NEW ZEALAND WINE INDUSTRY: FULL BODIED GROWTH

JUNE 2016
SUMMARY

Wine sector earnings have doubled over the past 10 years. Yearly growth has averaged 8.4%. Total sales are now around $2 billion per annum.

The New Zealand wine story is mainly driven by Sauvignon Blanc. While other varieties have grown, it’s the unique flavour of our ‘savi’ that stands out. Sauvignon Blanc currently accounts for around 57% of the planted area, 69% of annual production and 86% of annual exports.

Other varieties are also on the rise, with plantings of complementary white styles such as Chardonnay and Pinot Gris set to increase, as well as Pinot Noir and Merlot. Grower survey data undertaken by NZ Winegrowers reveals total vineyard area could expand by as much as 7,000 hectares over the next five years, which equates to a lift of close to 20% on current producing vineyard area.

There is scope for more growth from consumers looking for sophisticated foods and beverages, a new generation of younger consumers coming through, and a trend towards ‘premiumisation’. Health concerns around the amount of alcohol being consumed are having an impact too. However, many consumers appear to have opted for a ‘quality over quantity’ attitude. All of these trends suit New Zealand’s market positioning.

Distribution channels are changing. Tasting rooms, wine clubs, online marketing and other direct sales channels that reach consumers through the internet, mobile apps and social media are growing strongly.

Cash rates of return of 5.6% for grape growers and development returns of 120-125% of cost (bareland, development costs and ‘time’) are currently sufficient to stimulate new investment. However, there is limited suitable land in the likes of the Marlborough region for further development – anecdotally, the range is 7,000 to 10,000 hectares. This implies the possibility of some future scarcity if market demand continues to increase as expected.

Will there be further upside for New Zealand wine? The answer appears to be yes. Like for many goods, fashion has a role to play and Sauvignon Blanc remains ‘in’ as a wine preference in established markets and is finding favour with new consumers in developed and developing markets.

On a global basis New Zealand is a small player, accounting for just 1% of total global production and 3% of the value of global wine trade. The larger proportion of value is in the premium New Zealand wine currently commands.

NEW GRESHEETHS

The viticulture sector has grown strongly over the last 10 years. Between 2005 and 2015 the production area was up nearly 71% to 35,860 hectares and the total crush up 130% to 326,000 tonnes. The 2016 vintage was even bigger at 436,000 tonnes.

Total sector earnings have soared nearly threefold to $2 billion over the same period, led by strong sales growth to the major markets of Australia, the US and the UK, but also further afield to other niche markets.

GROWTH METRICS FOR NZ WINE INDUSTRY

<table>
<thead>
<tr>
<th></th>
<th>2005</th>
<th>2015</th>
<th>% change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wine Companies</td>
<td>516</td>
<td>673</td>
<td>30%</td>
</tr>
<tr>
<td>Producing Area</td>
<td>21,002</td>
<td>35,859</td>
<td>71%</td>
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<tr>
<td>Tonnes Crushed</td>
<td>142,000</td>
<td>326,000</td>
<td>130%</td>
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<tr>
<td>Average yield (per hectare)</td>
<td>6.9</td>
<td>9.1</td>
<td>32%</td>
</tr>
<tr>
<td>Total Production (millions of litres)</td>
<td>102</td>
<td>234.7</td>
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</tr>
<tr>
<td>Domestic sales (millions of litres)</td>
<td>45</td>
<td>61.9</td>
<td>38%</td>
</tr>
<tr>
<td>Export sales (millions of litres)</td>
<td>51.4</td>
<td>209.4</td>
<td>307%</td>
</tr>
<tr>
<td>Total earnings at export values ($bn)</td>
<td>$0.82</td>
<td>$1.97</td>
<td>141%</td>
</tr>
</tbody>
</table>

Source: ANZ, NZ Winegrowers

TOTAL NEW ZEALAND VINEYARD AREA

Further growth is expected over the coming years with new greenfield investment being led by the larger wine companies. Consolidation and growth continue in earnest.
Planting surveys by New Zealand winegrowers suggest the vineyard area is set to expand by as much as 7,000 hectares or 20% by 2020/21. This expansion is currently underway with an estimated 1800ha (or 5%) additional plantings already in the ground and coming into production by Vintage 2018.

The Marlborough region will remain the epicentre of the sector at 65-70% of the growing area. The next-largest growing areas will be Hawke’s Bay, Otago and Gisborne.

Sauvignon Blanc is expected to continue to dominate plantings, rising 8% to 21,900 hectares (58% of total growing area) in 2018. The next-largest white wine plantings by 2018 are expected to be Chardonnay (3,303 ha, 9% of growing area) followed by Pinot Gris (2,579 ha, 7% of growing area). Riesling is expected to remain constant, but plantings of Gewurztraminer and Viognier are tipped to fall slightly.

Pinot Noir leads the red wine varietals, with a projected 5,768 hectares of plantings by 2018 (15% of growing area), followed by Merlot (1,327 ha), Syrah (450 ha) and Cabernet Sauvignon (280 ha).

Wineries are getting larger. It appears to be a case of be big and get scale, or be very, very boutique. While there are no formal statistics on who is funding the new development, the majority is being undertaken by large wine companies that are both foreign and locally owned.

Wineries that have annual sales in excess of 4 million litres now control an estimated 64% of exports versus 49% only five years ago. While a larger proportion was controlled by these companies 15 years ago, this was just two players. Today there are 17 companies with annual sales in excess of 4 million litres. The number of smaller wineries that are locally owned and largely service the domestic and Australian markets peaked in 2012 and is now on the decline (both by number and share of production).

**WINE COMPANIES BY CATEGORY**

<table>
<thead>
<tr>
<th>Category</th>
<th>Number</th>
<th>% of number</th>
<th>% total exports</th>
</tr>
</thead>
<tbody>
<tr>
<td>Category 1</td>
<td>587</td>
<td>87%</td>
<td>14%</td>
</tr>
<tr>
<td>Category 2</td>
<td>69</td>
<td>10%</td>
<td>22%</td>
</tr>
<tr>
<td>Category 3</td>
<td>17</td>
<td>3%</td>
<td>64%</td>
</tr>
<tr>
<td>Total</td>
<td>673</td>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>

Category 1 = grape wine sales not exceeding 200,000 litres
Category 2 = grape wine sales between 200,000 to 4 million litres
Category 3 = grape wine sales more than 4 million litres
Source: ANZ, NZ Winegrowers

**MARKET DRIVERS FOR INVESTMENT IN NEW ZEALAND WINE MAKING**

The logical question that precedes any new investment is “is further expansion financially sustainable?” To answer this we take a look at New Zealand’s major wine markets and the hottest trends within each. We also look at how returns are tracking for grape growers and wineries.

**NEW ZEALAND WINE SALES FOR 2015**

Total New Zealand wine sales are now around $2 billion per annum. Over the last 10 years total sector earnings have doubled, with annual growth averaging 8.4%. Packaged product destined for export markets accounts for around half of total sale volumes. Local packaged sales make up around an additional quarter of total sale volumes, and bulk wine exports account for the remaining quarter. This split has been fairly stable in recent years after bulk wine exports grew from virtually nothing in 2008.

Packaged product makes up a larger proportion of the sector’s earnings as it attracts higher returns versus bulk wine exports. Evolving business models and supply chain consolidation has led to the growth in bulk wine exports. Given our distance to export markets and high bottling costs it has made sense for many of the larger multinational wineries to export in bulk to achieve better logistical and packaging efficiencies.
The repackaging of bulk product offshore doesn’t necessarily mean lower returns, as long as it ends up in premium packaged wine. The fear for the New Zealand industry has been the risk that spikes in bulk export volumes drive increased supply into lower-value private brands in key export market outlets. This could then permanently erode New Zealand’s brand for premium packaged wine and have a negative impact on margins down through the supply chain.

Key offshore markets that have seen increased and volatile levels of private brand sales (i.e. those brands where the retailer’s name features on the front or back label) are the UK and Australia. While vintages of above-average productivity do support increased levels of private brand sales, these levels notably reduce in periods of weaker supply. In periods of lower supply, a smaller price differential to move from private brands to premium branded wines is seeing consumers prepared to pay the relatively small extra price for a premium wine with provenance.

This is highlighted by the latest Nielsen Report, which noted that just 4.8% of sales volumes of New Zealand wines in the UK are in ‘private brand’ form. This is the lowest percentage in this category of all major wine suppliers to the UK market (Australian wine is 19.2%). Further, private branded sales of New Zealand wine remain at retail price points materially above average, adding significant support to the average retail price per unit of total New Zealand wine sales.

Many other major wine-producing countries have experienced margin compression with the growth in bulk wine exports. For the likes of Australia, bulk wine exports now account for some 60% of total exports, compared with just 10% in the early 2000s. This has significantly impacted on margins and the brand positioning of Australian wine over the last 15 years.

This hasn’t happened in New Zealand so far. New Zealand is a higher-cost producer when you look at the cost of production against a range of other competitors. Therefore, high-quality, proprietary-branded packaged wine with a high margin/price focus is an imperative to retain New Zealand wineries’ bottom lines. The numbers simply do not stack up otherwise.

**NEW ZEALAND WINE PRODUCTION BY VARIETAL**

New Zealand wine is of course dominated by Marlborough Sauvignon Blanc, which has received many international accolades and awards. In total, Sauvignon Blanc accounts for nearly 70% of annual production and 85% of total export sales. It has been the focal point of industry expansion over the last 10 years, accounting for 87% of the increase in growing area over this period. Industry investment surveys suggest this is set to continue over the medium term.

The next major varietals are Pinot Noir, Chardonnay, Pinot Gris, Riesling and Merlot. Of these, only Pinot Noir and Pinot Gris have experienced an increase in their growing area over the last 10 years. Smaller varietals experiencing growth include Gewurztraminer and Syrah. Most of the other varietals have seen a decrease in their growing area.

On a global basis New Zealand is a small player. It accounts for just 1% of total global production and 1.8% of total trade by volume. As New Zealand produces higher-value wine it accounts for nearly 3% of the total value of global trade. This places it 8th on the global league table by traded value and 11th by traded volumes. The top five exporters of France, Spain, Italy, Chile and Australia account for 70% of the total volume and value of traded wine.

**NEW ZEALAND’S PLACE IN THE GLOBAL WINE MARKET (2015)**

![Graph of New Zealand’s place in the global wine market](source: ANZ, OIV)

**A LOOK AT THE MOST IMPORTANT MARKETS**

New Zealand’s domestic market and top three export markets of Australia, the US and UK account for 86% of total wine sales and 83% of total sector revenue. While other markets such as Germany, the Netherlands and Canada are slowly increasing their market relevance, the top four markets are expected to continue to dominate overall sales into the 2020s. This is due to supplier/ownership relationships with other parts of the supply chain and strong prospects for Sauvignon Blanc and premium wine within these markets.
Around a quarter of New Zealand’s wine is consumed domestically, with the rest exported. In total the domestic market consumes 90-95 million litres of wine each year, or 20-21 litres per capita. Imported product can account for anywhere from 35% to 45% of total consumption.

Of the various wine types (table, sparkling, carbonated and fortified) New Zealand consumers’ strong preference is for still and sparkling wines. White still wine accounts for approximately 60% of total sales. The favoured varietals are Sauvignon Blanc (52%), Chardonnay (36%) and Riesling (5%). Red still wine accounts for 30% of total sales. The favoured varietals are Pinot Noir (52%), Merlot (29%) and Cabernet Sauvignon (15%). Sparkling wine accounts for 7.5% of total sales.

Australian wine accounts for 75-80% of total imports, the majority of which is Shiraz and Cabernet Sauvignon. These two varietals, alongside Chardonnay, are the cornerstones of Australian production, accounting for 59% of their total crop. Outside of Chardonnay, New Zealand and Australian supply is generally complementary, with the likes of Sauvignon Blanc and Pinot Noir accounting for only 8% of the Australian crop. Other major sources of imports are France, Italy, South Africa and Chile. French product is targeted at the premium end, whereas all the other importers have an average price of just $2-5/l. The majority of the cheaper imported product is sold via the supermarket/retail channel.

An influential consumer trend is around health and wellness, which is leading to more low-alcohol wines and smaller servings. New legislation lowering the alcohol limit for driving has also supported a similar trend in New Zealand bars and restaurants. These trends, alongside a more knowledgeable consumer, are driving an increase of domestic product sales at the premium end as consumers ‘trade up’.

**Distribution**

In the international market, most of New Zealand’s wine is generally still sold through the retail channel, but this is changing. The fastest-growing international sales channel is online – either direct, or through a third party website/distributor.

The domestic distribution channel is more diverse. It has five key distribution channels: supermarkets, liquor stores, hospitality & foodservice, cellar door and online. Of these, off-trade sales (i.e. supermarkets, liquor stores and online) account for around 80% of total sales and on-trade and cellar door sales make up the remaining 20%.

In the off-trade channel, supermarkets are the main players, having increased their share from 30% in the early 2000s to an estimated near-50% today. The New Zealand supermarket industry is concentrated in two entities with centralised buying functions: Foodstuffs and Countdown (Woolworths). Like supermarkets anywhere, they offer the ability to shift volume, but at more competitive margins. Retailer margins usually range from 25-40% of the end retail price.

Smaller wineries are more reliant on cellar door sales and tourism. This often involves other products/services too, such as a dining experience, special occasion entertainment (eg. weddings) and accommodation in some cases.

**SELECTED ACTIVITIES VISITED BY INTERNATIONAL TOURISTS (2015 SEPT YEAR)**

Of the various wine types (table, sparkling, carbonated and fortified) New Zealand consumers’ strong preference is for still and sparkling wines. White still wine accounts for approximately 60% of total sales. The favoured varietals are Sauvignon Blanc (52%), Chardonnay (36%) and Riesling (5%). Red still wine accounts for 30% of total sales. The favoured varietals are Pinot Noir (52%), Merlot (29%) and Cabernet Sauvignon (15%). Sparkling wine accounts for 7.5% of total sales.

Source: ANZ, New Zealand Winegrowers

Source: ANZ, NZ Winegrowers

Source: ANZ, MBIE
Spending from tourism is significant, with 18% of international tourists visiting a winery. That's the initial connection online distribution mechanisms can then support. Indeed, the number of international wine tourists now totals some 540,000 per annum and they spend some $2.8 billion when they visit. On average they spend $5,000 per visit, significantly higher than the average (about $3,500), primarily because they stay longer.

This highlights that the wine industry’s economic reach goes beyond just the revenue generated from direct product sales. The top five sources of international visitors to wineries are Australia, the US, China, England and Germany.

**United States**

The United States is now New Zealand’s largest export market on both a volume and value basis. This follows a 19% surge in sales for the 2015 vintage, with growth in the USD8-15/bottle price category driving sales.

From a purely economic perspective, the US economy (and consumer) looks on a stronger footing than a host of others around the globe. Combine that with increasing tourism connectivity (i.e. US airlines resuming direct flights to New Zealand) and a huge market in the first instance, and opportunities abound.

The United States recently surpassed France as the largest wine market in the world (on a volume basis) following a period of sustained growth since the late 1990s. This is the opposite of what has happened in France and Italy, where wine consumption is declining (from a high level).

On a per capita basis, US consumption has crept up to 11 litres per year. Per capita consumption of wine in the US is likely to continue to grow in the short term, driven by increasing sales to the under-40 cohort and baby boomers.

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**Average Spend by International Tourist (2015 Sept Year)**

Source: ANZ, MBIE
maintaining consumption levels. However, consumption growth will moderate as consumers favour premium versus generic/lower-priced wine and as more of the baby boomer cohort begins to retire. Retirement generally coincides with a rapid decline in alcohol and wine consumption.

The growth part of the market, especially for Sauvignon Blanc, is the under-40 cohort who are looking for more sophisticated foods and beverages, a trend that naturally favours wine given its wide range of flavours and ability to be paired with different food. The challenge is that this cohort is more discerning, with access to a wider array of market intelligence via information technology. This provides improved opportunities for imported products by breaking down traditional marketing and distribution channels (i.e. more online sales), but also creates fierce competition from direct competitors and other products, such as alcohol blends, cider, craft spirits and beer.

Craft beer and spirits are seeing phenomenal growth in the United States by tapping into different flavours and characteristics that appeal to a specific consumer’s palate. This is in direct contrast to mass-produced beer that often has limited or no defining taste characteristics and therefore has wide appeal to most consumers’ palates. This has seen the number of craft breweries in the United States increase more than 50% since 2008 and craft production grow at 25% per annum over the last several years. This is in stark contrast to the overall beer category, which is in decline.

Wine consumption faces the same challenge if it is to continue to grow in appeal. Nearly 40% of adults drink wine in the US, with a third consuming wine several times a week and the rest only occasionally. So there is still scope for growth and broader appeal.

Some of the biggest trends in the US market are the movement toward ‘premiumisation’ and growth in product availability of mid-tier priced wines. Indeed, there is double-digit growth in the USD10 to $20/bottle range at the expense of the under USD10/bottle category, although this still makes up 75% of total sales. The majority of volume growth for Sauvignon Blanc is occurring in the USD8 to 15/bottle price category.

This shift is being fuelled by an improvement in the fortunes of the US consumer due to an improved labour market and the wealth effects of higher equity and house prices. The growth in the availability of mid-tier priced wine is also creating a bridge for the under-40 cohort looking for a more individualised palate offering, but at an affordable price point.

Sauvignon Blanc accounts for around 5% of total US sales, but is one of the fastest growing varietals. Blends are hot items as consumers want to try new, more interesting flavours.

The main US sales channel for wine is off-premise, accounting for more than 80% of wine sold. Within this, the three main distribution channels are grocery stores (42%), liquor stores (22%) and direct-to-consumer (20%). Direct-to-consumer sales are increasing market share at the expense of traditional retail. This channel is experiencing success through tasting rooms, wine clubs, online marketing and other direct sales channels that reach consumers through the internet, mobile apps and social media.
On-premise sales are more sluggish as consumers appear to be buying more wine by the glass instead of the bottle. This appears to be due to a range of factors, such as greater awareness of health impacts, demographics (with younger generations consuming a variety of drinks when dining out), budgetary constraints, more casual dining reducing average eating times, and ‘premiumisation’ reducing volumes consumed.

United Kingdom
The United Kingdom is New Zealand’s second-largest export market on both a volume and value basis. It is a little different to the Australian and US markets in that the majority of supply is from imports, with very little domestic production. In fact domestic production accounts for less than 2% of total consumption.

UNITED KINGDOM WINE CONSUMPTION, EXPORTS AND IMPORTS

The top import sources are Australia, France, Italy, US, South Africa and Spain. New Zealand ranks 8th, but has been one of the fastest growing in recent years as Sauvignon Blanc has taken market share from other varietals.

Health concerns, along with changing lifestyles and demographics, mean that the volume of wine consumed per capita is in slow decline. There seems to be a split market, with many consumers having traded down to less expensive wines in recent years, but many others choosing to reduce consumption and opt for better-quality wines.

In recent years there has been an increased focus on reducing youth binge drinking and raising awareness of the health implications of daily recreational wine drinking by the middle aged. This has prompted government policy changes such as increased excise duty and minimum pricing policies (i.e. no loss-leading by retailers, similar to some of the changes in the domestic market). Preferences for more sophisticated and unique styles of wine have also been driven by educational promotion on the different types of wine and their combination with food.

The majority of UK wine sales (around 80%) are through the off-trade channel. The main reason for the dominance of off-trade sales is that the average price is 60% lower than on-trade channels. The majority of off-trade sales are through the major supermarket retailers, such as Tesco, Sainsbury’s, Marks & Spencer, Asda, and Morrison. However, there is somewhat of a polarisation, with retail discounters, such as Aldi and Lidl, attracting price-conscious consumers at one end, and independent liquor stores/merchants attracting consumers interested in spending more due to a special occasion, or for better quality.

The largest suppliers through the UK retail channel are Australia, Italy, US and France. New Zealand ranks 8th, but achieves the highest average price per bottle (GBP7.33/bottle) of the top 10 suppliers. This places New Zealand wine at the premium end of the market with the vast majority of wine sold in the GBP3-6/bottle range.

New Zealand red wine (all varietals) also has a retail selling price substantially (approximately 50%) above the nearest competition. The average retail price per bottle of wine is typically higher in the UK compared to other EU countries due to higher excise duty and taxes. However, fierce in-market competition reduces actual profit margins for wineries.
The top red varietals are Merlot, Shiraz and Cabernet Sauvignon. Pinot Noir is increasing its exposure and understanding in the red category, as is Zinfandel. Red wines from lesser-known grapes and regions in Europe have also gained in popularity.

Promoting a varietal with a regional story that reflects the diversity of wine producers is generally more readily understood. Fruit-flavoured and lower-alcohol wines are new-style products considered to have growth potential too.

Bars, restaurants, hotels and other foodservice channels account for the remaining 20% of UK sales. The foodservice market is fairly steady in volume terms, but value has increased with some consumers trading up. The foodservice sector is dominated by French and Italian wine, followed by that from Australia, USA, Chile, and Spain.

White wine is a more dominant choice in foodservice than in retail, with a 53% share, compared with 37% for red wine and 10% rosé. The majority of New Zealand wine is sold through the retail channel so there would appear to be opportunities in the less price-conscious foodservice channel.

### Australia

The Australian market is New Zealand’s third-largest export market on both a volume and value basis.

### WINE SALES BY PRICE SEGMENT – 2015

Still white wine is consumed in slightly greater volumes (45%) overall than still red wine (43%), with rosé accounting for around 10% of the market. Sauvignon Blanc and Pinot Grigio/Gris continue to take market share from Chardonnay in the white category. Sauvignon Blanc has around an 8% market share by volume and New Zealand sourced product accounts for around half of this. Aromatic whites such as Albariño, Gruner Veltliner and Riesling are also widening their appeal.

### TOP 10 SUPPLIERS OF UK RETAIL MARKET IN 2015

<table>
<thead>
<tr>
<th>Country of origin</th>
<th>000s Hectolitres</th>
<th>% chg (y/y)</th>
<th>£ million (y/y)</th>
<th>£ per 75cl</th>
<th>% chg (y/y)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>1,686</td>
<td>+4</td>
<td>1,172</td>
<td>+3</td>
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<tr>
<td>Italy</td>
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<td>127</td>
<td>-13</td>
<td>78</td>
<td>-13</td>
<td>£4.62</td>
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</tbody>
</table>

* Hectolitre = 100 litres, approximate exchange rate during 2015 £1 = USD1.50
Source: ANZ, Wine & Spirits Trade Association

UK consumers are generally very price sensitive when shopping for wine in supermarkets and will often only trade up to mid-priced/premium brands when they are heavily discounted. Private labels are important too, accounting for around 15% of sales through the off-trade channel. This is a higher proportion than for other alcoholic drinks. Supermarkets offer a wide selection of private labels, often filling the gap between economy and premium categories.

### AUSTRALIAN WINE PRODUCTION, EXPORTS AND IMPORTS

Still white wine is consumed in slightly greater volumes (45%) overall than still red wine (43%), with rosé accounting for around 10% of the market. Sauvignon Blanc and Pinot Grigio/Gris continue to take market share from Chardonnay in the white category. Sauvignon Blanc has around an 8% market share by volume and New Zealand sourced product accounts for around half of this. Aromatic whites such as Albariño, Gruner Veltliner and Riesling are also widening their appeal.

Source: ANZ, ABARE

Around one third of Australia’s wine production is consumed domestically, with the rest exported. Domestic consumption of wine (table, sparkling, carbonated and fortified) has been relatively stable in recent years, at around 460 million litres, or 20 litres per capita each year. This is in stark contrast to the decline in beer consumption.

Market surveys of Australian consumers show the following factors figure prominently in shaping purchasing behaviour:
- price
- grape variety
- style of the wine
- region of origin
- country of origin

* Hectolitre = 100 litres, approximate exchange rate during 2015 £1 = USD1.50
Source: ANZ, Wine & Spirits Trade Association/Nielsen
• peer influence
• style of wine; and
• food complementarity.

These features are obviously not unique to the Australian market.

New Zealand product accounts for around 15% by value and 10% by volume of wine sales in Australia. Australian consumers have a strong preference for still white wines (50% of sales), still red wine (34%) and sparkling (10%). The major white varietals are Sauvignon Blanc (40%), Chardonnay (25%) and other white blends. The major red varietals are Syrah (25%), Cabernet Sauvignon (15%) and Cabernet Merlot (14%). New Zealand’s largest share is for Sauvignon Blanc (around 70% of volume) followed by Pinot Gris (20-25%) and Pinot Noir (30-35%). Other more minor varietals are Chardonnay, Riesling and Merlot.

The majority of New Zealand’s sales are through the retail and online sale channels, as opposed to foodservice. The two largest supermarket chains, Coles and Woolworths, dominate total sales with an estimated 70% share. The domestic market share of private labels of both major retailers is around 15%, whereas in New Zealand it’s less than 2%. Although consumers are able to benefit from lower-priced private label products, this tends to squeeze margins for others in the supply chain and can inhibit innovation for fear a new product won’t be accepted by the two dominant retail players.

Premium wine products continue to grow at the expense of cheaper bulk wine, with increased sales through online channels. Online wine retailers have increasingly stocked premium, niche and independent wine labels that are not available from the major retailers. The major growth is in the AUD10-25/bottle price segment. Consumers are also attracted by online wine clubs, offering members better deals and the chance to be a part of wine events, creating an immersive wine experience.

New Zealand wine dominates Australian sales of imported wines, accounting for around half of total volumes, with France the next-largest supplier at a touch under 15% (but nearly double on a total value basis due to higher returns).

The appreciation in the NZD/AUD, more challenging local economic conditions and higher supply hampered returns for the 2014 vintage, with in-market pricing pushing back to the lows of 2010-2012 (AUD5.86/l). However, a smaller 2015 vintage and better market prospects in the US appear to have relieved the pressure, with prices back to AUD6.84/l this year as exports by volume have dropped by 13%. In comparison, the average French wine price is AUD10-11/l.

WINE INDUSTRY RETURNS

Currency movements and their impact on returns

While currency movements are a key influence on returns, the impact is difficult to work out due to the sales split between the UK, Australia and US. For individual exporters it will depend on their market split. For the industry we have constructed a trade-weighted index (for wine exports) as a proxy to examine the effect of currency movements.

Average NZD export returns have been remarkably stable since the shift down experienced during the GFC, though returns are well down versus the early 2000s. The average export price has been around NZD7/litre, with a +/- 5% range over the last seven years. Looking back further in time shows much more volatility was experienced during the 1995 to 2009 period.

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There are several trends that have been influential for NZD returns in the post-GFC period. One was the lift in the NZD over the 2010 to 2014 period. The industry’s trade-weighted index increased by 36% over this period. This reduced average export returns by NZD1.82/l, or 27%. The offset was in-market prices improving by NZD1.29/l, meaning the average decline was NZD0.52/l, or -7% versus 2010 returns.

However, the improvement in in-market prices over this period perhaps owes a lot to the smaller 2012 vintage. This tightened supply (especially bulk exports) in the 2013-2014 period.

The last 18 months have been somewhat different to the previous five years. A substantial drop in the NZD/USD and softening in NZD/GBP has delivered currency gains of NZD1.72/l. The flipside is that some of this has been given back to retailers and consumers in the marketplace (−NZD1.50/l), and a stronger NZD/AUD has provided a drag on returns from Australia. Indeed in-market prices have faced pressure in all three major export destinations from a lift in supply following the large 2014 vintage. Pressures have moderated in the UK and Australia this year (2015/16), but average in-market prices in the US have moved lower again.
Part of the movement lower for the US has been more product being diverted from Australia to the US, but there has also been an increased proportion of bulk wine exports (39% as opposed to approximately 30%) lowering the average export price. However, quite a lot of the bulk wine will no doubt be repackaged in the US and then sold for similar prices to already packaged export product.

**Business models**

As in every industry there are a wide range of business models. In the wine industry there are grape growers and there are wineries, but there are also businesses that grow grapes and then produce, bottle and distribute their own stable of brands. These businesses vary in size, the types of product they produce and the different markets they participate in. This can make it difficult to analyse returns and benchmark performance across the broader sector.

**Wine industry terms of trade**

At an industry level the wine industry suffered a very large fall in its terms of trade through the rapid growth period of the early-2000s to 2012 period. The fall was driven equally by lower export prices (currency driven) and an increase in input prices.

**WINE INDUSTRY’S TERMS OF TRADE**

Source: ANZ, NZ Winegrowers, Statistics NZ

Over the last 5-6 years things have stabilised, with export prices flattening out and input prices up only 2% over this period. This, combined with improved economies of scales via both consolidation and individual business growth, as well as a continued focus on productivity and collaboration to drive supply chain efficiencies, has led to more stable economic returns and less volatility in the terms of trade (a flat trend as opposed to a declining one).

Larger, corporate wineries have driven a more integrated supply chain helping smooth export returns too. New Zealand-sourced wine makes up only a small part of their offering to major retailers. As the industry has matured there has also been more active crop management to ensure steady returns. Many of these trends are typical of what a sector goes through during a consolidation period following rapid growth.

**Winery returns**

At an individual winery level, returns have remained stable as wine producers have cautiously grown revenues and focused on maintaining margins. Based on our analysis of the financial records of around 50 wine companies over the last 5 years, the average business has typically achieved an EBITDA margin of 15.1%.

Stable margins and returns have been supported by steadier export returns, as highlighted earlier. However, cost efficiencies have played an equally important role. Wages have been maintained at around 11% of revenue and marketing expenditure has been carefully targeted. Other cost categories such as bottling, packaging, storage and administration have been kept under control, through improved economies of scale and capital reinvestment to drive processing/supply chain efficiencies.

**BENCHMARK RETURNS TO NZ WINE PRODUCERS**

Source: ANZ, various wine companies

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1 Terms of trade is a ratio of prices received for outputs to prices paid for inputs. The ratio indicates the real purchasing power of each dollar of revenue at the industry level relative to previous years.

2 EBITDA = Earnings before interest, tax, depreciation and amortisation.

3 EBITDA margin = EBITDA/revenue
These margins have translated into a Return On Equity (ROE)\(^4\) of 9.2% and a Return on Invested Capital (ROIC)\(^5\) of 5.3%. Not high by any means, but certainly well above benchmark 10-year bond yields around the globe.

**Market value of wineries**

To gauge how returns translate into market value, we analysed the trading multiples of 33 listed wine companies that operate in New Zealand with turnover under $150 million over a five year period. A wide range of value can be observed, reflecting the volatility in returns/dividend, size of company, brand strength, stage in the development cycle and tangible asset base. However, 50% trade within a range of 1.2 to 8.1 times revenue multiple, with a skew toward the median of 2.5. In terms of EBITDA, 50% trade within a multiple of 8.8 to 65.9 times, with a skew toward the median of 14.1.

**PRICE/REVENUE MULTIPLES FOR WINERIES**

![Price/revenue multiples for wineries graph]

Source: ANZ

**PRICE/EBITDA MULTIPLES FOR WINERIES**

![Price/EBITDA multiples for wineries graph]

Source: ANZ

**Grape grower returns**

Over the last 10 years vineyard returns in Marlborough have averaged $6,500 per hectare, but there has been huge variation. The majority of this variation has been driven by the revenue side (yields and grape prices) as opposed to costs. This is not unusual for a primary sector.

**VINEYARD PROFIT BEFORE TAX**

![Vineyard profit before tax graph]

Source: ANZ, MPI

In recent years tight cost control and improved grape prices have led to three years of back-to-back returns, encouraging new investment. Sauvignon Blanc grape prices have increased to $1,600-$1,700/t over this period – a substantial lift from the 2010-2012 average of $1,200/t. However, there continues to be large variations in yields and cost pressures on labour. Labour accounts for 50-55% of an orchard’s cost structure and sourcing quality labour is always a challenge. For this reason, trends towards mechanisation in vineyard tasks such as harvesting and pruning will continue.

**REVENUE SPLIT FOR VINEYARDS**

![Revenue split for vineyards graph]

Source: ANZ, MPI

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\(^4\) Return on Equity: Net Profit/Equity

\(^5\) Return On Invested Capital (ROIC): EBIT * (1-Tax Rate) / (Debt + Equity – Cash)
Total returns have averaged 6.7% over the last 10 years. Of this, 3.8% has been the average cash return and 2.9% the capital return. However, this masks the volatility in capital returns that occurred with the global financial crisis and subsequent adjustment in the sector’s terms of trade. The average vineyard’s asset footprint more than halved from the peak in 2008 of $336,000/hectare to $154,500/hectare in the trough of 2012. The vast majority of the crunch was a drop in land and building values, which account for approximately 90% of a vineyard’s asset base.

**TOTAL VINEYARD RETURNS**

![Graph showing vineyard returns]

Source: ANZ, MPI

Indeed, in Marlborough unforced sale values fell by $87,000/hectare through this period (-44%) and the total number of sales fell dramatically. Of course there is large variation even within the growing area of Marlborough. The range depends on factors such as yield history and potential, disease pressures, climatic and soil variations due to locality, irrigation, varietal and clonal mix, age and quality of infrastructure, and reputational attributes of fruit qualities.

**MARLBOROUGH VINEYARD LAND MARKET**

![Graph showing vineyard land market]

Source: ANZ, Alexander Hayward Ltd Property Advisers

Over the last three years returns have settled into a more sustainable mix and range given inherent business/sector risks. Cash rates of return have averaged 5.6% and capital returns 3.1%. This makes for a more respectable total return of 8.7% through this period (for land use investments relative to history anyway).

In terms of alternative land uses, the wine sector’s critical mass in the Marlborough region and superior returns are the main reasons Marlborough is attracting additional investment. There is also the capital development aspect, with recent market activity suggesting a mature vineyard value ranging between 120 and 125% of cost (bareland, development costs and ‘time’).

**CONCLUSION**

Is there further upside for New Zealand wine in coming years? The answer appears to be yes. As with many goods, fashion has a role to play and Sauvignon Blanc remains ‘in’ as a wine preference in established markets and is finding favour with new consumers in developed and developing markets.

On a global basis New Zealand is a small player, but continues to focus on selling a high-quality, high-margin product. Returns are currently sufficient to stimulate new investment. There is limited suitable land for further development in the likes of the Marlborough region – anecdotally, the range is 7,000 to 10,000 hectares. This implies the possibility of some future scarcity of product out of the sought after Marlborough region if market demand continues to increase as expected.
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