seems to be that some of the excessive recent growth has been the result of decisions about vineyards that have been linked only tenuously to the needs of wineries. Whether or not that conclusion would be sustained if more data were available, it is apparent independent wine grape producers make up an increasing part of total vineyard ownership.

Another reason the relationship between Australian wine grape producers and winemakers changed during the period of growth is linked to the means by which success has been achieved. The Australian wine industry is fundamentally different from the Old World model. Wine growing regions of Europe focus on the notion of *terroir,* i.e. success is based on having particular regions produce particular styles of wine to the highest possible quality. The Australian industry focuses relatively more on grape varieties than on regions and has pursued quality by the skilful blending of grapes.

[9] The Barossa Valley, for example, has many independent growers but the total grape harvest has not increased substantially. Part of the complication is that some independent growers, especially in regions such as the Barossa and Clare, have close relations with wineries.

This means that transferring grapes about the country is and will continue to be a virtue of the Australian industry. Wineries now source grapes from many locations and large wineries neither need so many large vineyards adjoining their facilities nor are they as closely tied to local grape producers as they once were.

Another aspect of the growth phase has been the steady rise in the concentration of ownership among wineries so that the largest three wine companies now control 75% of Australian winemaking. That increased concentration has also been associated with a change of ownership so that wine companies now have new multinational links, which have played a key role in the strong export performance.

This growing concentration among winemakers is mirrored by consolidation and some collaboration among wine grape producers. For example:

- Some are using collaborative organisations to specify, monitor and enforce quality and delivery standards and also to strengthen wine grape producers' negotiating position by selling fruit from a common pool (examples include Winegrapes Australia operating in McLaren Vale and the CCW organisation in the Riverland);
- New vineyards are being developed on a much bigger scale, increasingly with professional managers acting for investment companies;
- Specialist viticulturalists and equipment owners are servicing wine grape producers and so operate profitably with higher fixed costs.

The intensive communication between wine grape producers and wineries to ensure grapes match the latter's specifications is one of the Australian industry's competitive advantages, but it imposes significant transaction costs on both parties. The move to greater aggregation among wine grape producers has been enhanced by wineries' apparent preference to deal with bigger and better-performing wine grape producers, or organised groups of growers. That preference has also prompted the emergence of specialist grape processors. They now stand between wine grape producers and wineries. Some of these also make and sell their wines on export markets. Contract processing for others has also increasingly become a major activity for smaller wineries that do not have sufficient grapes to fully utilise their production facilities.

All those developments are part of the separation of wineries from vineyards and impact on the flow of market signals within the industry. We have already seen that

significant growth has come from independent wine grape producers. Table 3.4 allows us to further characterise that growth as the result of a large increase in the number of small wine grape producers.

	Average size (ha)		% < 10 ha	
Region	**2001**	**2005**	**2001**	**2005**
Adelaide Hills	12.1	12.5	62.2%	65.1%
Barossa	16.7	16.0	54.1%	60.5%
Clare Valley	21.5	19.3	59.2%	62.6%
Coonawarra	54.5	43.6	29.7%	41.5%
Langhorne Creek	50.6	61.3	22.3%	15.6%
McLaren Vale	15.4	12.9	61.4%	69.7%
Riverland	15.3	13.9	62.2%	67%
Total SA	**19.9**	**18.4**	**57.0%**	**62%**

Table 3.4: Changes in average vineyard scale and vineyards of less than 10 ha during the recent boom

Source: Phylloxera and Grape Industry Board

Note: some large wine grape producers may be reflected more than once in these data, which may distort the picture.

The table shows:

- Relatively small vineyards exist in many regions and it is not true that warm climate regions have greater average scale;
- Vineyards are largest in the Coonawarra and Langhorne Creek;
- Vineyards are smallest in the Adelaide Hills and McLaren Vale.

The table also shows the recent growth phase has had little effect on vineyard size although there have been some well known large plantings by investment companies and fewer, but still a significant number by wineries, themselves. That means there has been a large rise of entries by smaller, independent wine grape producers.

The table also shows:

- There has been some growth in the Coonawarra of new, small vineyards, particularly those of less than 10 ha;
- Growth in Langhorne Creek has been the result of establishing relatively large vineyards;
- In all other areas, average vineyard size has remained relatively constant while the proportion of grapes grown in vineyards of less than 10 ha has increased.

In summary, while some growth has come from establishing new, large vineyards, much of it has come from significantly smaller establishments. Many of these smaller investors are new entrants to the wine industry with no prior industry experience. In these instances, the market signals registering within the wine industry have been too weak or slow in reaching those smaller investors who have fuelled much of the growth.

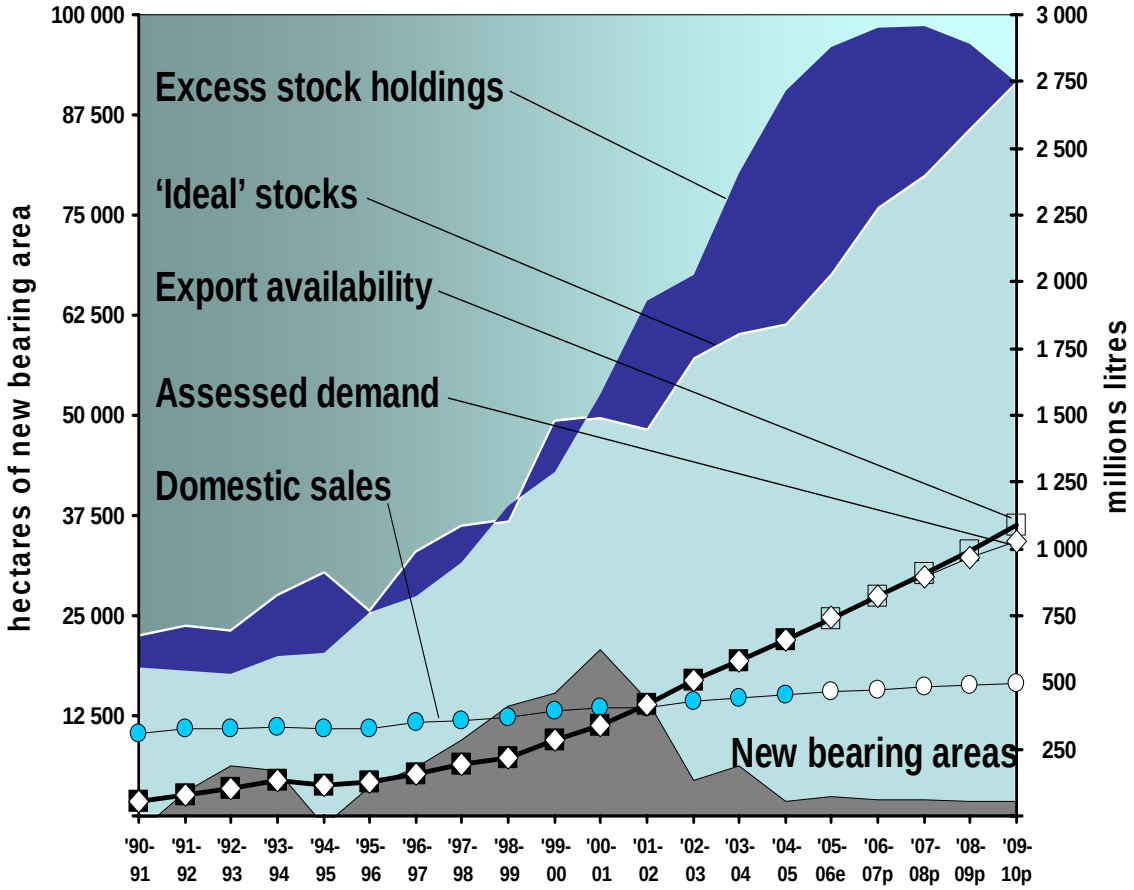
Many factors have contributed to over-supply and one cannot underestimate the impact of numerous individual decisions that, when aggregated, result in substantial increases in plantings. Furthermore, the rate of growth was beyond all industry expectations and occurred without a system to monitor progress and reassess future demand. Irrespective of the matters that have been decisive in causing over-supply, the adjustment process is placing pressure on all sectors within the wine industry supply chain and the evolving links between them, as shown in section 4.3.

Section 4: THE REBALANCING PROCESS

This section discusses the process that will restore a balance between Australian cool climate wine grape supply and demand.

4.1 Predictions about rebalancing

Section 2 shows that rebalancing in the cool climate wine grape sector is critically linked to rebalancing the wine grape sector as a whole. The AWBC produces authoritative projections regarding overall rebalancing and these are replicated in Figure 4.1.



NOTES: * "Ideal" stocks are based on current desirable stocks-to-sales ratios **Additional bearing areas over preceding year 'Surplus stock' is judged against in-year stock holdings and sales - estimates made against forward sales may differ. The stock-to-sales ratio determining an ideal stock holding is taken to be 1.58 with adjustments made to reflect changes in the red/white mix.

Figure 4.1: Achieving balance in the Australian Wine Sector
Source: Australian Wine and Brandy Corporation

Notes:

1. Overseas demand is the sum of assessments made for each of Australia's major individual export markets.
2. Current debate about the Australian wine sector's collection of stock data means there is some uncertainty attached to the estimates of stock levels and hence, surplus stocks. Industry thinking is that the illustrated position represents a probable high-end position rather than an under-estimate.

The model which generated Figure 4.1 estimates adjustments to stocks and then derives the quantity of wine available for export after accounting for existing stock, new wine production, domestic sales and wine allocated to (or removed from) stock. As such, balance is achieved when surplus stocks are eliminated and stock holdings are 'ideal'. The figure shows that by steady improvements beginning in 2004-05, in 2009-10 the industry is projected to be in balance. The feasibility of this projection is attested to by the rough match between the implied export availability and the assessed market-by-market demand (see Note 1 of Figure 4.1). In other words, "the current oversupply is assessed to have a home in Australia's current export markets over the next five years" (AWBC, 2005, p 5).

However, there are two further points. First, that does not mean there will be profitable homes for all Australian grapes by 2010 and it is possible some high cost, cool climate grapes will continue to be supplied at a loss. On current trends, this scenario assumes cooler climate fruit may continue to supply lower price-point wines. This means cooler climate fruit continuing to be sold at unsustainable prices.

Secondly, Figure 4.1 is not saying that prices will recover to levels prior to the over-supply by 2010. For cooler climate fruit, there is no expectation grape prices will recover during the rebalancing phase. As the AWBC puts it, "current low prices can be expected until balance is achieved" (AWBC, 2005, p 25).

Both points together mean the adjustment process might continue after 2010 and will not be complete until cool climate grapes have viable homes.

There are many additional factors that might further complicate the adjustment process. The global wine industry is undergoing rapid change with consolidation and rationalisation of very large corporations right along the supply chain. Those changes impact on Australian wineries and can affect the prospects for Australian wine.

Another complication, given the importance of export growth in restoring balance, is that uncertainty over the future value of the Australian dollar will be a primary determinant of the speed and length of the adjustment process. Indeed, some argue that appreciations of the A$ since 2000 have been the primary factor in stopping the acceleration in export growth. Predictions about exchange rates are many and varied. The consensus is merely that the key determinants will be the size of Australia's current account deficit and the future of interest rates.

4.2 Ways in which rebalancing can occur

Consideration has been given to the mechanisms by which rebalancing can occur. During the rebalancing phase, it will be important to assess the role each mechanism can play. It is their interaction that will determine the length of the over-supply phase and its impacts.

Potential mechanisms for rebalancing:

- Expanding wine sales is the preferred means of adjustment. Reducing the price for Australian wine could assist this but will commoditise wine in the long-term and is not in the Australian industry's best interests. As the AWBC puts it: "The dominance of lower price points in Australia's sales mix is … serving as its own advertising" (AWBC, 2005, p 10);
- Reducing wine stocks is an inevitable and desirable part of the adjustment process but will mean wine from previous vintages will displace grapes in the current year. That will add to the short-term pain of wine grape producers. Financial pain will also be felt by winemakers because further stock write downs can be expected;
- Removing vines is both necessary and desirable in some regions and for some varieties, and will strengthen the industry in the long run;
- A voluntary reduction in yield or production undertaken by all vineyards, including independent and winery-owned;
- Some consider mothballing to reduce supply as a useful short-term option. While this might increase prices initially, it could also blunt the adjustment pressures. Some who would otherwise leave the industry might take advantage of the price increases resulting from mothballing to stay in the industry. Mothballing is also not necessarily a low cost option; up to 50% of costs would still be incurred. There are also plant health concerns to consider.

Whichever combination of these mechanisms emerges, the rebalancing process can be expected to create pressures along the supply chain.

4.3 How rebalancing is proceeding: recurring themes among wine grape producers from the regions

In preparing this report, PIRSA conducted workshops in cool climate regions to collect both cost data and information on the impact over-supply is having on wine grape producers. That information provides an important perspective on how the rebalancing process is perceived by many wine grape producers.

The Australian wine industry has experienced amazing success supported by a partnership between wine grape producers and winemakers. The current over-supply places enormous pressure on both sectors and, in many instances, can strain relations.

It is important wine grape producers and winemakers appreciate the difficulties faced by each other and endeavour to work together to rebalance over-supply. This report set out to examine the economic situation of wine grape producers and listed below are the major themes expressed by these producers.

This report has not examined the economic situation of wineries in detail. It does however acknowledge the difficulties faced by this sector of the industry. Wineries have faced fundamental shifts in consumer demand, ongoing retail consolidation and unfavourable exchange rates, and are dealing with large stocks, and stock write-downs as they attempt to absorb the over-supply. This has been complicated further by company mergers and takeovers followed by internal restructuring.

Relationships between wine grape producers and wineries vary across the industry. However, it is important to acknowledge the following themes raised by some wine grape producers, which highlight the strain in relations in some instances:

- ***Quality grading***: Despite attempts being made, there is still no objective and consistent system for grading grape quality and many wine grape producers believe this enables grades to be reduced unjustifiably in difficult times. They support a standard quality grading system to provide a fairer trading environment. There are also concerns with winemakers who grade after the grapes have left the vineyard – wine grape producers would prefer closer communication with winemakers in this process.

- ***Industry relationships***: Some wine grape producers voiced concerns about poor communication and engagement by winemakers. It was acknowledged that this varies significantly between different companies.
- ***Contracts***: While most wine grape producers still have contracts for some of their fruit, many of these will expire in the next two years with few indications that they will be renewed. This problem is affecting all growers, including those supplying premium quality fruit. There are also reports of some wineries failing to comply with the *Wine Grape Industry Act.*
- ***Continued plantings***: Many wine grape producers were concerned that in the current over-supply plantings continue, with some supported by contracts. Concerns were also expressed about Managed Investment Schemes that have contracts with wineries and are progressing with new plantings rather than deferring them.
- ***Growing practices***: The cost pressures on wine grape producers are seeing some move away from industry best practice viticulture to reduce expenditure. This process not only jeopardises current production, it can also have a cumulative, negative effect on future vintages. There was also a view that some vineyards established in the growth phase were in unsuitable locations and might be contributing to a diminishing quality of grapes.
- ***Marketing***: Many wine grape producers are concerned with the marketing focus on popular premium Australian wine by many wineries and on labels that indicate only south east Australia as the wine's source. They feel a greater focus on promoting higher value premium and super premium wine and regional branding is needed.
- ***Industry structure***: Many wine grape producers are aware of the restructuring of their industry and are concerned about the implications for their businesses. As discussed in section 3.2, wineries are increasingly buying wine from processors. They are also consolidating supply of their stocks, whether that is grapes or wine.

It is emphasised that these recurring themes have emerged from discussions with a limited number of wine grape producers. Nonetheless, the themes underline the fact that many relationships within the wine industry are suffering during the rebalancing process and this should be understood as a further development of the changing relationships within the wine industry that pre-dated over-supply and will likely continue after the balance between grape supply and demand is re-established.

Appendices

Appendix 1

5.3 COOL CLIMATE ECONOMIC STUDY

Background

At the December 2005 Supply / Demand meeting held by the South Australian Wine Industry Association, there was considerable concern expressed that cool climate grape growing areas were in distress. Representatives from throughout South Australia attended the meeting.

The Supply / Demand meeting called for the preparation of an economic modelling study conducted in the Riverland to be extended to cover the cool regions of South Australia.

The South Australian Wine Industry Council endorsed the preparation of a cool climate economic study at the February 2006 meeting.

A number of South Australian Wine Industry Council members nominated to form a steering committee with PIRSA officers to develop the scope for the study and to manage the study.

Discussion

The Supply / Demand meeting called for the preparation of an economic modelling study conducted in the Riverland to be extended to cover the cool regions of South Australia.

In February 2005 representatives of the Riverland Winegrape Growers Association (RWGA) met with the Premier, the Minister for Agriculture, Food and Fisheries and the Minister for the River Murray to discuss grape growers' concerns related to rapidly declining prices paid for wine grapes.

The February 2005 meeting led to a request for PIRSA to work with RWGA to undertake an economic assessment of the impact of lower grape prices on the Riverland community. The subsequent study was confined to the economic impact on growers of grape pricing issues and did not address the social impacts.

The Riverland study pointed to a fundamental structural issue in the Riverland with a large proportion of growers operating on properties of 10 hectares or less and the meeting posed the question of whether there were similar issues to be addressed in cool climates and if so, to set a factual basis for reform.

The Cool Climate Economic Study will examine the economic situation of grape growers in the Coonawarra, Adelaide Hills, Clare Valley, Langhorne Creek, Barossa Valley and McLaren Vale regions.

The aim of the study is to:

- Alert cool climate growers / winemakers to the gravity of the problem;
- Obtain and analyse cool climate supply and demand data from relevant sources, including data from corporations regarding their future strategies;
- Provide guidance / toolkit to assist growers in making decisions about their business. This will involve undertaking case studies (2-3 from each region) and benchmarking;
- Identify and quantify the approximate fallout from the decline in demand of cool climate grapes.

The scope of the study involves identifying and quantifying the approximate fallout from the decline in demand of cool climate grapes. This will be done through:

- Likely demand scenarios and the differing effects on supply.
- Identifying the quantum of problems in reference to vineyard size and location and measures to address, including:
  - reduction of tonnage (option);
  - difference in supply and demand data (focusing on National data that is available) and information obtained from major companies and national associations.
- Provide guidance / develop a 'toolkit' to assist growers to make decisions about their business:
  - gross margin analyses;
  - 'costs of growing' as a case study (including people costs);
  - 'know your numbers – know your business' application / template similar to that proposed in the Riverland 'Future Options' paper.

Detailed assistance has been sought from regional associations and major wine companies to ascertain production figures for grape growing in the relevant Geographical Indications.

PIRSA Grape and Wine Group has engaged Rural Solutions SA to conduct the on-ground work in the designated GIs. PIRSA Corporate Strategy and Policy will provide economic analysis of the data received.

Current work in progress includes:

- How cool climate regions are different (5 different climatic regions).
- Blending wines (south eastern Australia).
- Are cool climate regions a problem for warm climate regions? Is there an imbalance?
- Implications and analysis of the 80:20/60:40 split.
- The role of cool climate grapes in the Australian / South Australian wine industry.

Appendix 2

Cool Climate Cost Data

Warm region	2005 Warm climate study ($/ha)	Independent ($/ha)	Cool climate study workshops ($/ha)	Cool region
Warm small vineyard	5789	6559		
Warm large vineyard	2775	4580		
		6703	5839 – 6450	Langhorne Ck
		-	6700 – 8833	Coonawarra
		5908 - 6491	5272 – 6800	McLaren Vale
		-	5750 – 6223	Clare
		6803 - 7661	6900 – 9435	Barossa Valley
		-	9000 – 14000	Adelaide Hills

Table 1: Grape-growing costs/ha: cool compared with warm climate regions

Source: Cool Climate Study workshops; PIRSA 2006; independent source.

The data in Table 1 include variable costs and direct cash overheads. **As such they exclude depreciation, a return on capital employed and other fixed costs.**

Warm region	2005 Warm climate study ($/t)	Independent ($/t)	Cool climate study workshops ($/t)	Cool region
Warm small vineyard	252	325		
Warm large vineyard	121	245		
		447	421 – 538	Langhorne Ck
		656-826	520 – 755	Coonawarra
		-	670 – 883	McLaren Vale
		-	719 – 778	Clare
		813-897	514 – 944	Barossa Valley
		-	900 – 1555	Adelaide Hills

Table 2: Grape-growing costs/tonne: cool compared with warm climate regions

Source: Cool Climate Study workshops; PIRSA 2006; independent source.

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McLaren Vale Grape Wine and Tourism Association

Clare Grapegrowers Association

Barossa Grapegrowers Association

Adelaide Hills Grapegrowers Association

Representatives from small, medium and large winemaking companies