

# Rabobank Wine Quarterly

## Trends and outlook for the international market

### Rabobank International

#### Authors

Stephen Rannekleiv  
[Stephen.Rannekleiv@Rabobank.com](mailto:Stephen.Rannekleiv@Rabobank.com)  
 Marc Soccio  
[Marc.Soccio@Rabobank.com](mailto:Marc.Soccio@Rabobank.com)  
[www.rabobank.com/far](http://www.rabobank.com/far)

### Summary of Trends

#### Export Trends

The gradual improvement in the global economy is becoming evident in recent wine trading trends. Nearly all major global suppliers are reporting improved export trends for Q1 2010, compared to the abysmal Q1 2009. In some cases, as in Argentina, volumes may have declined due to poor harvests, but average prices per bottle are improving. Even Chile, which experienced a challenging environment as a result of the recent earthquake, managed to generate a strong increase in total exports and improvements in average prices for bottled wine exports.

Excluding the impact of the decline in bulk wine imports from Australia, US wine imports also experienced important gains. Bottled wine imports grew 8% in Q1 2010. With only a few exceptions, nearly every major exporter to the US delivered strong gains.

#### US Market Developments

The US has become an important market for super-premium wines for both domestic and foreign producers, but 1H 2009 saw dramatic declines. 1H 2010 has seen a marked improvement in sales of wine priced over USD 15/bottle. There are reports of improving trends in direct-to-consumer sales, and on-premise sales appear to be stabilising. ACNielsen data shows super-premium wine sales in grocery stores growing over 10% compared to 2009. This somewhat overstates the rate of recovery in that some of the growth in grocery store sales reflects the migration from on-trade to off-trade sales over the past year, and it does not adequately reflect the degree to which the increase in sales is being driven by promotions and price reductions. Discussions with key distributors indicate that case sales of super-premium wines are indeed well above last year's levels, but sales values are rising more slowly due to price reductions and discounting.

While US super-premium wine sales are showing momentum in the right direction, the true litmus test of growth will come in 2H. Declines in discretionary spending were most pronounced in 1H 2009, when consumers were bracing for the worst, but began to improve in 2H. The growth rate may slow in 2H 2010 as we begin to make comparisons to the improved 2H 2009, but is expected to remain firmly entrenched in positive territory. Our view is that the premium-and-above segment will continue to grow, but at much slower rates than prior to the recession and with some resetting of prices.

#### Global Supply/ Demand Balance

In spite of the improving trends among key exporters and the recent improvements in the US market, the global wine market continues to struggle from oversupply. According to the International Organization of Wine and Vine, wine production exceeded wine consumption by approximately 9% in 2007 and

2008, and with the recession, consumption was believed to have declined twice as fast as production, further widening the gap.

The excess supply constantly available in the market has made it difficult to build solid brands with strong pricing power, creating headwinds for profitability in the sector. A recent Rabobank report "Convergence in the beverage sector: Seeking new growth opportunities in alternative beverage segments" highlights the trend among beverage companies to become increasingly active in additional beverage segments. However, wine is proving to be the exception to this rule, with many major beverage companies seeking to limit or modify their exposure to wine. Capital employed in the wine sector can be much more profitably employed by major beverage companies in beer or spirits. Q2 2010 saw numerous announcements by beverage companies to limit their exposure to wine, including demergers of wine from other activities, sales-leaseback agreements and sales of assets.

Figure 1: ROA of Beverage Companies by Segment		
Wine	Constellation	8.9%
	Foster's Wine Australia & Asia	5.1%
	Foster's Wine N.A.	8.9%
	Average	7.6%
Beer	Anheuser-Busch InBev	10.3%
	SABMiller	9.9%
	MillerCoors	6.2%
	Foster's Beer Australia	45.8%
	Lion Nathan Australia	18.9%
	Boston Beer	20.6%
	Average	18.6%
Spirits	Diageo	14.9%
	Bacardi	12.0%
	Brown Forman	20.0%
	Fortune Brands	7.3%
	Average	13.6%
Source: Company financials, Rabobank analysis		

Oversupply will be key in determining the profitability of the sector. Reports of increasing demand from China and Russia may help bring supply and demand into balance, but Europe remains a key concern. Subsidies to producers to reduce vineyards are meant to cut production prior to the scheduled phasing out of crisis distillation subsidies in 2012. However, the recent announcement by the Muscadet producers in France to apply for crisis distillation for the first time casts further doubt on whether EU producers are making sufficient adjustments to compensate for the end-of-crisis distillation.

## International Supply

### Southern Hemisphere Review

In the April 2010 Wine Quarterly report, we noted that the wine grape crop across the Southern Hemisphere was light, with lower than recent average production in Chile, Argentina, Australia, New Zealand and South Africa. It is worth noting, however, that in spite of the impact of the earthquake, the Chilean wine industry appears to have recovered quite quickly, minimising the impact of the lost inventories and damaged infrastructure.

### US

Initial reports indicate that cool weather at the start of the season has the crop running a bit late, and some inopportune rains have created concern over mold issues. Preliminary indications are that this year could see a light crop, but it is still very early.

On a related note, the January 2010 Rabobank Wine Quarterly predicted that super-premium vineyard and winery deals would begin to pick up in 2010 vs. 2009 due to increased pressure for potential sellers to sell, converging views on valuations and improving financing opportunities. Anecdotal evidence suggests that 2010 is indeed seeing more deals getting done for many of the reasons noted, but a clear trend in vineyard valuations is still a bit difficult to discern. Some deals are closing at bargain prices, particularly if the seller is in trouble, but other sales are being done at or close to full market value. We expect to eventually see some light downward pressure on valuations, but as always, the pressure will be felt more in some regions than in others.

### EU

In the EU, the progress of the crop is perhaps less critical than the progress of the grubbing up scheme. This year, the EU is subsidising the elimination of approximately 54,000 hectares of grape vines, in addition to the 74,000 hectares pulled out last year. This should help ease Europe's oversupply situation, but it is important to note that the EU is also phasing out its crisis distillation budget, which has helped keep excess supply off the market. A critical question for the future of the global supply-demand balance will be whether or not the two policies have a net positive or a net negative effect on the global supply situation. This will likely depend on future consumption trends within the EU, as well as its success in developing export markets, but it is an issue to monitor moving forward.

## International Trade

Exports for the major suppliers in Q1 2010 have made significant improvements over 2009 levels. This is, in part, a reflection of the improving performance of the global economy, but also to some degree, a reflection of the easy comparisons to 1H 2009 when trade had slowed most dramatically. While 2010 will almost certainly prove to be a much better year than 2009 for global wine trade, pricing remains under pressure and the rate of growth is likely to slow in 2H, as comparisons become more challenging due to the stronger growth rates in Q2 2009.

- Spanish exports rose 16.7% by volume and 5.8% by value, with average prices declining 9.4%. All of the growth came from lower-priced wines without DOP (Denominacion de Origen Protegida) certification, with the biggest percentage growth coming from Canada, Mexico, Ireland and China. China is still a relatively small market for Spanish wines, but exports grew 246% by volume and 152% by value in the first four months of 2010 compared to the same period in 2009.

- Italy's exports grew strongly, mainly from improvements in the US market but also from growth in exports to Mexico, Brazil and Russia.
- US exports showed increases in both volume and value, with the biggest value increases coming from Canada, China and Belgium.
- Argentine export volumes declined due to back-to-back poor harvests, but export values are showing strong improvements.
- Chilean exports showed strong increases in volume, due to last year's large harvest, but much of the volume increase came from bulk exports, which lowered average price per litre. Bottled wine exports were up 6.4%, with a 2% increase in average price
- Australian exports continue to show volume growth and are again approaching the record levels observed in 2006-07, albeit at a significantly lower value owing to an elevated currency and disproportionate growth in bulk and basic wine sales.
- New Zealand exports continue to show strong volume gains as producers have continued to actively deplete elevated inventory levels. While discounted bulk shipments rose sharply in the lead up to the 2010 harvest, growth in bottled shipments has been more or less sustained and shipments are beginning to show signs of stabilisation.

Figure 2: Changes in Exports for Key Exporters, 2010

Country	Volume change (%)	Value change (%)	Period of measure
France	n.a.	n.a.	
Spain	+16.7	+5.8	Jan- Apr
Italy	+7.6	+8	Jan- Mar
US	+2	+9	Jan- Mar
Argentina	-7	+18	Jan- Apr
Chile	+ 27	+ 12	Jan- Apr
Australia	+6.9	-5.1	Jan- Apr
New Zealand	+26.0	+4.9	Jan- Apr

Source: Australian Wine and Brandy Corp., 'The Gomborg-Fredrikson Report', Instituto Nacional de Vitivinicultura (Arg), Observatorio Español del Mercado de Vino, South Africa Wine Industry Information System, French Federation of Wine and Spirits Exporters, Wines of Chile, The New Zealand Winegrowers  
Note: Value changes in local currencies

### US Imports

Imports into the US are also showing signs of improvement, despite a nominal drop in total volumes.

- Total import volumes for Q1 2010 were down 2%, but value increased 8%.
- Volumes of imported bulk wine declined 30%, while bottled imports grew 8%.
- Most of the decline in total bulk wine imports were the result of the decline in bulk imports from Australia.
- Except for France and South Africa, every major country supplying imports to the US experienced an increase in bottled wine volumes to the US.
- Biggest total volume gains were made by Argentina, New Zealand and Spain
- Average price per bottle of bottled imports is down more than 10% from 2008 levels.

Figure 3: US Imports by Country of Origin, Jan-March 2010

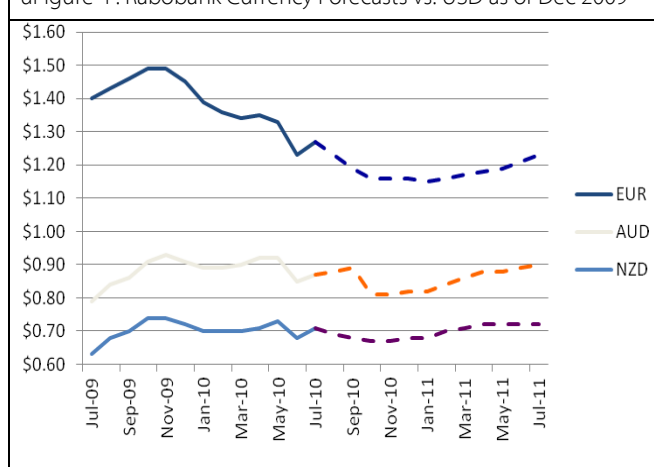
	Value (USD million)	Change (%)	Volume (million cases)	Change (%)
Italy	269.6	6	5.9	2
France	195.7	0	2.1	-8
Spain	56.2	29	1.3	32
Australia	150.0	-2	6.2	-17
New Zealand	48.0	61	.8	62
Chile	57.6	1	3	8
Argentina	60.8	18	2.3	-14
World total	926.1	8	24	-2

Source: 'The Gomberg-Fredrikson Report'

### Currency Commentary

The major news on currency has been the declining value of the euro due to the recent challenges facing the region. According to Rabobank projections, the euro will likely remain relatively weak for most of the upcoming year, with some mild improvements starting in 2011. The continued weakness of the euro is likely to provide some momentum for European wine imports into the US and may also improve European exporters' competitive position against Australia and Chile in the price-sensitive emerging markets.

uFigure 4 : Rabobank Currency Forecasts vs. USD as of Dec 2009



Source: Rabobank

### Rabobank International

Rabobank Food & Agribusiness Research and Advisory Beverages Global Sector Team Analysts

Argentina – Paula Savanti  
[Paula.Savanti@rabobank.com](mailto:Paula.Savanti@rabobank.com)

Australia – Marc Soccio  
[Marc.Soccio@rabobank.com](mailto:Marc.Soccio@rabobank.com)

Chile – Valeria Mutis  
[Valeria.Mutis@rabobank.com](mailto:Valeria.Mutis@rabobank.com)

EU – Cyrille Filott  
[Cyrille.Filott@rabobank.com](mailto:Cyrille.Filott@rabobank.com)

EU – Tiemen Leijh  
[Tiemen.Leijh@rabobank.com](mailto:Tiemen.Leijh@rabobank.com)

EU – Francois Sonnevill  
[Francois.Sonneville@rabobank.com](mailto:Francois.Sonneville@rabobank.com)

Hong Kong – Brady Sidwell  
[Brady.Sidwell@rabobank.com](mailto:Brady.Sidwell@rabobank.com)

India – Cherry Jacob  
[Cherry.Jacob@rabobank.com](mailto:Cherry.Jacob@rabobank.com)

Mexico – Ken Shwedel  
[Ken.Shwedel@rabobank.com](mailto:Ken.Shwedel@rabobank.com)

China – Cindy Yang  
[Cindy.Yang@rabobank.com](mailto:Cindy.Yang@rabobank.com)

Singapore – Oscar Tjakra  
[Oscar.Tjakra@rabobank.com](mailto:Oscar.Tjakra@rabobank.com)

US – Stephen Rannekleiv  
[Stephen.Rannekleiv@rabobank.com](mailto:Stephen.Rannekleiv@rabobank.com)

[www.rabobank.com](http://www.rabobank.com)

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